

Response to the Consultation Paper issued by the DETE

Code of Practice for Grocery Goods Undertakings

30 September 2009

1 INTRODUCTION AND BACKGROUND

1(a) About Musgrave

The Musgrave Group is partner to entrepreneurial food retailers and foodservice professionals in Ireland, the UK and Spain and supports more than 3,400 stores in these territories. In Ireland, Musgrave owns the SuperValu, Centra, Daybreak and DayToday brands – the leading network of independent supermarkets and convenience stores in the Republic of Ireland and Northern Ireland. The network in the Republic comprises a total of 810 stores which are owned by progressive independent food retailers. Musgrave and its retail partners employ 35,000 people and support a further 10,000 jobs in Irish companies through a policy of sourcing from Irish suppliers. Consistent with this approach, the Musgrave Group has made the following commitments:

- to conduct its business based on developing long term sustainable relationships both with its suppliers and retail partners;
- to deliver the best possible deal for consumers without compromising on quality or the consumer's ability to choose Irish products.

Earlier this year, SuperValu launched its "All We've Cut is Our Prices" value campaign, a major initiative introducing €230 million in long-term price reductions for shoppers on 3000 everyday products and brands. SuperValu's 194 independently owned stores across the country reduced the cost of an average weekly trolley of goods by €30, from €129.96 to €98.56, a drop of

23%. This campaign was based around reducing prices without compromising quality and continuing to source from Irish suppliers.

Furthermore, seventy-five percent of everything sold in SuperValu and Centra is sourced in Ireland which translates into approximately €3bn in retail sales from Irish suppliers.

1(b) The Challenges facing the Irish Grocery Sector

The Irish grocery retail sector is facing a number of significant challenges.

Irish consumer spending will contract by a further 4.5% in 2009, compared to a decline of 0.5% in Europe as a whole while the North/South pricing differential has seen a surge in southern shoppers going to the North to shop. As sterling continues to move toward parity with the euro, Northern Ireland will become an even more attractive shopping destination for southern shoppers.

The high cost of doing business in the grocery retail sector is also a significant challenge with a recent Forfás report finding that it was 25% more expensive to run a business in Dublin than in Belfast. The most recent study by the Competition Authority on the grocery industry - Retail-related Import and Distribution Study (Competition Authority 2009) - acknowledged that the North/South pricing differential was due to the higher cost of doing business in the Republic while the collapse in the value of sterling accounts for the remainder of the price difference. Irish retailers have had genuine difficulties in securing the benefits of sterling's weakness from international suppliers and passing on these benefits to Irish consumers.

Retailers have responded to these challenges in a number of ways with some international retailers embarking on a policy of large scale sourcing of branded goods directly from the UK to the detriment of Irish suppliers. Musgrave, on the other hand, has focused on cutting costs in its own operations while working with suppliers to create savings. These combined savings have been passed on directly to consumers.

The DETE consultation paper notes that *"retailers in Ireland are frustrated by the fact that it is more expensive to source goods in Ireland"*. The paper also refers to *"a significant imbalance between retailers and suppliers which is giving rise to suppliers being squeezed by the increasingly difficult demands made by retailers"*. Retailers and suppliers are both subject to significant market pressure, and before introducing a code to protect the position of suppliers in this sector, we would like to point out that:

- many suppliers are larger than most retailers active in Ireland and actually have greater economic power than the retailers or wholesalers they are taking issue with;
- recent supermarket price competition has led to lower prices for consumers;
- any initiative which is designed to protect suppliers from competitive forces will result in higher prices for consumers and will promote inefficiency in Irish suppliers which will operate to the disadvantage of those suppliers in the medium to long term.

Forfás dealt directly on the issue of retail costs in Ireland. Their report noted that the cost of goods to retailers and wholesalers was the most significant element in retail cost to consumers and set out a detailed analysis of all other retail costs. Any development which increases these costs or insulates suppliers from competitive pressure to lower their costs is likely to result in increased prices to consumers.

