

# 6 Relationships with suppliers

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## **Introduction**

6.1. As noted in Chapter 4, all the bidders expect to achieve lower prices from their suppliers as a result of a merger. These lower prices were expected to come about, in the main, from price harmonization (taking the lower of the prices available to the two parties prior to the merger), larger-volume discounts on branded goods and greater production efficiencies in own-label manufacture. To the extent that such savings are made and passed on to customers, this would be a benefit to them of the merger. However, if it also resulted in adverse effects on suppliers, this might offset the benefit. In this chapter we examine the relationship between multiple grocery retailers and their suppliers and note trends in the number of suppliers used by the main parties. We also look at the results of two questionnaire-based surveys carried out as part of this inquiry. As noted in paragraph 6.23, the data obtained from the responses to these questionnaires covered certain products, normal parts of the one-stop offerings of multiple grocery retailers, that are not included in the inquiry's definition of groceries (see glossary). In this chapter only, therefore, 'groceries' may, according to context, be used in a slightly wider sense than elsewhere in this report.

## **The concerns of suppliers**

### ***The findings of the 2000 report***

6.2. The CC examined the relationship between multiple grocery retailers and their suppliers in detail in the 2000 report. That report noted that buyer power, when exercised appropriately in a competitive market, can be used to counterbalance the market power of large suppliers and that this may result in lower wholesale prices, and hence lower retail prices, than might otherwise be the case (see paragraph 2.441 of the 2000 report). However, in the case of multiple grocery retailers, the CC found that 'a climate of apprehension exists among many suppliers, founded on their view that there was an imbalance of power between them and the multiples they serve' (paragraph 2.440). The CC found that even the largest suppliers accepted lower prices and lower margins from larger multiple grocery retailers than from smaller ones, that there was a significant inverse correlation between the prices paid by multiple grocery retailers and their share of total purchases, and that these differences were greater than could be explained by cost differences alone (see paragraphs 2.443 to 2.451).

6.3. The CC also found that the great majority of suppliers were far more dependent on their multiple customers than the multiple grocery retailers were on them (see paragraphs 2.452 to 2.457). Nevertheless, during the current inquiry some of the main parties pointed out to us that they were much more dependent on certain suppliers than the suppliers were on them, especially where 'must stock' brands were concerned.

6.4. The CC identified 27 practices in relation to suppliers that, when carried out by Asda, Safeway, Sainsbury's, Somerfield and Tesco (the five multiple grocery retailers with more than an 8 per cent share of grocery purchases for resale which the CC found to have market power), were against the public interest (see paragraph 2.548 and Table 2.14). The CC recommended that, to ensure that buyer power was not abusively exploited, multiple grocery retailers should be required to adhere to a Code of Practice approved by the DGFT (see paragraphs 2.588 to 2.590).

6.5. A Code was subsequently negotiated between the OFT and Asda, Safeway, Sainsbury's and Tesco, and became effective on 17 March 2002. Somerfield argued that its share of grocery purchases had fallen below 8 per cent since the submission of the 2000 report and that it was therefore no longer required to be a signatory of the Code. Morrisons was not required to comply with the Code, as its share of grocery purchases had, at the time of the 2000 report, been below the 8 per cent threshold and had not subsequently exceeded it.

### ***Suppliers' submissions***

6.6. We received written submissions from a number of individual suppliers and many more referred us to their earlier submissions to the OFT about the proposed merger. Between them these covered all the

principal product sectors and ranged very widely in sales volume. A number of producer and distributor associations also wrote to us. Common themes ran through suppliers' submissions to us; in particular it was put to us that:

- (a) The multiple grocery retailers use their buyer power to oblige suppliers to reduce their prices or otherwise accept lower returns, for instance by compelling them to bear costs that should properly be regarded as the retailer's or to give discounts on supplies.
- (b) Further concentration among multiple grocery retailers is bound to exacerbate suppliers' problems. There was a fear that, if Safeway is acquired by any of the bidders, the efforts of weaker multiple grocery retailers to retain market share through even harsher terms for suppliers will do further damage to suppliers.
- (c) Intense buyer power and internationalization of procurement will damage UK farming and primary production.
- (d) Trading conditions make it impossible for suppliers to raise prices to the large multiple grocery retailers (some took the same view of prices to smaller retailers as well).
- (e) Many suppliers, faced with large multiple grocery retailers' buyer power, saw it as their only option to cut costs, especially those of research and product innovation, leading eventually to reduced consumer choice.
- (f) The OFT Code of Practice has failed to curb what several of the submissions referred to as predatory practices.
- (g) Asda's acquisition by Wal-Mart marked a fundamental change in multiple food retailing in the UK. In response, its competitors (most notably Tesco) had intensified the price and cost pressures they exerted on their suppliers both large and small.

## Views of the parties

6.7. Asda told us that it had traditionally had good relationships with suppliers. In 2002 it had commissioned research which concluded that suppliers were generally positive in their attitudes to Asda. It said that it cooperated with its suppliers, in particular giving them access to its Retail Link information system, allowing them to retrieve sales data regarding their products.

6.8. Asda considered that its good supplier relations meant that the OFT Code had had limited impact on it. [ *Details omitted. See note on page iv.* ] But it recognized that the Code might protect small suppliers in the event of a strengthening of Asda's bargaining position if it acquired Safeway. In the case of large suppliers, the impact of the Code, which made no distinction between suppliers on the basis of size, would remain minimal. These suppliers, particularly large multinational and national food and beverage manufacturers, were, it said, in a position to look after their own interests without recourse to the Code.

6.9. Asda said that it viewed its EDLP policy as allowing products to compete solely on the attraction of the value and choice they provide. In that way it regarded its EDLP strategy as avoiding the distortion of competition that can derive from promotions. Following a merger, Asda said that it would roll out its EDLP policy to all Safeway stores as part of its normal process. This would lead to increased volumes and greater efficiency. Asda's greater penetration of own-label products would be extended to Safeway stores, with consequent supply realignments.

6.10. Asda also told us that whilst some procurement of its non-grocery products was undertaken internationally or globally by Wal-Mart, all procurement of grocery products (including non-food items

such as toiletries and household cleaners traditionally sold by multiple grocery retailers) was undertaken by Asda itself rather than the parent company. Bananas were the sole exception to this, because of the relative uniformity of the product and the small number of suppliers worldwide, which made international buying sensible.

6.11. Morrisons told us that it had strong positive relationships with suppliers, whose critical part in the supply chain to consumers it recognized. Its policy was to keep its buyers responsible for the same product areas for as long as possible.

6.12. Morrisons said that its vertically-integrated approach meant that it dealt direct with many primary producers. Its emphasis on fresh food meant that some 55 per cent of sales were of own-label products bought from a broad supply base including many small suppliers. Nevertheless its relations with large branded suppliers remained as good as, if not better than, at the time of the 2000 report. However, Morrisons considered the manufacturers of leading brands to be powerful, arguing that consolidation of the UK supply base had taken place since 2000.

6.13. Morrisons reminded us that it was not a signatory to the Code. It had been suggested to it by representatives of the Department for Environment Food and Rural Affairs that it might wish to become one. However, it believed that as it had excellent relationships with its suppliers and that its purchasing procedures exceeded the requirements of the Code, there would be no benefit to its suppliers in its becoming a signatory. If Morrisons acquired Safeway, it would be required to become a signatory, and it told us that it was perfectly happy to do so.

6.14. Sainsbury's said that it had historically had good relations with its suppliers, which particularly valued its use of promotions and new product development. It had effective machinery for the resolution of disputes with suppliers and considered that the Code had worked well. It had had an existing Code of its own which was updated to ensure consistency with the OFT Code.

6.15. Sainsbury's considered that a merger with Safeway would enhance the efficiency of its suppliers and that it would maintain its good relations with them. Around [ ] per cent of its suppliers also supplied Safeway. Over time it would expect to rationalize the supply base. To do this, it would benchmark all its suppliers in order to optimize its product range based on the relative efficiencies of suppliers. That would lead to some reduction in the supplier base, but would be helpful to those retained, for example through improvements to efficiency.

6.16. Sainsbury's expected any rationalization mainly to affect food processors rather than primary producers. It said that retailers achieve cost reductions by reducing the number of suppliers and thus needing fewer but larger deliveries. It would share these benefits with its suppliers so that the effect of increased buyer power following a merger with Safeway would be a more efficient and competitive UK supply base.

6.17. Sainsbury's also considered that Tesco and Asda (following its acquisition by Wal-Mart) showed the effects of global or international purchasing power. It noted that Wal-Mart sourced non-food products globally and believed it was extending this into its sourcing of food products.

6.18. Tesco stressed that its relationships with its suppliers were based upon maintaining a mutually advantageous trading relationship. Whilst the manufacturers of leading brands supplied all multiple grocery retailers, retailers' choices of smaller suppliers were an important factor in their ability to differentiate their offerings to consumers.

6.19. Tesco did not consider that the OFT Code had significantly altered its relationships with its suppliers. It acknowledged that its buying terms tended in general to be better than those obtained by

smaller multiple grocery retailers, but believed that any differences in buyer power among the main parties were much less significant. Any differences in the cost prices achieved by the large national multiple grocery retailers reflected differences in technical efficiency and skill in buying rather than in intrinsic buyer power. Tesco cited Morrisons' success in support of this view.

6.20. It did not expect an acquirer of Safeway to gain significant extra buyer power, noting that this was the lesson of its own experience of acquisitions; that the CC had previously found that most of the larger multiple grocery retailers had been able to achieve most of the economies of scale that were available; and that cost reductions were only feasible in the case of suppliers with above-average profitability.

6.21. Following a merger, Tesco would review all suppliers to the combined group and in each case decide either to use a supplier, indicate willingness to use it if its offering were improved or decide against using it (a strategy which Tesco said had proved successful in previous cases). In so far as Tesco was able to reduce its cost prices as a result of acquiring Safeway, it expected this to be the result of harmonization of the prices previously achieved by the separate companies (though there might be scope for improved prices from suppliers of leading brands which had been able to maintain high levels of profitability). It did not expect to realize any significant overall economies of scale and was sceptical of claims to the contrary by others.

## **Number of grocery suppliers and supplier dependency**

6.22. We asked the five main parties to provide details of their suppliers, including in each case the net value of purchases from the supplier during the party's most recent financial year and a categorization code (based on a set we specified) which indicated the type of goods supplied or that the supplier was a supplier of services. The responses from the main parties differed considerably in the number of non-grocery suppliers included. Asda only provided details of suppliers from which its annual purchases were at least £10,000 and Tesco was unable to apply the category codings we requested. As a result we were unable to identify with confidence the number of grocery suppliers to each of the five on a comparable basis.

6.23. From the lists we excluded suppliers of services, clothing, capital goods, domestic electrical goods and DIY goods. We also excluded suppliers with non-UK addresses. The previous CC supermarkets inquiry worked to a definition of reference goods which incorporated a limited range of household goods or non-(food and drink) groceries. In examining the relationship between the main parties and their suppliers, we adopted a wider definition of groceries<sup>1</sup> which included suppliers of non-food consumables such as cigarettes, newspapers, magazines and CDs, as these products are normal parts of the one-stop grocery offering. We also included petrol, but as a separate exercise (see paragraph 6.39).

