Supply Chain and SCOP

1. Introduction

1.1 This submission contains Asda's comments on the CC's working papers related to the supply chain and the Supermarkets Code of Practice (SCOP). This includes the following working papers in Emerging Thinking: Buyer Power, Supply Chain Profitability, and Supply Chain Practices.[1] Asda also comments on the following working papers published since Emerging Thinking: Own Label, Waterbed Effect, Supplier Pricing and Supply Chain Practices/SCOP.

1.2 Asda's main comments are as follows:

(i) Horizontal supplier competition should not be confused with buyer power.

(ii) Asda has a balanced relationship with its suppliers and suppliers are not dependent on Asda.

(iii) Asda agrees with the CC's analysis to date in so far as:

- The CC has not advanced any theory or structural indications that the supermarkets actually have buyer power.
- The CC has found that small retailers and wholesalers can obtain better pricing terms than larger retailers.
- The CC has found that supplier innovation and profitability is generally robust.
- The CC has not presented evidence to support, or has rejected, particular mechanisms associated with buyer power (demand withholding, waterbed or own label as a factor increasing buyer power).

(iv) In relation to the SCOP, however, Asda is concerned that the CC appears to have formed the preliminary view that a number of the practices have an adverse effect on competition without presenting any evidence. The CC has moved from a general analysis of pros and cons associated with generic practices in Emerging Thinking (in all cases listing pros as well as cons), to the view that an adverse effect on competition is "possible" in relation to many of the specific practices (in Annex E of the SCOP Working Paper) to the conclusion that an adverse competition effect is "likely" (in the main body of the

[1] Asda has no comments on the Wholesalers Working Paper in which the CC suggested that the wholesale chain was healthy. This was consistent with evidence presented in Asda's Overview Submission at paragraphs 6.12 to 6.15.

SCOP Working Paper). Yet the CC has done so without presenting any supporting evidence at any stage, or any evaluation of the pros and cons initially identified. Indeed, such evidence as the CC has presented in working papers other than those related to supply chain practices appears to suggest the opposite conclusions (in particular that there is healthy supplier innovation).

1.3 Asda expects to receive a further working paper from the CC in relation to primary producers and possibly in relation to category management.[2] Asda has not commented on these issues in this submission.

2. Buyer Power: Summary of Asda's case

Asda has a balanced relationship with its suppliers

2.1 In looking at buyer power, the CC needs to consider the alternative options available to both Asda and to the relevant supplier.

2.2 That is best done supplier by supplier (or at least by grouping of suppliers). But the following general points are worth drawing out:

i) The alternatives available to Asda may be limited.

- Customers expect OSS retailers to have a full range (in contrast to smaller shops which have greater flexibility as to what to stock). The absence of a particular brand or product may cause a customer to shift his entire trolley to an OSS competitor. That is most obviously the case for leading brands. But it is also true for secondary/tertiary brands – in the customers' mind there is no differentiation between primary/secondary/tertiary brands; a secondary brand is simply a primary brand for fewer people.

- And even where the effect is not immediate, it will be cumulative where customers are repeatedly unable to find what they are looking for.

- This "loss of trolley" threat also applies to unbranded products and own-label. Unless Asda is able to provide each customer with the product they are looking for – at the right quality and price – it risks losing that customer's entire OSS trolley to an OSS competitor.

- There are often very few suppliers meeting Asda requirements. Product integrity, traceability, supply regularity etc. are critical to an OSS operator. The set of suppliers that can provide these features is narrower than is commonly

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2 Asda notes that the CC indicated that category management was not to be covered in detail in Asda's Second Hearing (telephone conversation with Tim Oyler, 21 June 2007).

understood. For example, Asda considers it only has one possible alternative UK supplier for each of own label [ ] and [ ].

- In some instances, Asda's sourcing policy will further reduce that set. In [ ] for instance, Asda has a policy of fragmenting its supplier base regionally to reduce transport costs (suppliers are generally given exclusivity at depot level). [ ].