1(c) Regulation of the Industry

Musgrave's approach to dealing with its suppliers is based on long term sustainable relationships and, therefore, we have no objection in principle to the creation of a framework which will govern the relationship between suppliers and other levels in the supply chain, provided its cost is proportionate to the benefits it achieves for the consumer and society as a whole. Musgrave believes that this should be based on a partnership between suppliers, wholesalers and retailers and should not seek to put the entire onus for compliance on any one element of the supply chain. Any such framework should be voluntary and agreed by the industry as a whole. It would need to be flexible enough to respond to market requirements and should be based on guiding principles rather than prohibitions. A clear distinction needs to be made between legitimate negotiation which takes place in every industry, and which is vital to driving down costs and delivering value to consumers, and sharp practice.

It is important to note also that the Competition Authority's report on the grocery industry did not identify sharp practices as a major problem in the Irish grocery sector, but on the contrary cautioned:

"If the consumer price differential that has emerged between the Republic of Ireland and Northern Ireland is to narrow, retailers must, without exception seek to reduce their costs. Cost reductions can come from examining internal efficiency and from pressurising suppliers for better deals or seeking better deals elsewhere. It is, therefore, of the utmost importance that the abusive exercise of market power is not confused with legitimate actions by businesses seeking to protect their business in the face of the fall off in consumer spending and Irish consumers' expectations for lower prices."

The ability to drive a hard, but fair bargain is a vital element of legitimate business activity. Any attempt to constrain the ability of a business to bargain, will inevitably lead to higher prices for consumers. Suggestions in the proposed code that contracts cannot be varied, once agreed, will restrict normal commercial negotiations and will limit the ability of suppliers and retailers to deliver lower prices to consumers.

The advent of large scale UK sourcing and delisting of Irish brands by some international retailers has had a serious impact on Irish suppliers. It could be said this led to the publication of the consultation paper and the proposed code. The code of practice as currently constituted and the proposed ombudsman for the grocery sector will have no impact on the move by some retailers to source goods from abroad. We cannot see how any code or regulations could impose restrictions on retailers sourcing product from outside the jurisdiction. We are concerned that the proposed code would predominantly police those retailers and wholesalers that have continued to source from and support Irish suppliers, adding a significant administrative cost to these retailers. This would put them at a further disadvantage vis-à-vis larger retailers in the market who can get supply more easily from outside the jurisdiction.

Additionally, the proposed code would create an extra layer of regulation and bureaucracy for retailers who deal with Irish suppliers and may actually exacerbate the situation by forcing other Irish retailers to begin sourcing in the UK. There is also a very real risk that additional rules and regulations to govern relations between suppliers and retailers may act as barriers to new suppliers entering the market. Consumers would be impacted as the additional costs of compliance, if borne by the industry, would ultimately be reflected in prices at retail level.

Notwithstanding the concerns outlined above, we have no objection in principle to a code or framework which does not involve excessive regulation or cost, is pro-consumer, improves the supplier-retailer working relationship and does not adversely affect smaller indigenous retailers in the market. We have presented specific alternative proposals as a way forward in the section which follows.

2 A PROPOSED WAY FORWARD

We believe that this code has been put forward as a response to concerns raised by suppliers. One of these concerns is the fact that there exists no effective mechanism to expose illegal practices in the industry. Another is the advent of large scale UK sourcing that is having a major impact on the Irish food sector. We would like to table a number of matters for

discussion on these very important issues. Before any specific measures are put in place, there should be an informed debate so that the purpose of those proposals is made clear. Once there is an agreed objective any regulatory proposal should be subject to a rigorous cost/benefit analysis. This would ensure that the competitiveness of the market is improved and there is no adverse impact on consumers.

2(a) Voluntary framework agreement

Musgrave believes that one of the main issues underlying the call for this code is that Irish suppliers feel that they have no recourse against wholesalers or retailers who engage in sharp practices. It has been said that certain suppliers may not have the resources to get proper legal advice or may be reluctant to take any action that may jeopardize their relationships with their major customers and therefore do not take any action. At the same time, these suppliers have been willing to speak to journalists and politicians about specific grievances on a 'no-names' basis that brings the entire industry into disrepute.