6.24. In 1999, the previous inquiry obtained lists of suppliers which supplied more than £10,000 of reference goods. Both that list and the 2003 supplier lists for main parties appear to include some duplicates, for example more than one address, name or account for a particular supplier, perhaps because it supplied products in more than one category or possibly resulting from supplier reorganizations or mergers. In its 2003 supplier list, Asda had a greater prevalence of multiple entries than the other main parties. For example, for one large supplier Asda had 11 separate account headings, whilst other parties had a single entry for this supplier.

6.25. Because there are duplications, the number of entries on the supplier lists provided by the main parties can be viewed as the maximum possible numbers of suppliers. To establish the minimum possible numbers of grocery suppliers, we eliminated all duplicate postcodes from the lists provided. These extreme values are shown in Table 6.1. Although there were some instances of different divisions of a company sharing a postal address for invoicing purposes, and of separate companies sharing postcodes,

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<sup>1</sup>See Glossary.

inspection of the supplier lists indicated that these only account for a minority of the duplicated postcodes. The actual number of grocery suppliers for each of the main parties is therefore likely to be closer to the lower extreme.

TABLE 6.1 Breakdown of numbers on 2003 supplier lists

| <i>Retailer</i> | <i>Total suppliers on list</i> | <i>Grocery suppliers (upper extreme)</i> | <i>Grocery suppliers after duplicate postcodes omitted (lower extreme)</i> |
|-----------------|--------------------------------|------------------------------------------|----------------------------------------------------------------------------|
| Asda            | 3,921                          | 1,937                                    | 1,155                                                                      |
| Morrisons       | 4,471                          | 1,786                                    | 1,589                                                                      |
| Safeway         | 2,684                          | 2,173                                    | 1,984                                                                      |
| Sainsbury's     | 2,535                          | 2,505                                    | 2,238                                                                      |
| Tesco           | 3,677                          | 2,808                                    | 2,164                                                                      |

Source: CC estimates, based on information supplied by the main parties.

Note: Asda's list only included suppliers from which at least £10,000 was purchased.

6.26. The analysis of the supplier lists, discussed in the remainder of this section, is based on the data exactly as submitted by the main parties. To avoid any misallocation of sales figures, it would have been necessary to ask the main parties to consolidate all duplications, but that would have been onerous and the effect of doing so would have been small, except for Asda. In Asda's case, the degree of duplication appears to affect larger suppliers disproportionately, as larger suppliers are more likely to appear as multiple accounts.

6.27. Table 6.2 contrasts, for each main party, the number of grocery suppliers which supplied more than £10,000 of groceries, derived from the 1999 and 2003 lists.

TABLE 6.2 Comparison of grocery supplier numbers

| <i>Retailer</i> | <i>2003 Grocery suppliers &gt;£10,000</i> | <i>1999 Reference goods suppliers &gt;£10,000</i> |
|-----------------|-------------------------------------------|---------------------------------------------------|
| Asda            | 1,937                                     | 1,592                                             |
| Morrisons       | 1,662                                     | 1,875                                             |
| Safeway         | 1,854                                     | 2,153                                             |
| Sainsbury's     | 2,216                                     | 1,892                                             |
| Tesco           | 2,226*                                    | 2,178                                             |

Source: CC estimates, based on information supplied by the main parties.

\*Estimated.

6.28. Everything else being equal, given that the span of products from the suppliers retained, as described above, from the main parties' supplier lists was somewhat broader than that of reference goods in 1999, we would expect the numbers of suppliers to be higher in 2003. As Morrisons and Safeway have lower figures for the broader definition, it appears that they have fewer grocery suppliers supplying at least £10,000 of goods than in 1999. The apparent increases in numbers for Sainsbury's and Tesco could reflect the broader definition of groceries as well as a possible increase in the number of suppliers. Based on the supplier accounts as submitted, Asda also appears to have more grocery suppliers in 2003. Asda told us that, on a like-for-like basis, it was now dealing with a little over 100 more suppliers, supplying more than £10,000, than had been the case in 1999.

6.29. For the main parties other than Asda, the proportion of grocery suppliers with sales of less than £10,000 varied from 7 per cent (with combined sales of £0.6 million) for Morrisons to 21 per cent (with combined sales of £1.5 million) for Tesco.

6.30. Table 6.3 illustrates the range of variation in suppliers' sales to the main parties. Part I of this table shows the annual sales for each party's largest grocery supplier, 20<sup>th</sup> largest supplier and the particular suppliers that lie at the upper quartile, median and lower quartile points. Part II expresses the

same suppliers' sales as a proportion of the multiple grocery retailer's total grocery purchases. Part III indicates the cumulative percentage of the multiple grocery retailer's grocery purchases which the selected supplier and larger suppliers provide. For example, Safeway's annual purchases from its median supplier amounted to £[ X ], which represented [ X ] per cent of Safeway's purchases. This, together with supplies from suppliers larger than the median, comprised [ X ] per cent of Safeway's groceries by value.

TABLE 6.3 Analysis of grocery suppliers' dependency

| Retailer                                                                  | Number of grocery suppliers | Total grocery purchases | Largest supplier | 20 <sup>th</sup> largest supplier        | Supplier at the upper quartile | Supplier at the median | Supplier at the lower quartile |
|---------------------------------------------------------------------------|-----------------------------|-------------------------|------------------|------------------------------------------|--------------------------------|------------------------|--------------------------------|
| Part I—Net annual purchases from supplier                                 |                             | £m                      | £m               | £m                                       | £m                             | £m                     | £m                             |
| Asda                                                                      | 1,937                       | [                       | ]                | Figures omitted.<br>See note on page iv. |                                |                        |                                |
| Morrisons                                                                 | 1,786                       |                         |                  |                                          |                                |                        |                                |
| Safeway                                                                   | 2,173                       |                         |                  |                                          |                                |                        |                                |
| Sainsbury's                                                               | 2,505                       |                         |                  |                                          |                                |                        |                                |
| Tesco                                                                     | 2,808                       |                         |                  |                                          |                                |                        |                                |
| Part II—Annual purchases from supplier as a percentage of total purchases |                             | £m                      | %                | %                                        | %                              | %                      | %                              |
| Asda                                                                      | 1,937                       | [                       | ]                | Figures omitted.<br>See note on page iv. |                                |                        |                                |
| Morrisons                                                                 | 1,786                       |                         |                  |                                          |                                |                        |                                |
| Safeway                                                                   | 2,173                       |                         |                  |                                          |                                |                        |                                |
| Sainsbury's                                                               | 2,505                       |                         |                  |                                          |                                |                        |                                |
| Tesco                                                                     | 2,808                       |                         |                  |                                          |                                |                        |                                |
| Part III—Cumulative percentages of purchases                              |                             | £m                      | %                | %                                        | %                              | %                      | %                              |
| Asda                                                                      | 1,937                       | [                       | ]                | Figures omitted.<br>See note on page iv. |                                |                        |                                |
| Morrisons                                                                 | 1,786                       |                         |                  |                                          |                                |                        |                                |
| Safeway                                                                   | 2,173                       |                         |                  |                                          |                                |                        |                                |
| Sainsbury's                                                               | 2,505                       |                         |                  |                                          |                                |                        |                                |
| Tesco                                                                     | 2,808                       |                         |                  |                                          |                                |                        |                                |

Source: CC analysis, based on information provided by the main parties.

**Notes:**

1. Figures for Asda exclude suppliers from which it bought less than £10,000 a year.
2. Figures for Morrisons, Safeway, Sainsbury's and Tesco exclude suppliers to which they made no net payment.
3. For Morrisons, largest non-subsidiary supplier is quoted.

6.31. The similarities between the results are more striking than the differences. For each party, suppliers larger than the median supplier together account for between [ X ] per cent (Morrisons) and [ X ] per cent (Safeway) so that those smaller than the median supplier, ie [ X ] suppliers to each main party, provide only about [ X ] per cent of main parties' grocery purchases. The 20 largest suppliers of each chain, on the other hand, account for [ X ] per cent of purchases. Suppliers smaller than the supplier at a party's upper quartile point (ie three-quarters of its suppliers) account for [ X ] per cent of Morrisons' purchases and just [ X ] per cent of Tesco's purchases.

6.32. In the 2000 report, the CC commented that the median Tesco supplier represented 0.0024 per cent of Tesco's purchases of reference goods. Tesco's annual purchases from its median supplier at that time were £220,000. In 2002 the corresponding figure was £200,000, representing 0.0016 per cent of Tesco's grocery purchases.

6.33. The profiles for Asda were somewhat different from those for Safeway, Sainsbury's and Tesco, at least in part because of the higher level of duplicate duplicate accounts and the omission of suppliers selling from £1 to £10,000 (which inflates the quartile points).

6.34. Sainsbury's and Tesco have particularly high turnovers with their largest supplier. This arises because both purchase certain high-volume branded goods, produced by more than one manufacturer, from a wholesaler.

## **The suppliers' questionnaires**

### ***Objectives***

6.35. The suppliers' submissions, which included some copies of submissions made to the OFT, indicated that there was considerable concern that some or all of the mergers would increase buyer power to their detriment. They also indicated a widespread belief that the Code of Practice had not been successful in improving the position of suppliers.

6.36. We did not want to rely on the self-selected sample of suppliers making submissions to us as it could not have been considered representative. We therefore decided to conduct our own surveys of the views of suppliers. We were particularly interested in:

- (a) how large suppliers' ability to negotiate prices had changed since the 2000 report;
- (b) how their dealings with Asda had changed since its acquisition by Wal-Mart;
- (c) the impacts of Somerfield's acquisition of Kwik Save and Iceland's of Booker on suppliers' businesses including the prices they obtained for their goods;
- (d) their views on the proposed mergers and the effect they might have on their own businesses; and
- (e) their views on the effectiveness of the Code of Practice.

We decided that we would conduct a larger suppliers' questionnaire and a separate small and medium suppliers' questionnaire.

### ***Procedure***

6.37. As described in paragraphs 6.22 and 6.23, we asked the main parties for details of their suppliers. The information was amalgamated by postcode and sorted by name to avoid obvious duplications. Tesco was unable to provide the classification codes we had specified, denoting type of goods or services supplied. We agreed that it should classify its suppliers on an alternative basis, though as a result we were unable reliably to exclude non-grocery suppliers from the sample frame for the SSQ. However, it was possible to validate LSQ candidates by inspection.

6.38. After excluding suppliers whose sales to the main parties totalled less than £100,000, we were left with about 2,500 suppliers, which were ranked by turnover. Working down from the highest turnover, approximately 100 were taken as candidates for the LSQ. Each of these had total annual sales to the main parties of £73 million or more. The remainder (2,413) formed the sample set for the survey of small/medium suppliers which was carried out for us by NOP.

### ***Larger suppliers' questionnaire***

6.39. From the list of candidates, about 20 suppliers of fresh fruit and/or vegetables, meat or poultry or fish, and own-label products were eliminated on the grounds that they supplied either fewer than three of the main parties, or a great majority of their sales were to a single multiple grocery retailer, with minimal sales to others. Results from these suppliers would have been of little value in comparing the main parties. Nor could those whose sales to the main parties were all, or mainly, of own-label or unbranded goods have contributed to the price comparisons: these were to be of branded goods so as to avoid unknown quality differences that could have invalidated such comparisons. This left 79 suppliers, to which we added the five largest petrol suppliers, giving a total of 84 suppliers to whom we mailed the questionnaire (it is reproduced in Appendix 6.1). Sixty-three responses were received, those from petrol suppliers being excluded from the financial analyses described in this chapter.