- In addition to possible loss of trolley, there are substantial costs to Asda in switching suppliers (see Asda response to MPQ 75).

ii) Suppliers are not dependent on Asda

- There are a number of alternative channels: other multiples, discounters, wholesalers, independent retailers, farmers markets, horeca[3] and export.

- Even as between OSS operators, suppliers are able to vary the weight of product/investment by retailer, e.g. through differential pricing, promotions, allocation of new products, allocation of product in the event of shortages, etc.

- It is not in Asda's interest to encourage supplier dependency. On the contrary, it is in Asda's interests for there to be a healthy supplier base able to compete for the next tender. Asda therefore generally welcomes suppliers working with other retailers/channels. The market is in this sense self-correcting towards non-dependency.

Horizontal supplier competition is not "buyer power"

2.3 The CC needs to avoid confusing competition between suppliers with "buyer power". Suppliers may compete to supply Asda, and that may well drive cost prices down. But that is competition and not "buyer power".

Consumers benefit from Asda obtaining better terms

2.4 To the extent that Asda has been able to obtain better terms from their suppliers, this has benefited customers in the form of lower prices and investment in other areas e.g. better service.

2.5 Asda's gross profit margin for groceries was [ ]%, [ ]% and [ ]% in 2004, 2005 and 2006 respectively. Asda's net profit margin for groceries was [ ]%, [ ]% and [ ]% for the same three years. The operating margin of the Asda Group (including its non-grocery and property business) has [ ].[4]

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[3] Hotels, restaurants and catering.

[4] Source: Asda statutory accounts.

Relevance of planning

2.6 To the extent that a supplier does face a bottleneck at the local level, Asda considers that this issue is best addressed by way of reform of the planning regime so as to encourage retail entry.

3. Comments on Buyer Power Working Paper and Supply Chain Profitability Working Paper

No structural indications of buyer power

3.1 Asda has the following comments on the "indicators" of buyer power cited in the CC's Buyer Power Working Paper.

i) Share of grocery sales accounted for by Tesco, Asda, Morrison and Sainsbury's.

- Suppliers can and do flex the weighting as between OSS operators (see paragraph 2.2 above).
- Suppliers are able to supply through alternative channels including the rest of the grocery market, horeca and export.
- It is too simplistic for the CC to look at national shares and draw conclusions as to the ability of retailers to exert buyer power. As mentioned above, the CC needs to consider the alternative options available both to the retailer and to the relevant supplier. Some suppliers may only supply locally/regionally. Others will supply internationally.

ii) Increasing tendency for retailers to source on national or international basis.

- There is also a trend towards more local sourcing (particularly for produce) (see paragraph 2.2 above).
- To the extent that retailers are sourcing more widely, that should also provide suppliers with wider alternatives (e.g. exports).

iii) [ ]% of products sold are own label (OL).

- It is too simplistic to view OL as a straight alternative for branded product. Many customers have strong preferences for one or the other. And Asda risks loss of trolley if it does not meet those preferences.
- The Working Paper on Own Label Goods recognises the ability of branded product to compete successfully with own label (e.g. yogurt). In fact, the

Mintel report cited by the CC suggests a wide range of categories across chilled, ambient and frozen in which branded products have gained share at the expense of own label.[5] Asda has also observed that brands have responded to competition from own label (e.g. in [ ]).

iv) The ability of a retailer to switch may be limited by customer expectations. And there is a cost to switching.

- Asda agrees. See paragraph 2.2 above.

No evidence of demand withholding

3.2 The CC suggests that the conditions for demand withholding are most likely to be present in the produce sector; but it does not provide any evidence that the five necessary conditions[6] are in fact met.

Healthy supplier investment and innovation

3.3 The CC has provided a number of alternative statistics in its Buyer Power Working Paper and Supply Chain Profitability Working Paper which all suggest no general concern as to:

i) supplier viability (see GfK, Investec, OC&C, Insolvency trends); or

ii) supplier investment and innovation (see ONS, GfK, DTI, EU(CIAA)).