In terms of developing a framework to find a solution to these issues and to govern the relationships between suppliers and retailers, we would suggest looking at the experience of the Irish publishers, wholesalers and retailers who recently came together to launch a new agreement for the news distribution sector. Their agreement – along with the Environmental Standards Convention – covers a range of long standing bugbears in that sector including returns, retailer/distributor communications and delivery protocols. The creation and publication of the agreement followed a period of negotiations between retailer representative groups and industry under an independent Chairman. We believe that this type of approach where all sides of the industry come together to understand each others concerns and to look for solutions would result in an appropriate framework balancing the needs of both suppliers and retailers. To this end, Musgrave has had an initial meeting with suppliers through the Food Processors and Suppliers Group within IBEC to discuss the possibility of pursuing this approach.

Another example where the retail grocery sector developed a voluntary agreement was in relation to the display and sale of alcohol. The industry devised improved practices for the display and sale of alcohol in retail outlets which were submitted to, and agreed with Government. This resulted in Government achieving its overall policy objectives of improved control over the display and sale of alcohol without placing an undue cost burden on small and medium sized retailers.

2(b) Enforcement of existing legislation

We believe that it would be beneficial to look at the enforcement of existing legislation such as the ban on paying “hello money” to ensure compliance by the entire industry with existing legislation. This would eliminate illegal business practices which put suppliers at risk and damage the reputation of the industry. Musgrave and its retail partners do not engage in such practices and we believe that it is clearly to the advantage of every legitimate operator that the existing laws on illegal and sharp practices are rigorously enforced.

2(c) Information to consumers on sourcing

We would welcome any initiative that increased real transparency in relation to the origin of goods sold in Ireland. Under the rules of the single market the Irish Government cannot, nor should it attempt to create a barrier to entry for non-Irish goods. However, Musgrave believes that the Irish consumer should be put in a position where they can make an informed decision about the origin of the goods which they purchase. Consumers should be made aware of where each product is manufactured or sourced, where it is processed, packaged and the location of the supplier. This would give consumers transparency and would give local suppliers a selling point for their produce against large multinationals. Irish consumers should be able to identify clearly the provenance of the goods they are purchasing and it would assist this process if all Grocery Goods Undertakings were required to publish verifiable details of the origin of the goods they are selling.

3 SPECIFIC CONCERNS ABOUT THE PROPOSED CODE

While Musgrave is not against the idea of a code in principle to govern the relationship between retailers and suppliers, we have a number of practical concerns with the proposed code. These are detailed below.

3(a) Purpose of the code

The purpose of the code is not clearly stated in the consultation paper. While it seems that the main purpose is to assist Irish suppliers in their negotiations with retailers and wholesalers in Ireland, this is not set out in the draft.

Any efforts to govern the relationship between retailers and suppliers, either through a mandatory code or a voluntary framework agreement must be based on a set of clear objectives with the ultimate purpose of benefiting consumers. Before evaluating the most

appropriate way forward, a detailed review should be carried out providing specifics on how the market is not working and what action is required to address problems which are identified. This would form the basis of a robust voluntary supplier retailer framework agreement to implement the actions identified.

3(b) Impact on retail prices

It has been suggested that the cost associated with the office of an ombudsman would have to be paid for by the industry i.e. suppliers, wholesalers and retailers. Furthermore, all parties would be required to employ administrative staff and third parties to monitor compliance.

It should also be noted that as there is a similar code in place in the UK, any UK retailers operating in Ireland will be spared the expense of putting new compliance and audit processes in place. This code would result in disproportionate extra cost being imposed on Irish based retailers and wholesalers who are not currently subject to a similar regime and particularly those Irish retailers who continue to support Irish suppliers.

3(c) Code could accelerate UK sourcing

We believe that the proposals set out in the draft code, if introduced, would encourage retailers to increase their sourcing of supply outside of Ireland as the proposals are likely to increase the cost of goods in the Republic of Ireland. Given that the proposals cannot have any extraterritorial effect it will easily be circumvented by the major retailers in the industry who have the scale to buy outside of this jurisdiction. This would reduce the bargaining power of Irish suppliers even further.