6.40. Asda criticized the methodology of our large and small supplier surveys. Its principal criticisms were that both surveys were based on an unrepresentative sample of suppliers; that both surveys excluded suppliers dedicated to Asda, who were commonly own-label suppliers and were most likely to have a positive view of Asda; that the surveys were likely to have been seen by suppliers as providing them with an opportunity to try to sway the CC's decision-making in favour of the acquirer of Safeway

best suited to their commercial interests; and that the surveys would have had an inbuilt response bias, because respondents would have known that their views would be relied upon as part of the merger inquiries.

6.41. It should be noted that the term ‘supplier’ is somewhat ambiguous. Most large UK suppliers are subsidiaries of transnational or national corporations, whose legal, operational and trading organizational structures vary. The multiple grocery chains’ supplier lists include many subsidiaries and divisions of subsidiaries. Whilst we undertook some analysis to determine which ‘divisions’ of the parent companies to select, we allowed respondents to submit combined or separate responses, if appropriate.

6.42. For LSQ respondents, on average, sales to multiples accounted for about two-thirds of turnover; half of their total sales, on average, were to the five main parties. However, these figures hide a wide range, largely dependent on the categories of goods supplied. For example, food manufacturers are particularly reliant on the multiple channel, whereas drinks manufacturers obtain substantial sales from other distribution channels.

6.43. Table 6.4 gives a breakdown of the average sales to the main parties and sales to other customers for all LSQ respondents and for those who were food suppliers (58 per cent of the sample).

TABLE 6.4 Breakdown of sales averaged over LSQ respondents

|                                | <i>per cent</i>                          |                                        |
|--------------------------------|------------------------------------------|----------------------------------------|
|                                | <i>Averages over<br/>all respondents</i> | <i>Averages for<br/>food suppliers</i> |
| Asda                           | 10.3                                     | 12.0                                   |
| Morrisons                      | 3.2                                      | 3.6                                    |
| Safeway                        | 8.5                                      | 10.1                                   |
| Sainsbury's                    | 10.5                                     | 11.5                                   |
| Tesco                          | <u>18.4</u>                              | <u>20.8</u>                            |
| Total sales to main parties    | 50.9                                     | 58.0                                   |
| Sales to other multiple chains | <u>15.1</u>                              | <u>18.6</u>                            |
| Total sales to multiples       | <u>66.0</u>                              | <u>76.6</u>                            |
| Other sales                    | 34.0                                     | 23.4                                   |

Source: CC analysis, based on information provided by the main parties.

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Note: Some suppliers include sales to both Booths and Budgens within other sales, since they receive delivery through Nisa-Today.

6.44. The importance of multiples in the retail supply of food can be seen from Table 6.4 in the finding that, on average, multiples accounted for 76.6 per cent of the sales of LSQ respondents supplying food. The five main parties alone accounted for 58 per cent of those respondents’ sales. Though not shown in the table, the underlying data showed that 53 per cent of food-supplying LSQ respondents rely on multiple grocery retailers for 80 per cent or more of their turnover, and for 50 per cent of them, the main parties account for over 60 per cent of their turnover.

### ***The small and medium-sized suppliers’ questionnaire***

6.45. We commissioned NOP Business to conduct the survey of small and medium-sized suppliers. The NOP report is at Appendix 6.2.

6.46. We supplied NOP with details of 2,413 possible candidates for telephone interview (including suppliers of unbranded and own-label goods to single multiples). In many cases telephone numbers were missing and NOP undertook data-matching exercises to improve the quality of address information and add telephone numbers. The final sample frame consisted of 1,743 contacts with telephone numbers, each of which was sent a letter informing them of the survey.

6.47. NOP completed interviews with 400 sales directors or, in 3 per cent of cases, equally knowledgeable colleagues, between 20 May and 6 June 2003. NOP set fieldwork quota controls by region (North, Midlands and South), otherwise contacts were selected randomly. The refusal rate was 15 per cent.

6.48. Comparison of the sample with that obtained for the 2000 report shows consistency, as shown by the distribution of respondents by type of product which closely follows that observed in the previous report.

6.49. Table 6.5 shows the proportions of the SSQ sample that currently supplied each of the main parties as well as other multiples and retailers. Slightly less than half (48 per cent) of the respondents supplied Asda, while Morrisons, Safeway, Sainsbury's and Tesco were each supplied by over half (between 55 and 68 per cent). When considering any differences in the proportions observed in Table 6.5, it should be borne in mind that variations of  $\pm 5$  per cent are expected to occur due to chance.

**TABLE 6.5 Multiple grocery retailers currently supplied by SSQ respondents**

|                               | <i>per cent of sample</i> |                                        |                                     |
|-------------------------------|---------------------------|----------------------------------------|-------------------------------------|
|                               | <i>Supplied currently</i> | <i>Supplied in the last four years</i> | <i>Mean per cent of sales value</i> |
| Asda                          | 48                        | 59                                     | 19                                  |
| Morrisons                     | 61                        | 68                                     | 19                                  |
| Safeway                       | 55                        | 66                                     | 18                                  |
| Sainsbury's                   | 58                        | 67                                     | 22                                  |
| Tesco                         | 68                        | 75                                     | 33                                  |
| Other multiples/<br>retailers | 72                        | 76                                     | 45                                  |

*Source:* NOP.

*Base:* All 400 suppliers interviewed.

*Note:* Multiple responses.

6.50. Based on their proportions in the original supplier lists provided by the main parties, the proportion of Morrisons suppliers in the sample is somewhat higher, and that of Asda suppliers somewhat lower, than might have been expected. In Asda's case this is at least in part because in its original data the proportion of suppliers appearing more than once was higher than in the data provided by the other main parties.

6.51. The proportion of Tesco suppliers was influenced by the fact that we could not reliably screen out its non-grocery suppliers. Care is therefore needed in drawing any conclusions, on the basis of the survey, about the numbers of UK suppliers to particular main parties or the numbers supplying particular goods to particular main parties. However, for each of the main parties, the respondents included a good representation of suppliers of a wide range of grocery and household goods. NOP considered that the opinions of these respondents would be representative of the population of all similar suppliers of grocery and household goods. In addition, the sample obtained was representative of the original contact list in terms of the expected turnover, indicating that a spread of small to medium-sized suppliers was achieved in terms of expected turnover.

6.52. Table 6.5 also shows which main parties were supplied over the previous four years. For example, 11 per cent of the suppliers had sold previously to Asda but no longer did so; similar or slightly smaller percentage changes occurred for the other main parties (the differences are not statistically significant). In every case fewer of our sample supply each main party now than they did four years ago. This is rather more likely to be a genuine reflection of an overall trend towards concentration of multiple grocery retailers' supply bases.

6.53. Table 6.5 also shows the average proportion of sales to each multiple grocery retailer for those suppliers who supply it. It suggests that suppliers to Tesco tended to be more dependent on Tesco than on the other main parties because suppliers to Tesco tended to sell more by value to Tesco. For example, Asda suppliers reported on average that 19 per cent of their sales were to Asda, whereas Tesco suppliers reported on average that 33 per cent of their sales went to Tesco, which is larger and sells more goods.

6.54. On average, half of SSQ respondents' turnover was generated from sales to multiple grocery retailers. For 20 per cent of SSQ respondents, sales to multiple grocery retailers accounted for more than 90 per cent of their turnover. At the opposite end of the scale, 25 per cent of these suppliers relied on the

multiple grocery retailers for less than 20 per cent of their turnover. Approximately half of SSQ respondents which supplied frozen food and unpreserved food rely on the multiple grocery retailers for more than 70 per cent and 75 per cent, respectively, of their sales. For all categories, except the non-(food and drink) grocery category as defined by NOP for the purposes of the SSQ, about one-quarter of suppliers relied on multiple grocery retailers for at least 80 per cent of their sales.

6.55. The SSQ showed that the average small to medium-sized supplier to Tesco relied on Tesco for one-third of its sales. The average small to medium-sized supplier to the other four main parties relied on that main party for about one-fifth of its sales. Of such suppliers to Tesco, 22 per cent relied on it for between 50 and 100 per cent of their sales. The equivalent figures for other main parties are: Asda—9 per cent of suppliers; Morrisons—11 per cent of suppliers; Safeway—10 per cent of suppliers; and Sainsbury's—13 per cent of suppliers.

6.56. On average, about 45 per cent of the value of sales to each of the main parties was of the suppliers' own brands.

6.57. It should be noted that in Appendix 6.2, NOP categorizes suppliers into six product categories. One of these, 'non-grocery', is a shorthand for non-(food and drink) products, since it includes products such as toilet rolls, detergents and other cleaning products, and other household consumables, which are regularly purchased as part of the one-stop grocery shop and were regarded as 'groceries' for the purposes of the surveys.

### ***Market changes***

6.58. Similar questionnaires had been used in the previous inquiry and were issued in July 1999. The data submitted was for calendar year 1998, whereas the present data is for calendar year 2002.

6.59. Various changes in ownership and business strategies—including the manner and extent of the use of promotions—took place either before or during the previous inquiry:

- (a) Somerfield acquired Kwik Save, harmonizing on the better of the terms previously obtained by the two multiples separately, and demanding additional discounts;
- (b) Wal-Mart acquired Asda, which then drew on Wal-Mart's experience in continuing its development of EDLP, begun in 1999;
- (c) Tesco indicated that its strategy was to become the lowest-priced national grocery retailer in the UK;
- (d) Iceland acquired Booker; and
- (e) Safeway adopted its high-low pricing strategy.

Only the Somerfield acquisition was even partly reflected in the LSQ data the CC obtained at that time.

6.60. In 1998, most multiple grocery retailers featured similar promotions and their attitudes to promotional offers were not too dissimilar. By 2002, there appears to have been substantial divergence in the promotional strategies of the multiple grocery retailers.

6.61. The differences in promotional strategies during 2002 have an important bearing on the interpretation of the results of the current analysis. One large supplier commented:

Listing prices net of discounts and promotions (as the questionnaire requests) can distort price information so it appears inconsistent; when in reality we have a set price list across all customers. The reason for the distortion is the level of promotional activity and multiple grocery retailers' take-up of that activity leading to differences in pricing ... For example, Iceland only buy [a particular product] when it is supported by a promotional offer, leading to an exceptionally low average net price.

## The results from the questionnaires

### *Prices paid for leading branded goods*

6.62. For the 2000 report, the CC made a comparison between the prices paid by the multiple grocery retailers for leading branded goods. On average, the larger multiple grocery retailers paid less for their supplies than the smaller chains. Since the CC had separately concluded that there were few differences between the major multiple grocery retailers in the costs that the largest suppliers incurred in supplying them, it attributed the lower prices paid by the largest multiple grocery retailers to 'buyer power'. The relatively few anomalies in the 2000 results could be attributed to careful buying of branded goods on temporary promotion by smaller chains such as Iceland and Netto.

### *2003 analysis*

6.63. We repeated the comparison outlined in the previous paragraph for the current inquiry, using two specific measures of buyer power developed for the 2000 report. These referred only to the power of multiple grocery retailers in relation to the largest suppliers of branded goods. They were:

- (a) a measure of prices paid for the best-selling items; and
- (b) supplier gross margin analysis.

6.64. We used the LSQ to ask suppliers for the average net prices paid, during their most recent financial year, by their multiple customers for each of their five top-selling branded product lines (for example, a 100g jar of a brand of instant coffee). From the 52 responses to the LSQ from suppliers which supplied significant quantities of branded goods and which provided the necessary sales data, we thus obtained data on about 240 product lines. We decided, as had been done in the 2000 inquiry, to index the average prices paid by each multiple grocery retailer to those paid by Tesco. For each multiple, we calculated, by averaging over all of the top five product lines bought by both it and Tesco, an overall ratio of its prices to those of Tesco. The overlap, of product lines which were sold by Tesco and by each of the other main parties, resulted in about 150 common lines in each case. This number was smaller in the cases of the smaller multiples for which we received price data. The results are shown in Table 6.6.