3.4 This is consistent with Asda's experience:

- As outlined above, it is in Asda's interests for there to be a healthy supplier base;

- It is also in Asda's interest for there to be innovation – since this generates customer excitement and drives customer spend. Asda launched over [ ] new food lines in 2006.[7]

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5 Mintel, "Own-label Food and Drink, Market Intelligence, October 2006", Figures 7, 9 and 11. Out of the 36 product categories included in these tables, the share of own label is reported to have decreased for 19 and increased for 15. In the remaining two cases, no change is reported.

6 These conditions are: (i) market power of supermarket in the retail market; (ii) upward sloping supply curves of grocery manufacturers; (iii) buyer power of the retailer on the wholesale market; (iv) no (perfect) price discrimination; and (v) competition between manufacturers on the wholesale market. The CC has provided no evidence on (ii) – (v).

7 Asda input [ ] new lines onto its system last year ([ ] were non-seasonal). A smaller proportion of these are re-listed lines than for the corresponding figure in 2005 (see further Asda response to MPQ 77). [ ].

Conclusion

3.5 In view of the above, Asda considers that the CC has not shown evidence for the existence of buyer power as distinct from a balanced relationship and/or supplier competition. In so far as there is buyer power, the CC has not shown that it is associated with any consumer harm as opposed to resulting in lower prices.

4. Comments on Supplier Pricing Working Paper

Pricing Analysis does not suggest "buyer power"

4.1 Asda considers the CC's pricing analysis (as reported in the Supplier Pricing Working Paper) is consistent with its position as summarised at Section 3 above. In particular:

- The CC reports results that suggest on average a 10% difference between very small and very large purchasers (at product level).[8] This is not indicative of "buyer power". Asda would generally expect higher quantities to result in lower prices – to reflect efficiencies.[9] The CC recognises the difficulty of controlling for differences in cost of supply (production, packaging and/or distribution). It is not clear to Asda that the CC's econometric method has controlled for such efficiencies. Asda has requested further details of the CC's econometric method to be able to comment on this further.

- Controlling for the identity of the customer does not materially affect buying terms.[10] This is consistent with customer's overall size (as distinct from the size of the relevant order) not affecting buying terms.

4.2 Asda also notes that the CC's Cost Price Ranking shows a number of small retailers / wholesalers as receiving better prices on average than larger retailers. Again, that is consistent with Asda's case. Asda would expect some smaller retailers to source more cheaply.

4.3 Asda also notes the CC's evidence from discussions with suppliers, which suggests that supplier prices are driven by factors in addition to retailer size such as history of the account, growth potential, promotional/retail strategy and cost factors.[11] Asda does not find this result surprising. Asda would add to that list the ability of smaller retailers to be more flexible as to what they stock without risking customer switch of trolley.

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8 Working Paper on Supplier Pricing, paragraph 4.

9 Subject to exceptions e.g. job lots / grey market / short supply.

10 Working Paper on Supplier Pricing, paragraph 46.

11 Working Paper on Supplier Pricing, paragraph 39.

ACS analysis is flawed

4.4 The CC dismisses ACS' analysis. Asda agrees. Indeed, Asda considers that there are other flaws with the ACS analysis, as outlined at Appendix A.

4.5 Asda cannot comment on the other party's (confidential) analysis since it has not been able to review this.

5. Comments on Waterbed Working Paper

5.1 Asda agrees with the CC that:

i) the five key assumptions underlying the waterbed model are unlikely to hold;[12] and

ii) there is no direct evidence of a waterbed effect or of harm to consumers on any of three different indicators.[13]

6. Comments on Own Label Working Paper

6.1 Asda supplies own label where this allows it better to respond to customer demand. See Asda response to MPQ 62.

6.2 Asda has the following comments on the possible concerns identified by the CC:

i) Retailers enjoy significant advantages over branded suppliers through control of route to market ("gatekeeper") and access to branded supplier plans

- A retailer's ability to leverage its position as "gatekeeper" is severely curtailed by its need to respond to customer demand.
- There are plenty of examples of brands winning share at the expense of own label. The CC mentions yogurt. See paragraph 3.1(iii) (above) for further examples.

ii) Presence of OL may overall reduce levels of innovation

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12 (i) Retailers purchase directly from monopolistic supplier; (ii) retailer's size determine its buyer power; (iii) discounts affect the unit (wholesale) price and are non-cost related; (iv) large retailers' gains are small retailers' losses; and (v) larger retailers pass-through only depends on competition from small retailers.