3(d) The law already provides protection

The proposed code requires suppliers and purchasers to set out all of the terms relating to their commercial relationship in an agreement at the start of a contract period and these terms cannot be changed even if the parties wish to do so. Purchasers and suppliers need to have the flexibility to respond to market conditions. The need for flexibility means that it is neither desirable nor beneficial to require all terms be fixed at the start of a contractual period. This would operate to the detriment of all parties who would be required to hedge against all possible fluctuations in commodity prices and other variable costs. Any contracting out of risk would carry additional cost for the industry.

The draft proposals also impose a number of additional specific limits on the freedom of contract between suppliers and retailers. It is likely that if these proposals were introduced the market will rebalance so that the overall level of payments made by suppliers to retailers comes back to a similar level regardless of the fact that particular types of payments may be

prohibited. The principal effect will be that a layer of regulation is created which is paid for by consumers. These are issues which we believe could be addressed through the framework approach agreed between suppliers and retailers as detailed in section 2(a) above.

Irish Competition law currently regulates situations where there is an abuse of market power by a dominant undertaking and where contracts have the distortion of trade as their object or effect. In Ireland, the Competition Act 2006 introduced a number of additional specific prohibitions which relate solely to Grocery Goods Undertakings. In addition to the ban on paying 'Hello Money' there are prohibitions on Resale Price Maintenance, applying dissimilar conditions to equivalent transactions and on any Grocery Goods Undertaking compelling or coercing another Grocery Goods Undertaking to make any payment or grant any allowance for the advertising or display of grocery goods. It appears to us that these prohibitions cover the areas of any potential imbalance in the trading relationships between buyers and suppliers. If there is an issue in relation to the enforcement of these provisions, we would suggest this is not something that is going to be dealt with by the introduction of a code that imposes specific restrictions on contracts between suppliers and purchasers.

3(e) Employment in the grocery retail sector

There is pressure on all levels of the grocery goods supply chain at the moment. The retail and wholesale levels of the supply chain provide substantial employment. We are concerned that the current proposals will create more cost for retailers or wholesalers leading to job losses at the retail and wholesale levels of the market. These job losses may not attract the same headlines as the closure of a manufacturing or processing plant, but they still have significant negative macro-economic effects.

3(f) UK experience

The draft code is based on the current proposed code in the UK market. This was developed over many years following extensive investigation of that market by the UK Competition Commission. The Irish Competition Authority has carried out a similar investigation of the market in Ireland and has not made any recommendation for the introduction of a code. There is a reference to the UK code of conduct as well in the consultation paper, and fairly it notes that this has been the subject of criticism. The Supermarket Code of Practice has been in place in the UK in one form or another since 2002 and was recently amended in 2009. There has been no evidence that the UK code has led to any material change to the commercial relationship between suppliers and retailers, but it has introduced further regulation and has led to increased costs for the industry. It should be noted that the Competition act 2006 has no regulatory equivalent in the UK and therefore the regulatory environment is not the same in Ireland.

3(g) Threshold for applying the code

The compliance costs associated with the code would be substantial and we believe that any threshold should be sufficiently low to include all of the main retail groups operating in Ireland, but sufficiently high to avoid including small local retail groups whose businesses have already suffered greatly as a result of the economic downturn.

Additionally, the definition of grocery goods ignores a large number of products that would be sold by a grocery store and this needs to be examined as to whether the code applies to all goods sold by Grocery Goods Undertakings which happen to sell groceries or if the code only applies to the grocery goods sold by Grocery Goods Undertakings. This will be important when calculating thresholds as to when the code applies.

4 CONCLUSION

We would stress that we are not opposed in principle to a framework to cover the relationship between retailers and suppliers. Where imbalances in the retailer/supplier relationship exist, it is important to consider that these are not exclusive to the supplier side. Notwithstanding this, we have a policy of developing long term stable relationships with our suppliers. This includes a commitment to work in partnership with them for mutual benefit and to address issues in a fair and reasonable manner when they arise.

Based on this approach, we have suggested a number of possible routes forward. These proposals are based on reaching a voluntary agreement between all industry players. We support the desire on the part of Government to reach a solution which is in the best interests of the Irish grocery sector and consumers. We wish to work in partnership with the Department and the wider industry to address these concerns, while maintaining competitiveness and ensuring the best possible outcome for Irish consumers.