6.65. Table 6.6 shows that Tesco still bought these top-selling lines at keener prices than its main one-stop competitors. In fact, this advantage seemed to have widened somewhat. However, the data did reveal some important anomalies. The typical price paid by Asda, which had been slightly above Tesco in 2000, appeared, in 2003, to be substantially higher. The prices paid by Netto for the leading branded products to which this analysis applies were lower than those paid by Tesco. In other respects, the 2000 conclusion is still broadly true: bigger multiple grocery retailers obtained lower prices than their smaller rivals.

6.66. After detailed investigation of the data, we believe that the higher prices apparently paid by Asda, and the low prices paid by Iceland and Netto, reflect the outcome of particular buying policies adopted by these multiple grocery retailers. Specifically, the average prices paid seem to reflect the attitude of the multiple grocery retailer to buying goods on manufacturer promotion:

- (a) Iceland and Netto seemed to buy a large fraction of their total purchases of the branded lines examined in this analysis when they are on temporary manufacturer promotion. At times when a line is not on manufacturer promotion, they bought little or not at all. So they paid a low average price.
- (b) Asda, by contrast, was withdrawing from supplier-led promotional offers. Its focus was on holding prices at low levels all year round. It told us that supplier promotions tended to produce inefficiency in the retailer's supply chain. This drove up manufacturer costs and was therefore inconsistent with Asda's EDLC policy for its supply chain. It was, therefore, pressing its suppliers to eliminate their promotional budgets and use the costs saved to reduce list prices.

TABLE 6.6 Summary of top five comparisons with Tesco net prices, based on branded suppliers' top five product lines

| Retailer                                 | 2003 survey  |                                           |         |                      | 2000 report                                                |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
|------------------------------------------|--------------|-------------------------------------------|---------|----------------------|------------------------------------------------------------|--------------|-------------------------------------------|---------|----------------------|------------------------------------------------------------|--|--|--|--|--|--|--|--|--|--|
|                                          | Common lines | Average difference from Tesco net price % | Ranking | Standard deviation % | % of lines for which net prices paid are less than Tesco % | Common lines | Average difference from Tesco net price % | Ranking | Standard deviation % | % of lines for which net prices paid are less than Tesco % |  |  |  |  |  |  |  |  |  |  |
| Asda                                     | [            |                                           |         |                      |                                                            |              |                                           |         |                      | ]                                                          |  |  |  |  |  |  |  |  |  |  |
| Booths                                   |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Budgens                                  |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Co-op (CRTG)                             |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Iceland                                  |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Morrisons                                |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Netto                                    |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Safeway                                  |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Sainsbury's                              |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Somerfield                               |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Tesco                                    |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Waitrose                                 |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Figures omitted.<br>See note on page iv. |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |
| Source: LSQ.                             |              |                                           |         |                      |                                                            |              |                                           |         |                      |                                                            |  |  |  |  |  |  |  |  |  |  |

Notes:

1. In 1998 buying arrangements varied from Co-op to Co-op, whereas in 2002 they all bought through Co-operative Retail Trading Group (CRTG).
2. Some suppliers were unable to provide disaggregated data for Booths' and Budgen's purchases through Nisa-Today.
3. Analysis based on suppliers who generally sell to all five main parties.
4. Three lines only stocked by some of five main parties when on promotion in 2002 have been excluded.
5. The number of 'common lines' for a retailer is the number of lines in the sample which they and Tesco both stock.

6.67. Whilst many suppliers appeared to have conformed to Asda's policy of consistent and lower pricing throughout the year, the biggest manufacturers have resisted. These manufacturers often believe that supplier promotions are a valuable tool for retaining control of some aspects of their business. The relatively high prices paid by Asda for the best-selling lines from major manufacturers suggest that it has not yet fully succeeded in inducing its suppliers to fit in with its policy. Indeed, Asda itself told us that it was only part-way through a process of 'converting' suppliers to its buying policy. The net result is that, on the leading brands that were the subject of our analysis, any reductions that Asda has negotiated on list prices have been insufficient to compensate fully for the reduced level of promotional activity.

6.68. We also note that the lower net prices, shown by Table 6.6 to be achieved by some smaller retailers, do not imply stronger buying power in respect of the branded lines underlying the table since—depending on how a promotion is financed—the retailer may make a loss on the promotion itself, whilst the supplier may achieve a higher overall cash margin from the additional sales generated. (This issue is considered further in Appendix 6.3.) Information from the main parties indicated that suppliers generally funded between [X] and [X] per cent of the cost of promotions.

6.69. By contrast, data from the respondents to the LSQ on the gross margins that they obtained from individual multiple customers showed a much more predictable pattern. The largest multiple grocery retailers did generate a lower gross margin for the supplier than the smaller chains. These major retailers were able to obtain keener prices, and although their accounts might be slightly cheaper for suppliers to administer per million pounds of turnover, the eventual gross margin was lower. The results of the analysis in respect of branded product supply are shown in Table 6.7. As in the case of prices, a reduction in gross margin may be advantageous to a supplier if the resultant increase in sales is large enough (see Appendix 6.3).

TABLE 6.7 Analysis of gross margin differences for suppliers' sales of branded products

|                           | Number of<br>suppliers | Sales<br>£m | Average<br>difference from<br>average gross<br>margin<br>% | Average<br>difference in<br>2000 report<br>% | Current<br>ranking | Ranking in<br>2000 report |
|---------------------------|------------------------|-------------|------------------------------------------------------------|----------------------------------------------|--------------------|---------------------------|
| Asda                      |                        |             |                                                            |                                              |                    |                           |
| Booths                    |                        |             |                                                            |                                              |                    |                           |
| Budgens                   |                        |             |                                                            |                                              |                    |                           |
| CRTG                      |                        |             |                                                            |                                              |                    |                           |
| Iceland                   |                        |             |                                                            |                                              |                    |                           |
| Morrisons                 |                        |             |                                                            |                                              |                    |                           |
| Netto                     |                        |             |                                                            |                                              |                    |                           |
| Safeway                   |                        |             |                                                            |                                              |                    |                           |
| Sainsbury's               |                        |             |                                                            |                                              |                    |                           |
| Somerfield                |                        |             |                                                            |                                              |                    |                           |
| Tesco                     |                        |             |                                                            |                                              |                    |                           |
| Waitrose                  |                        |             |                                                            |                                              |                    |                           |
| Totals                    | 48                     | 12,078      |                                                            |                                              |                    |                           |
| Totals for<br>2000 sample | 19                     | 4,217       |                                                            |                                              |                    |                           |

*Figures omitted.  
See note on page iv.*

Source: LSQ.

**Notes:**

1. In 1998 buying arrangements varied from Co-op to Co-op; in 2002 they all purchased through CRTG.
2. Some suppliers were unable to provide disaggregated data for Booths' and Budgens' purchases through Nisa-Today.
3. Suppliers selling less than £10 million of branded goods to multiple grocery chains have been excluded.

6.70. This data, along with other results from our surveys, gives us confidence that the larger retailers still commanded better prices from their suppliers than could their smaller competitors, and that these lower prices were, at least partly, a function of buyer power.

6.71. In addition, we note that if Asda paid significantly more for its supplies than its competitors, its prices to customers would be correspondingly higher unless it were prepared to accept a much lower gross margin. Most recent surveys show that, overall, Asda's retail prices were the lowest in the UK, a finding that would make it difficult to take the view that it had been paying substantially more to its suppliers, across the whole range of groceries, than had its competitors. We therefore believe that the price premium paid by Asda for the goods covered by the analysis underlying Table 6.6 is not typical of all the items in Asda's range.

## Negotiating strength and overall relations

6.72. The 2000 report noted the ability of large multiple retailers to use their buyer power to request or require non-cost-related discounts or payments from their suppliers (for many suppliers a particular multiple grocery chain may represent 10 to 30 per cent of its total sales, whereas for the multiple grocery chain the supplier typically represents a fraction of 1 per cent of its purchases). Other specific aspects of buying power included the ability of the larger multiple grocery chains to negotiate lower prices following a merger or change in strategy (for example, a move towards EDLP), lower prices on selected lines at any time, frequency of promotions, level of promotional support and charges for gondola ends and administration costs of promotions, overriding discounts on total sales, longer credit periods and minimum shelf-lives for delivered products.

6.73. Suppliers, particularly branded suppliers, seek wide distribution for their products, and, for grocery products, consider the multiple grocery chains to be 'gatekeepers' to the consumer. In negotiations, suppliers will wish to persuade multiple grocery chains to stock a wider range of their products in more of the chain's stores. Branded suppliers will wish multiple grocery chains to participate in their national promotional campaigns. Suppliers will also be concerned to secure favourable shelf positionings (including shelf height and length and depth of display). To maintain current distribution and shelf positioning of their products, or to seek improvements, suppliers may have to give ground on financial issues such as pricing and promotional support, especially with the largest chains. As the multiple grocery chain's negotiating strength may be expected to depend on its importance to the supplier, the largest chains generally obtain lower overall net prices than medium-sized chains, which in turn do better than smaller retailers (though, as evidenced by Table 6.6, some smaller retailers obtained low prices for leading branded products, probably because of selective buying at times when these products are subject to manufacturer promotions).

6.74. We wished to examine how, and to what extent, the main parties' buyer power had evolved since the 2000 report. Accordingly both questionnaires asked respondents to describe the changes in their negotiating strength and overall relations with each of the main parties over the last four years. They were asked to choose one of five descriptions ranging from 'much improved' through 'not changed' to 'much reduced'.

6.75. Table 6.8 summarizes the LSQ responses relating to change in negotiating strength. To indicate the overall response in relation to each party, 'means' were calculated (see Table 6.8) by assigning numbers to the descriptions, from 1 ('much reduced') to 5 ('much improved'). No specific significance can be given to these values (referred to below as indices) but they serve as indicators of the broad tenor of responses.

6.76. Although responses varied widely, the balance of the responses was that suppliers' negotiating strength with each of the main parties had weakened over the last four years, especially against Asda and Tesco. 'Not changed' was the most frequent response in relation to Morrisons, Safeway and Sainsbury's as well as to 'other' multiple grocery retailers. In Asda's case, the most frequent response was that negotiating strength had 'reduced a little', and in Tesco's that it was 'much reduced'. In every case, more respondents reported reductions in negotiating strength than improvements, though only in the cases of Asda and Tesco did more than half of respondents report reductions. Some of the comments made in answers to other questions in the LSQ were also relevant.

TABLE 6.8 Change in negotiating strength: summary of LSQ responses

| Party       | Total responses | Much improved | Improved a little | Not changed | Reduced a little | Much reduced | Mean index |
|-------------|-----------------|---------------|-------------------|-------------|------------------|--------------|------------|
|             | Notional index: | %<br>5        | %<br>4            | %<br>3      | %<br>2           | %<br>1       |            |
| Asda        | 60              | 2             | 8                 | 22          | <b>45</b>        | 23           | 2.2        |
| Morrisons   | 57              |               | 5                 | <b>54</b>   | 37               | 4            | 2.6        |
| Safeway     | 62              |               | 16                | <b>42</b>   | 27               | 15           | 2.6        |
| Sainsbury's | 61              |               | 13                | <b>41</b>   | 31               | 15           | 2.5        |
| Tesco       | 62              | 2             | 8                 | 19          | 34               | <b>37</b>    | 2.0        |
| Others      | 50              |               | 8                 | <b>64</b>   | 26               | 2            | 2.8        |

Source: LSQ.