13 (i) Direct evidence from the GfK supplier report shows that the vast majority of suppliers do not recognise a waterbed effect; (ii) retail prices have declined at the national level since 2000; and (iii) there is no evidence of suppliers exiting the market in greater numbers than might be expected from normal competitive behaviour or of reduction in suppliers willing to supply smaller retailers.

- The CC recognises that in many areas, innovation has been led by own label. The CC mentions fresh pasta but the point is true for chilled food and prepared produce generally.

- As noted above, the CC has provided no evidence that supplier viability and/or innovation are under threat.

- In those circumstances one would expect additional competition (e.g. from own label) to drive higher innovation.

iii) Copycat packaging

- Asda agrees that repeat purchases mean that this is highly unlikely to lead to on-going distortion. The introduction of Shelf Ready Packing and Retail Ready Packing is providing suppliers with increased opportunities to distinguish their products. See Asda's response to the 12 alleged supplier practices.[14]

iv) OL reduces ability of consumers to compare between retailers

- Asda agrees with the CC that consumers are able to compare. Indeed, Asda devotes considerable resources to ensure that its own label products are competitive with those at its OSS competitors.

7. Supplier Chain Practices: Summary of Asda's Case

7.1 Asda adheres to SCOP. Asda had already been following similar principles before the introduction of the SCOP because they make business sense.[15]

7.2 Asda's contractual terms with its suppliers are fair and balanced. Again, this is best assessed supplier by supplier, but the following general points are worth drawing out:

(i) Risk is fairly allocated (e.g. because suppliers have equal/superior knowledge than Asda; have depot exclusivity; have pre-season negotiations).

(ii) Fixed volume commitments would likely result in higher wastage or Asda providing the wrong products to customers. Allocation of wastage risk goes to cost.

(iii) Similarly, risk allocation on price goes to cost. Asda may be willing to give fixed annual price where sufficiently attractive (e.g. [ ]).

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14 Submitted 3 July 2007.

15 See further Asda's Overview Submission and response to MPQ 80, both dated 10 August 2006.

(iv) In the context of uncertain demand and/or supply (e.g. fresh produce where demand and supply may be affected by weather), leaving open contract terms allows the supply chain to be more adaptable to market conditions. The Commission recognised this in Emerging Thinking. And it is consistent with international practice.

8. Comments on Supply Chain Practices / SCOP Working Papers[16]

"Require" vs "request"

8.1 The CC attributes the continuation of practices in significant part to the substitution at the OFT stage in 2000 of the wording "not requiring" or "not unreasonably requiring" for the CC's recommendations in terms of retailers "not seeking"[17]. In other words, SCOP has the effect of regulating rather than prohibiting.

8.2 Asda considers that there is a real risk of undue regulatory prescriptiveness.

8.3 In its guidance to buyers, Asda distinguishes "request" and "require" as follows:

"Require [...] means demanding, insisting, threatening, giving an ultimatum or making a request on the basis that if the supplier doesn't comply he will be disadvantaged in some way (e.g. de-listed)."[18]

8.4 To be clear, a request is a suggestion which the supplier is free to reject.[19]

8.5 It is critical that buyers and suppliers are able to communicate clearly with each other. The ability to make suggestions forms an important part of that dialogue. Absence of buyer power (see above) means that Asda is not in a position to impose terms.

The CC must provide evidence of an adverse effect on competition

8.6 In relation to the SCOP, however, Asda is concerned that the CC has formed the preliminary view that a number of the practices have an adverse effect on competition without presenting any evidence.

8.7 In particular, the CC has moved from a general analysis of pros and cons associated with generic practices in Emerging Thinking (in all cases listing pros as well as cons), to

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16 Asda has commented in detail on 12 of the practices specifically put to it by the CC (submission of 3 July 2007).