Note: Modal values bold.

6.77. Though there was some indication in the cases of Asda, Morrisons, Safeway and Tesco that responses were more favourable when the multiple grocery retailer in question bought a high proportion of the supplier's total sales, it was not statistically significant.

6.78. We looked to see whether larger suppliers of particular kinds of product were particularly likely to have considered that their negotiating power had reduced. Respondents to the LSQ covered a wide range of products and comprised 23 suppliers of both branded and own-label/unbranded products, 29 of mainly or exclusively branded goods and 11 of mainly or exclusively own-label/unbranded goods.

6.79. Ten LSQ respondents answered 'reduced a little' or 'much reduced' in respect of all four of Asda, Morrisons, Safeway and Sainsbury's. (Tesco was excluded because these two options accounted for most of the answers that it attracted and would not help reveal any product-sector dependency of adverse responses.) Of the ten, four supplied household goods and/or toiletries, two dairy products, one fresh fruit and vegetables, one frozen food, one alcoholic drinks and one supplied other solid food. Four of the ten supplied branded goods only, two supplied unbranded/own-label only and four supplied branded and own-label products.

6.80. Widening the ambit to disregard answers in respect of Morrisons increased the number to 14: five were suppliers of household goods and/or toiletries, two each of dairy products and other solid food and one each of frozen food, chilled food, fresh fruit and vegetables, alcoholic drinks and fresh meat and fish. Four were suppliers of branded goods only, three of unbranded/own-label only and seven supplied branded and own-label products. Overall, therefore, the figures showed no evidence that perceived reduction in negotiating strength was more pronounced in certain product sectors than others. At first sight, it appeared that suppliers only of branded goods were less likely to have perceived a reduction in their negotiating strength. However, a more detailed analysis searching for possible correlation between LSQ responses and the proportions of sales to each party that were of branded goods found nothing significant.

6.81. Large suppliers were also asked to rate the change in their overall relations with the five main parties over the last four years. They were again asked to choose one of five descriptions ranging from 'much improved' through 'not changed' to 'much reduced'. Table 6.9 summarizes the responses. Indices were assigned in the same way as before in order to calculate 'means'.

TABLE 6.9 Change in overall relations: summary of LSQ responses

| Party       | Total responses | Much improved<br>% | Improved a little<br>% | Not changed<br>% | Reduced a little<br>% | Much reduced<br>% | Mean index |
|-------------|-----------------|--------------------|------------------------|------------------|-----------------------|-------------------|------------|
|             | Notional index: | 5                  | 4                      | 3                | 2                     | 1                 |            |
| Asda        | 60              | 15                 | <b>28</b>              | 23               | 23                    | 10                | 3.1        |
| Morrisons   | 57              | 9                  | <b>40</b>              | 37               | 10                    | 4                 | 3.4        |
| Safeway     | 62              | 7                  | 31                     | <b>34</b>        | 19                    | 10                | 3.0        |
| Sainsbury's | 62              | 5                  | 24                     | <b>36</b>        | 27                    | 8                 | 2.9        |
| Tesco       | 60              | 13                 | <b>30</b>              | 20               | 27                    | 10                | 3.1        |
| Others      | 48              | 2                  | 21                     | <b>63</b>        | 15                    |                   | 3.1        |

Source: LSQ.

Note: Modal values bold.

6.82. The higher mean indices and the significantly greater number of respondents reporting 'much improved' relations are evidence of a generally more favourable view of overall relations than of negotiating strength. This may be a sign of maturing relations between these large suppliers and the main parties, notwithstanding an increase in the exercise of negotiating strength.

6.83. Several large suppliers said that in response to Asda's policy of EDLP, other multiple grocery retailers had intensified their direct or indirect pressure on prices paid to suppliers. For example:

Asda Wal-Mart focus very heavily on net cost pricing (Every Day Low Cost) and on delivering lower retail pricing than their competitors (Every Day Low Price). This can result in our business having challenging discussions with Asda's retail competitors.

Asda's reductions in selling prices and margins have increased the pressure from the other retailers for [respondent] to reduce its prices to fund lower retail prices.

Wal-Mart has adopted a pricing policy that has reduced our flexibility in price promotion activity in other retailers.

Since the acquisition of Asda by Wal-Mart our negotiating power has been severely reduced and this in turn has had a cascading effect on our negotiating position with other supermarkets.

6.84. Other large supplier comments indicate ways in which multiple grocery retailers' buyer power is applied:

Tesco has used ASDA EDLP pricing as its benchmark, but has used its market power to insist on receiving, in addition, promotional payments and incentives.

The acquisition of Asda by Wal-Mart has accelerated a trend of ever increasing pressure to provide additional services with costs inevitably borne by ourselves. There is less recognition of supplier needs within the Wal-Mart culture and significantly less emphasis on developing long-term trading relationships based on mutual benefit.

The requirement for listing fees (as a passage to be included in the displayed range) also means that some products cannot achieve the necessary market coverage without prohibitive costs. Overall, the position is one of ever increasing pressure to meet the profit aspirations of these retailers, with little regard to legitimate needs and aspirations of other supply chain partners. The position is compounded by the recent market consolidations that put increasing share into the hands of fewer and fewer key players.

Since being acquired by Wal-Mart, Asda have pursued an 'Every day low price' policy. They have consistently requested that their 'fair share' of promotional discounts are rolled into an every day low COST price to them, in order to fund lower day to day retail prices. As we consider promotional monies to be discretionary and variable, we have not been able to fully meet Asda's requests. We have therefore found that support for our products has lessened since the Wal-Mart acquisition via reduced ranges and limited/slow support for new products.

6.85. These comments may go some way to explain the differences in suppliers' selling prices to the main parties, as illustrated in Table 6.6, and support the comment we make in paragraph 6.71 on the relatively high prices that appear to be paid by Asda.

6.86. We now move to a discussion of the views of small and medium suppliers about changes in negotiating strength and the quality of their relationships with the main parties. Table 6.10 shows how smaller suppliers responded when asked about the change in their ability to negotiate, over the past four years, prices, promotions, terms and conditions of supply with the multiple grocery retailers. The questions were asked of all these suppliers. Some would not have had experience of supplying particular main parties, but may have had experience of trying to negotiate with them. Suppliers to Morrisons tended to say that there had been no change and those that had detected change were about equally divided as to whether this was an improvement or not. However, a very different picture emerges for the other main parties: between 47 and 50 per cent of suppliers (excluding those saying 'don't know') said that negotiating conditions had worsened with Asda, Safeway, Sainsbury's and Tesco.

6.87. These results were similar to those from the LSQ (Table 6.8). To the extent that mean indices may be taken to represent the overall views of the two survey samples, small to medium-sized suppliers appeared to view Morrisons somewhat more, and Safeway and Tesco somewhat less, favourably in respect of changes in negotiating strength than did larger suppliers.

TABLE 6.10 **Change in negotiating strength: summary of SSQ responses**

| <i>Party</i> | <i>Total responses</i> | <i>Much improved %</i> | <i>Improved a little %</i> | <i>Not changed %</i> | <i>Reduced a little %</i> | <i>Much reduced %</i> | <i>Mean index</i> |
|--------------|------------------------|------------------------|----------------------------|----------------------|---------------------------|-----------------------|-------------------|
|              | <i>Notional index:</i> | 5                      | 4                          | 3                    | 2                         | 1                     |                   |
| Asda         | 210                    | 7                      | 5                          | <b>38</b>            | 16                        | 34                    | 2.3               |
| Morrisons    | 258                    | 9                      | 11                         | <b>56</b>            | 16                        | 8                     | 3.0               |
| Safeway      | 243                    | 1                      | 7                          | <b>44</b>            | 19                        | 29                    | 2.3               |
| Sainsbury's  | 251                    | 3                      | 8                          | <b>42</b>            | 20                        | 27                    | 2.4               |
| Tesco        | 282                    | 4                      | 8                          | <b>38</b>            | 20                        | 30                    | 2.4               |

Source: NOP.

Base: All suppliers interviewed, excluding 'don't knows'.

Note: Modal values bold.

6.88. We looked to see whether smaller suppliers of particular broad groupings of products were particularly likely to have considered that their negotiating power had reduced.

6.89. Table 6.11 classifies SSQ respondents as suppliers of food, drink and non-food (respondents may be counted in more than one classification) and uses mean indices as indicators of representative responses in each product classification. The table also shows the bases (numbers of contributing responses) for each mean index. There is little evidence of systematic differences in the responses according to the classification of goods supplied.

TABLE 6.11 **Change in negotiating strength: mean SSQ indices by broad product category**

| <i>Party</i> | <i>Mean indices</i> |                            |              |                  | <i>Number of respondents</i> |                            |              |                  |
|--------------|---------------------|----------------------------|--------------|------------------|------------------------------|----------------------------|--------------|------------------|
|              | <i>All*</i>         | <i>Type of goods sold†</i> |              |                  | <i>All*</i>                  | <i>Type of goods sold†</i> |              |                  |
|              |                     | <i>Food</i>                | <i>Drink</i> | <i>Non-food‡</i> |                              | <i>Food</i>                | <i>Drink</i> | <i>Non-food‡</i> |
| Asda         | 2.3                 | 2.5                        | 2.3          | 2.2              | 210                          | 106                        | 36           | 79               |
| Morrisons    | 3.0                 | 2.9                        | 2.8          | 3.1              | 258                          | 140                        | 40           | 88               |
| Safeway      | 2.3                 | 2.1                        | 2.8          | 2.5              | 243                          | 127                        | 48           | 80               |
| Sainsbury's  | 2.4                 | 2.5                        | 2.4          | 2.3              | 251                          | 132                        | 48           | 81               |
| Tesco        | 2.4                 | 2.3                        | 2.0          | 2.5              | 282                          | 145                        | 43           | 109              |

Source: NOP.

\*Includes suppliers of services.

†A supplier may be in more than one category.

‡Corresponds to the 'non-grocery' category in Appendix 6.2.

Note: Number of respondents: all those dealing with the party in the past four years, excluding those answering 'don't know'.

### ***Impact of earlier mergers***

6.90. In reply to questions about the effects of the acquisitions of Asda by Wal-Mart, Kwik Save by Somerfield and Booker by Iceland, 33 of the 63 LSQ respondents said that they received lower prices from one or more of the combined groups or their profitability fell. Twenty-eight of these referred to the acquisition of Kwik Save, 13 to that of Booker and 11 to that of Asda. (The question about Asda's acquisition asked how dealings with it had changed and, unlike that about Kwik Save and Booker, did not specifically ask how prices and profitability had been affected. This may explain the relatively few direct reports on this point.)

6.91. Nine respondents added that Somerfield had demanded, though not always with complete success, that the combined group bought at the lower of the prices previously paid by it and Kwik Save. Seven of these made the same point about Iceland's acquisition of Booker. Such harmonization of prices at the lower level was not a tactic available to Asda after its acquisition, but was frequently mentioned as an expected pattern were Safeway to be acquired by any of the parties.

6.92. Thirteen LSQ respondents, including two that had said that their prices to Asda, or their profitability, had fallen since its acquisition, said that it had become more aggressive, or applied greater pres-

sure, in its dealings with them. Twelve respondents noted that Asda was now very unwilling to participate in supplier promotions, lessening opportunities to drive consumer demand. Two suppliers claimed that refusal to accept Asda's demands led to action against them, such as reducing or downgrading display space.

6.93. Some respondents said that they had not been disadvantaged by one, or more, of the three acquisitions:

- (a) Twenty-four suppliers to Asda said that its acquisition by Wal-Mart had either had no effect or described ways in which it had been beneficial. In some cases this was linked to the supplier's involvement in Asda's category management arrangements, which are dealt with in paragraphs 6.122 to 6.128.
- (b) Thirty suppliers said that Somerfield's acquisition of Kwik Save had had no material effect upon them.
- (c) Thirty-seven said the same about Iceland's acquisition of Booker.

In each case, respondents who said that they did not supply the retailers in question were excluded, though data is lacking to allow complete certainty that all such suppliers were excluded. The figures suggest that the larger the combined group following acquisition, the smaller the number of suppliers who did not consider it detrimental.

6.94. 50 per cent of the smaller suppliers had dealt with Asda before its acquisition by Wal-Mart but all were asked about their experiences. Table 6.12 summarizes the responses of suppliers who had supplied Asda before its acquisition as well as those of all suppliers (again excluding those saying 'don't know'). The table also breaks down these summaries into three broad classifications of supply.

TABLE 6.12 **Change in overall business situation since Wal-Mart acquired Asda: summary of SSQ responses**

|                                        |                   | <i>per cent</i> |                            |              |                  |
|----------------------------------------|-------------------|-----------------|----------------------------|--------------|------------------|
|                                        |                   | <i>All*</i>     | <i>Type of goods sold†</i> |              |                  |
|                                        |                   |                 | <i>Food</i>                | <i>Drink</i> | <i>Non-food‡</i> |
| All suppliers                          | Improved a lot    | 10              | 11                         | 9            | 12               |
|                                        | Improved slightly | 8               | 8                          | 15           | 7                |
|                                        | Not changed       | <b>44</b>       | <b>44</b>                  | <b>30</b>    | <b>49</b>        |
|                                        | Worsened slightly | 10              | 11                         | 15           | 5                |
|                                        | Worsened a lot    | 27              | 27                         | 30           | 27               |
|                                        | <i>Base</i>       | (357)           | (190)                      | (53)         | (126)            |
| Asda suppliers<br>(before acquisition) | Improved a lot    | 14              | 16                         | 6            | 13               |
|                                        | Improved slightly | 13              | 15                         | 20           | 10               |
|                                        | Not changed       | 28              | 29                         | 23           | 26               |
|                                        | Worsened slightly | 9               | 9                          | 14           | 7                |
|                                        | Worsened a lot    | <b>36</b>       | <b>32</b>                  | <b>37</b>    | <b>44</b>        |
|                                        | <i>Base</i>       | (192)           | (103)                      | (35)         | (61)             |

Source: NOP, CC calculations.

*Base:* All excluding those answering 'don't know'.

\*Includes suppliers of services.

†A supplier may be in more than one category.

‡Corresponds to the 'non-grocery' category in Appendix 6.2.

Note: Modal values bold.

6.95. Table 6.12 shows that the balance of opinion of all suppliers was that overall business situations had worsened (37 per cent said that their situation was worse compared with 18 per cent that said it was improved). Most striking is the greater polarization of the views of pre-acquisition suppliers: 45 per cent considered that their position had worsened, 27 per cent that it had improved. Of respondents who said that their business situation had worsened, approaching half (42 per cent) cited 'worse prices' as a reason, making this the most frequently given reason, followed by loss of Asda's business following the acquisition (16 per cent of these respondents).

6.96. Of SSQ respondents who said that their business situation had been improved by Wal-Mart's acquisition of Asda, slightly more than a quarter (27 per cent) gave improvements in working relations with Asda as a reason, closely followed by better terms of business (26 per cent of these respondents).

6.97. Table 6.12 shows little evidence that smaller suppliers' views of changes in business situation following the acquisition of Asda are linked to the type of goods they supply.

### *The OFT Code of Practice*

6.98. Suppliers were asked about the impact of the Code of Practice on their dealings with the main parties and with other multiple grocery retailers. They were asked to choose one of five descriptions ranging from 'much improved' through 'not changed' to 'much reduced'. Although Morrisons was not required to be a signatory of the Code and had not become one (and the questionnaires reminded respondents of this), responses about Morrisons were invited for completeness. The results from the LSQ are summarized in Table 6.13. Numerical values have been assigned in the same way as before in order to calculate 'means'.

6.99. A high proportion of the responses reported 'not changed' in respect of each of the five main parties as well as 'other' multiple grocery retailers. Among the relatively few suppliers who reported a change, there were twice as many negative responses as positive. Overall, the responses indicated that LSQ respondents believed the Code to have had little, or even a slightly negative, effect.

TABLE 6.13 **Impact of OFT Code of Practice: summary of LSQ responses**

| <i>Party</i> | <i>Total responses</i> | <i>Much improved</i><br>% | <i>Improved a little</i><br>% | <i>Not changed</i><br>% | <i>Reduced a little</i><br>% | <i>Much reduced</i><br>% | <i>Mean index</i> |
|--------------|------------------------|---------------------------|-------------------------------|-------------------------|------------------------------|--------------------------|-------------------|
|              | <i>Notional index:</i> | 5                         | 4                             | 3                       | 2                            | 1                        |                   |
| Asda         | 60                     |                           |                               | <b>93.3</b>             | 5.0                          | 1.7                      | 2.9               |
| Morrisons    | 57                     |                           | 5.3                           | <b>94.7</b>             |                              |                          | 3.1               |
| Safeway      | 62                     |                           | 1.6                           | <b>90.3</b>             | 1.6                          | 6.5                      | 2.9               |
| Sainsbury's  | 63                     |                           | 1.6                           | <b>88.9</b>             | 6.3                          | 3.2                      | 2.9               |
| Tesco        | 63                     |                           | 9.5                           | <b>79.4</b>             | 4.8                          | 6.3                      | 2.9               |
| Others       | 49                     |                           | 2.0                           | <b>91.8</b>             | 6.1                          |                          | 3.0               |

Source: LSQ.

Note: Modal values bold.

6.100. Large suppliers' comments included assertions that particular multiple grocery retailers were in breach of the Code (details were not given); that the Code was ineffective or ignored; that it needed to be given teeth if it was to be made effective and that because of its ambiguities it was a factor in causing behaviour it was intended to curb.

6.101. Table 6.14 summarizes the equivalent results from the SSQ. It shows that the most common response (given by between 65 and 79 per cent of suppliers depending on the multiple grocery retailer) was that there had been no effect, although the proportions reporting no effect were significantly lower than for the LSQ. As for the LSQ, where effects were reported the balance of opinion was that, in respect of Asda, Safeway, Sainsbury's and Tesco, dealings with these multiple grocery retailers had worsened a little, though in Morrisons' case there was indication of a slight improvement.

TABLE 6.14 **Effect of the OFT Code of Practice: summary of SSQ responses**

| <i>Party</i> | <i>Total responses</i> | <i>Much improved</i><br>% | <i>Improved a little</i><br>% | <i>Not changed</i><br>% | <i>Reduced a little</i><br>% | <i>Much reduced</i><br>% | <i>Mean index</i> |
|--------------|------------------------|---------------------------|-------------------------------|-------------------------|------------------------------|--------------------------|-------------------|
|              | <i>Notional index:</i> | 5                         | 4                             | 3                       | 2                            | 1                        |                   |
| Asda         | 185                    | 3                         | 4                             | <b>82</b>               | 2                            | 9                        | 2.9               |
| Morrisons    | 241                    | 4                         | 5                             | <b>88</b>               | 3                            | 0                        | 3.1               |
| Safeway      | 229                    | 1                         | 4                             | <b>80</b>               | 7                            | 8                        | 2.8               |
| Sainsbury's  | 228                    | 2                         | 4                             | <b>82</b>               | 6                            | 6                        | 2.9               |
| Tesco        | 259                    | 1                         | 6                             | <b>82</b>               | 6                            | 5                        | 2.9               |

Source: NOP.

Base: All who supplied party during last four years, excluding 'don't knows'.

Note: Modal values bold.

6.102. We also looked to see whether the views of smaller suppliers differed according to the type of goods supplied. Table 6.15 summarizes the results in the form of mean indices calculated from the responses of suppliers of food, drink and non-food respectively. The uniformity of the results is their most striking feature.

TABLE 6.15 **Effect of OFT Code of Practice: mean SSQ indices by broad product category**

| Party       | Mean indices |                     |       |           | Base |                     |       |           |
|-------------|--------------|---------------------|-------|-----------|------|---------------------|-------|-----------|
|             | All*         | Type of goods sold† |       |           | All* | Type of goods sold† |       |           |
|             |              | Food                | Drink | Non-food‡ |      | Food                | Drink | Non-food‡ |
| Asda        | 2.9          | 2.9                 | 2.8   | 2.9       | 185  | 99                  | 32    | 63        |
| Morrisons   | 3.1          | 3.1                 | 3.1   | 3.2       | 241  | 134                 | 39    | 78        |
| Safeway     | 2.8          | 2.7                 | 3.1   | 2.9       | 229  | 118                 | 46    | 76        |
| Sainsbury's | 2.9          | 2.9                 | 2.9   | 2.9       | 228  | 122                 | 46    | 70        |
| Tesco       | 2.9          | 2.9                 | 2.8   | 3.0       | 259  | 138                 | 40    | 96        |

Source: NOP.

Base: All those dealing with the party in the past four years, excluding those answering 'don't know'.

\*Includes suppliers of services.

†A supplier may be in more than one category.

‡Corresponds to the 'non-grocery' category in Appendix 6.2.

### ***Predicted effects of the acquisition of Safeway***

6.103. Suppliers were asked about the effects on their business that they would expect if Safeway were acquired by each of the four presumptive bidders. They were asked to choose one of five descriptions ranging from 'very beneficial' through 'no change' to 'very detrimental'. Numerical values have been assigned in the same way as before in order to calculate 'means'.

6.104. Table 6.16 summarizes the results from the LSQ. In so far as the mean index may be considered as an overall view, respondents expected the effect of an acquisition of Safeway by Morrisons to be broadly neutral and by any of the other parties to be detrimental. But as Table 6.16 shows, views are widely scattered.

TABLE 6.16 **Predicted effect of Safeway acquisition: summary of LSQ responses**

| Party       | Total responses | Very beneficial | Somewhat beneficial | No change | Somewhat detrimental | Very detrimental | Mean index |
|-------------|-----------------|-----------------|---------------------|-----------|----------------------|------------------|------------|
|             |                 | %               | %                   | %         | %                    | %                |            |
|             | Notional index: | 5               | 4                   | 3         | 2                    | 1                |            |
| Asda        | 60              |                 | 8                   | 13        | 33                   | <b>45</b>        | 1.8        |
| Morrisons   | 60              | 3               | <b>38</b>           | 18        | 27                   | 13               | 2.9        |
| Sainsbury's | 62              |                 | 15                  | 21        | <b>40</b>            | 24               | 2.3        |
| Tesco       | 62              | 2               | 11                  | 11        | 27                   | <b>48</b>        | 1.9        |

Source: LSQ.