17 See Working Paper on SCOP, paragraph 17.

18 Annex 60 to Asda response to MPQ, submitted 10 August 2006.

19 Asda will provide examples of where a supplier has rejected Asda's request without being disadvantaged in response to the question raised by the CC at the hearing dated 4 July 2007.

the view that an adverse effect on competition is "possible" in relation to many of the specific practices (in Annex E of the SCOP Working Paper) to the conclusion that an adverse competition effect is "likely" (in the main body of the SCOP Working Paper). Yet it has done so without presenting any supporting evidence at any stage, including no evaluation of the pros and cons initially identified.

8.8 In short, the CC does not provide actual evidence that there is in fact an adverse effect on competition associated with particular practices – as it must to reach an adverse finding and impose a remedy.

There is no evidence that retrospectivity/uncertainty is reducing investment

8.9 At the general level, the CC suggests that retrospectivity/uncertainty has the potential to decrease investment/R&D.

8.10 Again, no evidence is provided to show that this is happening in practice. Indeed, the evidence cited at paragraph 3.3 above suggests healthy investment/R&D.

8.11 In addition to the points cited above at paragraph 7.2, the CC should note in particular that the decision whether to stock a product will always depend on profitability and demand for that product going forwards. As a consequence, it makes no sense for Asda to delist a supplier where that supplier refuses to amend terms retrospectively. Suppliers know this – such that any retrospective adjustments are at the supplier's choice. In those circumstances it would be surprising if such adjustments were to have the effect of decreasing investment/R&D.

There is no evidence that lump sum fees are acting as a barrier to entry for smaller suppliers

8.12 The CC also fails to provide evidence to support its view that lump sum listing / pay-to-stay fees may be seen as a barrier to entry for smaller suppliers.

8.13 As acknowledged by the CC in its Supply Chain Practices Working Paper, these kind of lump sum payments may be pro-competitive by compensating the retailer for the risk of listing new products. Reducing the cost price is an alternative mechanism (and indeed one that Asda generally prefers). But a reduced wholesale price offers little compensation to the retailer if the product doesn't sell. So paying a lump sum may be a better signal.

8.14 In fact, it is in Asda's interests to stock products of small firms where customers want these. And Asda provides considerable help to small suppliers.[20]

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[20] See further Asda's response to MPQ 76; and its put back to the Working Paper on Impact of Payments.

Appendix A
Comments on ACS Supplier Pricing Analysis

In addition to the criticisms of the ACS analysis of supplier pricing, Asda notes the following:

- Even on the most pessimistic analysis, convenience retailers can trade 26% of lines at better than the average 2002 margin when selling at the average price supermarket price.[21] Asda would expect a convenience retailer to focus on the profitable lines. This could generate an overall margin not dissimilar to the 2002 average.

- Convenience store profitability in 2002 is in any case an arbitrary benchmark.

- The 2002 gross margins reported are in fact higher than Asda gross margins,[22] suggesting that convenience stores buy better than supermarkets or sell at a higher price or both.

- Convenience stores can charge a convenience premium that is greater than the supermarket one-stop premium (because supermarkets are exposed to more competition).

- The supermarket retail price may reflect non-buying efficiencies that a convenience store may not share.

- ACS does not conduct analysis based on the best price offered by the three wholesalers. Asda would expect convenience stores to be able to buy disproportionately at this price by shopping around.

- Convenience stores can and do form buying groups.

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21 On 10% of the lines in the ACS sample the wholesale price is higher than the average supermarket price (ACS Commentary on Comparison of Supermarket Retail Prices and Wholesale Buying Prices, paragraph 27). For a further 64% of lines the gross margin achieved when selling at the average supermarket price would be lower than the 2002 margins (ACS Commentary on Comparison of Supermarket Retail Prices and Wholesale Buying Prices, paragraph 33). This implies a total of 74% of lines in the sample where the convenience store margin would be below the 2002 level and 26% where it would be above the 2002 level.

22 Comparing the figures reported by the ACS with Asda's own gross profit margins on comparable categories for 2005.