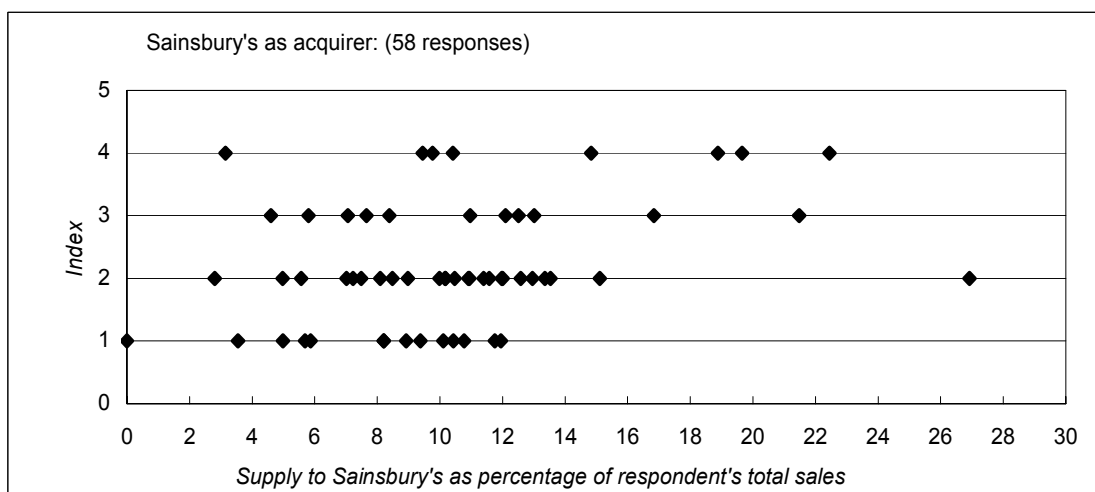
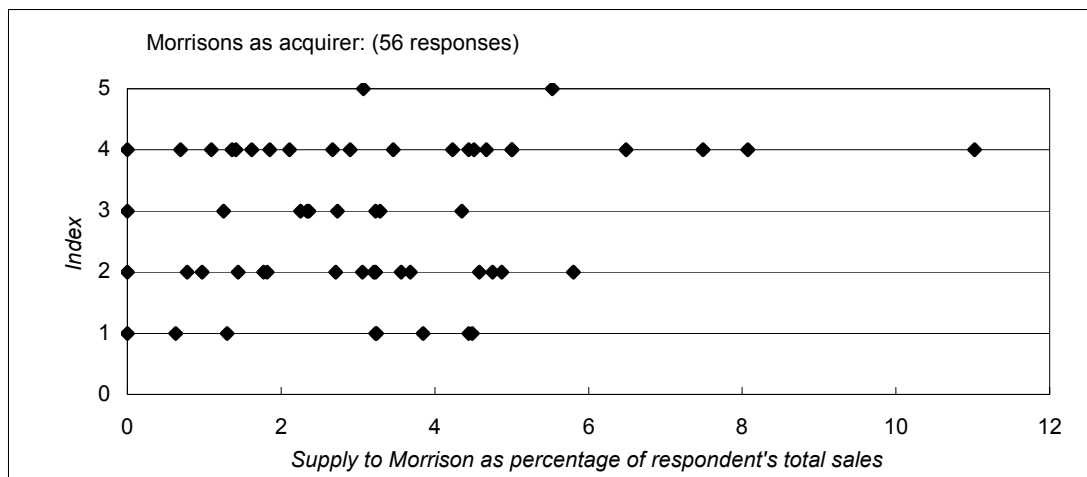
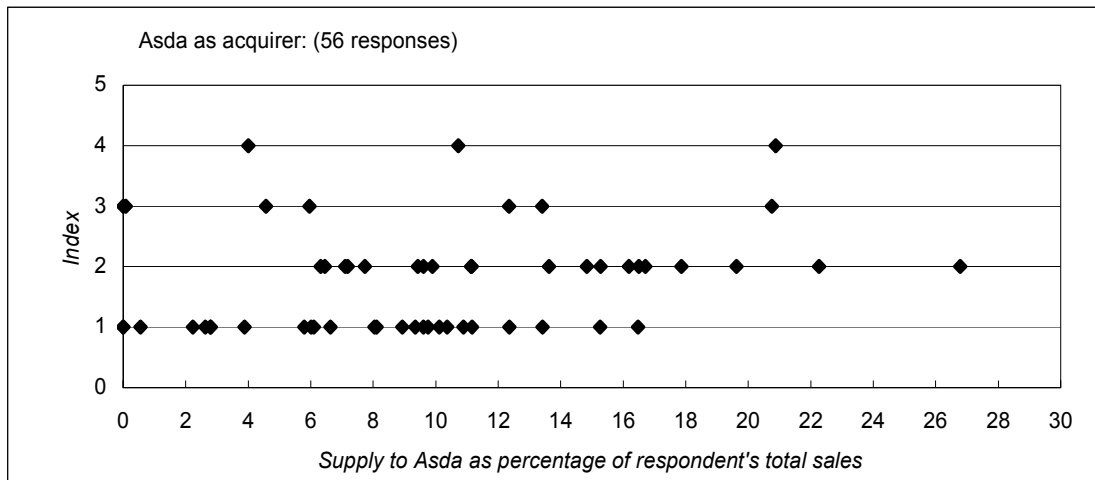
Note: Modal values bold.

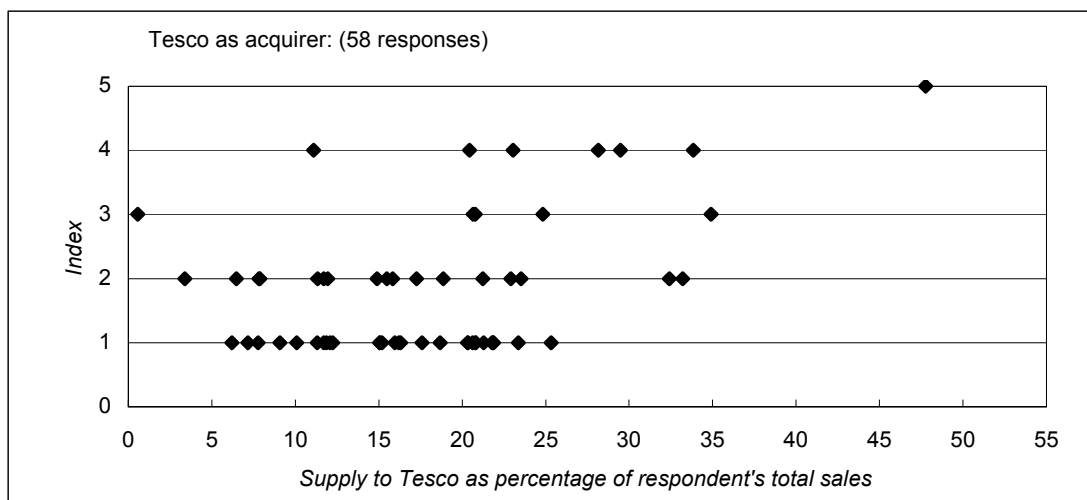
6.105. We looked to see whether there was any relationship between larger suppliers' current sales patterns and their views on the prospective mergers. The results are shown in Figure 6.1. The most favourable responses tend to come from suppliers with the highest dependency on the bidder in question (represented by the proportion of total sales attributable to a party). Though this was most pronounced in the case of Tesco, and can be seen in the other three cases as well, in no case was it statistically significant.

6.106. It was clear from the LSQ responses that the main reasons for regarding an acquisition of Safeway as detrimental were expectations of lower prices, lower profitability or both. A big majority of LSQ respondents expected the acquisition to result in stronger downward pressure on their prices to the combined group and, in some cases, from other retailers as well.

FIGURE 6.1

**Predicted effect on respondent's business according to party acquiring Safeway**





Source: LSQ.

Note: Because not all respondents gave the sales figures needed to construct Figure 6.1, fewer responses are shown than are recorded in Table 6.16.

6.107. Fifty-three respondents considered that an acquisition of Safeway, by whichever of the parties, would lead to a fall in the prices they received or in their profitability. Two of these said that they expected profitability to fall unless prices to other retailers were realigned. In addition, two other respondents expected prices or profitability to fall unless Morrisons was the acquirer. Three, all of which had relatively low proportions of their total business with multiple grocery retailers, did not expect prices to fall whichever bidder was successful.

6.108. Another reason for regarding an acquisition as detrimental was an expected fall in volume. Two large suppliers said that they expected to lose business if Safeway were to be acquired by any bidder; four others expected to lose business, three if Asda acquired Safeway and the fourth if either Sainsbury's or Tesco did so.

6.109. The main reason for regarding an acquisition as beneficial was an expectation of increased volume. Two suppliers said that they expected sales to the combined group to grow if Morrisons were the successful bidder. One of these suppliers also took this view if the acquisition were by Sainsbury's or Tesco and a third expected sales growth if Asda acquired Safeway.

6.110. Although the LSQ did not specifically ask large suppliers about possible effects of the proposed merger on innovation or R&D expenditure, three respondents commented that they expected an acquisition of Safeway to result in a reduction in R&D spend and thus reduced product innovation. Examples of relevant comments are:

We would certainly expect the average net prices paid for our products by the merged group would be lower than the prices they pay individually. In order to maintain the stocking of our range of products across all retail outlets, we could not afford to pass on increases in price to other retailers. We would have to seek to achieve further cost and efficiency savings, reduce some forms of trade or consumer investment without impairing our sales and suffer reduced profits, which would potentially prejudice new investment in research and development, product innovation and production facilities.

For the UK Manufacturing Industry it is vital that adequate levels of competition are maintained in the retail sector. If one or two retailers are allowed to become dominant they will exert a downward pressure on prices which, although potentially of benefit to consumers, will have an impact right through the supply chain. Not only is this likely to lead

to small suppliers being squeezed but even the large multi-national companies will find it difficult to finance R&D programs in the U.K. and support the launches of innovative new products.

6.111. Some large suppliers of branded products expressed concern that the acquisition of Safeway could result in an increased sales emphasis on own-label products at the expense of branded alternatives. A number of respondents' comments reflected concern at a weakening of competition in the event of an acquisition of Safeway.

6.112. Large suppliers were asked whether they expected lower prices to the combined group to feed through to other retailers as higher prices (taken to include reductions in supplier support for promotions and similar investment in retailers), and if so whether this would affect small retailers differently from large. Twenty-eight respondents foresaw no price rises to other retailers (one other did not expect to be able to increase prices to other major retailers); six said either that they would consider raising their prices to all other retailers or definitely expected to do so; six others were expecting small retailers to face the only, or the largest, rises. Six respondents believed that the combined group's ability to obtain lower buying prices would lead to intensified downward pressure on their prices to other retailers. Examples of comments are:

Lower prices anticipated by combined group. Would attempt to increase prices to others but unlikely to happen, could be lower as the result of likely aggressive policy of new group to regain share. Smaller retailers more vulnerable.

We would seek to maintain our level of profitability and so would consider a selling price increase to all other retailers.

Our prices will be lower .... But the consequence would not be an increase in the average net prices charged to other retailers. We do not have the power to do this on own label as customers would simply switch suppliers. Whilst we could do this on some branded products where that brand is strong, we wouldn't because it isn't ethical or fair on those customers and also it would make our retail prices too high in those customers.

Our net prices to the combined group would be lower than they pay individually. Our prices to other major retailers would be unaffected but would probably have to increase to smaller retailers and independents.

We would not try to recoup any reduction in revenue from the new combined group by increasing prices to other customers.

6.113. The LSQ question did not specify a timescale and respondents generally appeared to have given their view of the short term. Evidence given in submissions supported this, but it was also put to us that over the longer term any increase in buyer power resulting from an acquisition of Safeway would increase the differential between the prices paid by larger and smaller retailers. This is discussed further in paragraph 6.119.

6.114. Table 6.17 summarizes the SSQ responses on the expected effect of a merger. It shows that respondents were equivocal about the effects if Sainsbury's or Tesco acquired Safeway. On balance, however, respondents' opinion was that a takeover by Morrisons would improve their business situations whilst a takeover by Asda would worsen them. Thus, 19 per cent thought their situation would improve if Asda bought Safeway but 44 per cent thought their situation would worsen, whilst the corresponding proportions for Morrisons were 46 per cent who thought their situation would improve and 17 per cent who thought it would worsen.

TABLE 6.17 Predicted effect of Safeway acquisition: summary of SSQ responses

| Party       | Total responses | Much improved % | Improved a little % | Not changed % | Reduced a little % | Much reduced % | Mean index |
|-------------|-----------------|-----------------|---------------------|---------------|--------------------|----------------|------------|
|             | Notional index: | 5               | 4                   | 3             | 2                  | 1              |            |
| Asda        | 349             | 12              | 9                   | 30            | 15                 | <b>34</b>      | 2.5        |
| Morrisons   | 365             | 27              | 24                  | <b>32</b>     | 8                  | 10             | 3.5        |
| Sainsbury's | 352             | 13              | 22                  | <b>37</b>     | 13                 | 16             | 3.0        |
| Tesco       | 370             | 17              | 19                  | <b>26</b>     | 14                 | 24             | 2.9        |

Source: NOP.

Base: All respondents, excluding 'don't knows'.

Note: Modal values bold.

6.115. As in analyses described above, we looked to see whether the responses provided evidence that smaller suppliers' expectations of the effects of a merger differed systematically according to the classification of goods supplied. Table 6.18 summarizes this analysis, showing mean indices for suppliers of food, drink and non-food. It gives some indication that suppliers of drink (alcoholic and non-alcoholic) had more adverse expectations than other suppliers if Safeway were to be acquired by Asda or Tesco.

TABLE 6.18 Predicted effect of Safeway acquisition: mean SSQ indices by broad product classification

| Party       | Mean indices |                     |       |           | Base |                     |       |           |
|-------------|--------------|---------------------|-------|-----------|------|---------------------|-------|-----------|
|             | All*         | Type of goods sold† |       |           | All* | Type of goods sold† |       |           |
|             |              | Food                | Drink | Non-food‡ |      | Food                | Drink | Non-food‡ |
| Asda        | 2.5          | 2.5                 | 2.1   | 2.7       | 359  | 193                 | 54    | 127       |
| Morrisons   | 3.5          | 3.5                 | 3.4   | 3.6       | 365  | 191                 | 54    | 134       |
| Sainsbury's | 3.0          | 3.1                 | 2.9   | 3.0       | 352  | 191                 | 49    | 123       |
| Tesco       | 2.9          | 3.0                 | 2.3   | 3.2       | 370  | 197                 | 52    | 135       |

Source: NOP.

Base: All those dealing with the party in the past four years, excluding those answering 'don't know'.

\*Includes suppliers of services.

†A supplier may be in more than one category.

‡Corresponds to the 'non-grocery' category in Appendix 6.2.

6.116. Among reasons cited for changes following a takeover were: lower or higher prices, changes to working relationships, and losing or winning the Safeway business.

6.117. SSQ respondents were asked about possible changes in their prices to other retailers if, following an acquisition of Safeway, prices to the merged entity fell. Table 6.19 shows that, generally, smaller suppliers either thought there would be no effect or that there would be a decrease in prices overall. More than half (58 per cent) said that their prices to others would not change, whilst 32 per cent said that their prices to others would also decrease, and only 1 per cent said that they would increase their prices to others.

TABLE 6.19 **Whether prices to other multiple grocery retailers and retailers would change if prices to merged entity were to become lower: summary of SSQ responses**

|            | %     |
|------------|-------|
| Not change | 58    |
| Increase   | 1     |
| Decrease   | 32    |
| Don't know | 10    |
| Base       | (400) |

Source: NOP.

Base: All suppliers interviewed.

Note: Percentages do not necessarily sum to 100 because of rounding.

6.118. Table 6.20 shows that those smaller suppliers that thought their prices would decrease to other customers were largely split into two groups: 42 per cent said that the decrease would apply equally to all their customers, and 52 per cent thought it would apply to larger customers.

TABLE 6.20 **Whether price decrease would apply to smaller or larger multiple grocery retailers and retailers: summary of SSQ responses**

|                | %     |
|----------------|-------|
| Smaller        | 2     |
| Larger         | 52    |
| Equally to all | 42    |
| Don't know     | 4     |
| Base           | (128) |

Source: NOP.

Base: Suppliers that would decrease prices to other customers

6.119. As noted above, there was little evidence of an immediate or short-term waterbed effect. However, it was put to us that any increase in buyer power resulting from a merger would lead indirectly to higher prices of branded goods for smaller retailers in the longer term. If a large multiple grocery retailer secures an improvement in terms, through price reductions or otherwise, which reduces the supplier's margin, it is unlikely that any supplier would seek immediately to increase its prices to other retailers. However, branded suppliers periodically review their prices, and will assess changes in material or other input costs, changes in production costs, and the need to make sufficient margin to cover overheads and provide a return on their assets. If an acquirer of Safeway has been successful in reducing the prices it pays, the percentage increase in prices sought as a result of the supplier's periodic review might be higher than it otherwise would have been. Grocery suppliers have sufficient power to impose price increases on their larger customers, and therefore have to enter negotiation with their customers on the percentage increases.

6.120. It was suggested to us that the largest chain is likely to accept at most a fraction of the supplier's proposed increase, while medium-sized chains will accept most of the increase and smaller retailers will probably have to accept it in full. The ability of the largest chains to resist price increases is a particularly significant aspect of their buying power, and over time leads to the differentials in price paid by large and small chains, which were observed in the previous inquiry.

6.121. The 2000 report observed that the largest retailers were able to obtain non-cost-related discounts from suppliers and that the differentials in the prices charged by suppliers to large and small retailers could not be explained by cost differences. It was suggested to us that these findings themselves are evidence of the long-term waterbed effect and the effect of any of the mergers would be to increase the power of the largest multiple grocery chains, and exacerbate, over time, the price disadvantage experienced by smaller retailers.

### ***Use and effects of techniques for the management of supplier relationships***

6.122. The LSQ, but not the SSQ, asked whether the main parties adopt approaches to management techniques such as category management, factory-gate pricing or open-book costing which are particu-

larly beneficial or detrimental to their business. The question did not refer exclusively to these three techniques, though most respondents confined their comments to them. A few referred to ‘techniques’ at large.

6.123. It was clear from the responses that, to the extent that the main parties adopt the techniques mentioned by the questionnaire, they do so in differing ways which cannot be brought within precise definitions. Broadly speaking, however, we understand as follows:

- (a) *Category management* is a multiple retailer’s involvement of its suppliers of a particular product category in its strategy towards the stocking and presentation for sale of all products in that category. This involvement may be led by, or confined to, one leading supplier, designated as ‘category captain’.
- (b) *Factory-gate pricing* is the pricing of goods net of the cost of haulage from the supplier’s premises to the retailer’s. The retailer thus becomes responsible for the provision of the necessary haulage services, in-house or otherwise.
- (c) *Open-book costing* is a relationship between supplier and purchaser in which price is negotiated on the basis of mutual knowledge of the supplier’s costs.

6.124. Overall, the responses indicate that category management is widely used. All five main parties were said, by at least one respondent, to employ it (only one respondent asserted that Morrisons did not; Morrisons itself also told us that it did not). Only Asda was said by LSQ respondents to appoint category captains.

6.125. Tesco is the only one of the five stated unambiguously to operate factory-gate pricing with a respondent. Several others said that they were negotiating such arrangements with one or more of the main parties, which may explain why they were able to comment on its helpfulness.

6.126. Category management emerges as the best-established of the techniques mentioned by the questionnaire, seen generally as helpful to large suppliers, especially the few respondents which identified themselves as category captain. Its fullest implementation, including the appointment of category captains, appears to be by Asda. Only one of the respondents which considered Asda’s use of category management to be beneficial identified itself as not being a category captain. Four other suppliers of leading brands, silent on category captaincy, noted that Asda’s acquisition by Wal-Mart had enhanced cooperation, especially in relation to access to sales data; three others disagreed with this view. Five respondents said that appointment of a competitor as category captain had disadvantaged their business.

TABLE 6.21 **Illustrative analysis of LSQ respondents’ views of main parties’ use of techniques for management of supplier relationships**

| <i>Technique</i>     |             | <i>Total respondents</i> | <i>Asda</i> | <i>Morrisons</i> | <i>Safeway</i> | <i>Sainsbury’s</i> | <i>Tesco</i> | <i>General</i> |
|----------------------|-------------|--------------------------|-------------|------------------|----------------|--------------------|--------------|----------------|
| Category management  | Beneficial  | 25                       | 18          | 11               | 18             | 16                 | 19           | 7              |
|                      | Neutral     | 1                        |             |                  |                |                    |              | 1              |
|                      | Detrimental | 7                        | 3           | 1                | 2              | 2                  | 2            | 3              |
| Factory-gate pricing | Beneficial  | 7                        | 3           | 1                | 2              | 3                  | 6            |                |
|                      | Neutral     |                          |             |                  |                | 1                  | 3            | 1              |
|                      | Detrimental | 8                        | 1           |                  |                |                    | 4            | 6              |
| Open-book costing    | Beneficial  | 5                        | 3           |                  | 1              | 3                  | 3            |                |
|                      | Neutral     | 0                        |             |                  |                |                    |              |                |
|                      | Detrimental | 4                        |             |                  |                | 4                  |              |                |

Source: CC analysis of LSQ responses.

Note: The entries in this table are derived from comments by 37 LSQ respondents.

6.127. Table 6.21 summarizes LSQ respondents’ comments expressing an overall view on the effects on their business of the three specific techniques as practised by each of the main parties. A minority of respondents, represented in the last column of Table 6.21, made such comments without

referring to any party or multiple grocery retailer. Other comments, not part of Table 6.21's summary, referred to particular aspects of individual techniques but did not give an overall view of the effect on the respondent's business.

6.128. Taken as a whole, the views expressed were mixed. On the one hand, it was said that all the techniques are simply ways to leverage improved terms from suppliers. On the other hand, techniques were said to be capable of increasing sales volume. When the comments on particular features of the techniques, and those that spoke only of techniques in general, are taken with those specific to particular main parties, the picture overall is consistent with the view that category management is perceived as beneficial to many but not all large suppliers, factory-gate pricing as, on balance, detrimental and open-book costing too little practised for a picture to emerge.

### ***Use of multinational buying power***

6.129. Larger suppliers that are subsidiaries of international companies were asked whether any supermarket group seeks to negotiate terms of supply with, or receive direct discounts or payments from, the parent company—in the UK, Europe-wide or worldwide. Although the question was not restricted to transnational negotiations and deals, these were in practice its main targets.

6.130. Seventeen responses reported contacts between supplier and retailer at group/international level, of which seven referred to agreements in operation. Two respondents complained about actual or feared substitution by imports but did not refer to trading or agreements at group, rather than subsidiary, level.