

## Why large suppliers need to be included in the Supermarket Ombudsman scheme

ActionAid has substantial concerns regarding proposals to limit the size of suppliers eligible for coverage under the Supermarket Ombudsman scheme. The Competition Commission (CC) and ActionAid have found evidence that supermarkets transfer excessive costs and risks to large-scale suppliers, who in turn pass on these pressures to smaller suppliers, including farmers. If this proposal is implemented, it will mean:

- Small supplier businesses, including farmers in the UK and in developing countries, will remain exposed to excessive costs and risks that threaten to put them out of business.
- The Ombudsman will not be able to prevent the Adverse Effect on Competition (AEC) effectively.

### Supermarkets transfer excessive costs and risks to large suppliers

The CC's Final Report recognised that the largest branded suppliers to supermarkets have market power, however it did not find this to be equal to or greater than the market power of supermarkets.

Crucially, it is because supermarkets 'gatekeep' access to vast numbers of consumers that gives them the large part of their market power over suppliers, including multinational companies, rather than simply the relative size of retailers and their suppliers. To illustrate, the CC's data show that the largest supplier to Tesco represented 2% of Tesco's sales, while Tesco represents 30% of that supplier's sales. Furthermore, supermarkets exercise buyer power when negotiating contracts for individual products, rather than with supplier companies as a whole.

In a survey of 450 suppliers carried out for the CC, none of the largest companies felt it would be easy to replace their supermarket customers.

An example of a supermarket transferring a huge unexpected cost to a large supplier is cited in the CC's Final Report, which includes a specific instance of the 'pay-and-deduct' practice commonly used by retailers, in which a supplier invoiced a supermarket for £7 million, but received only £6 million for the order.

### Large suppliers pass on unreasonable pressures to smaller suppliers

The Competition Commission recognised that "excessive risks and unexpected costs" are passed on from supermarkets' direct suppliers to indirect suppliers further up the chain, including farmers.

ActionAid's research on the banana supply chain shows clearly that supermarkets transfer excessive costs and risks to large multinational suppliers, who in turn pass on these pressures to farm businesses and their employees in developing countries. Asda signed a major contract with Del Monte, a company that currently has a turnover of £2.4 billion, in 2002. The deal made Del Monte an exclusive supplier of bananas to Asda, who got a substantially reduced price in return. After signing the deal, Asda dropped the retail price of bananas from £1.08 per kilo to 94p per kilo. This triggered a price war and before long, bananas were retailing in supermarkets at 66p per kilo.

As well as cutting prices to Del Monte, Asda absorbed some of the costs by lowering its own profit margins on bananas. However, Asda's competitors kept their margins unchanged and passed the price cut straight on to suppliers. During a further round of retail price cuts on bananas in 2005, S H Pratts, one of the biggest UK banana importers, made a loss of £1.2 million. The company had to deal with a fall in the prices it was receiving from supermarkets while there was a shortage of bananas on world markets, which raised the price it was paying to producers.

ActionAid's research in Costa Rica shows that excessive costs and risks are passed on through the banana supply chain to primary producers, with damaging consequences for plantation businesses and their employees, who typically work 12 to 15 hours a day in dangerous conditions to achieve the minimum wage.

## **The Adverse Effect on Competition will only be remedied effectively if large suppliers are included**

If large suppliers are excluded from the Ombudsman scheme, supermarkets will have an incentive to transfer excessive costs and risks to these suppliers, rather than to smaller suppliers who could notify the Ombudsman about breaches of the Groceries Supply Code of Practice (GSCOP). In turn, large suppliers will have an incentive to accept unfair terms, as 1) they will want to retain contracts with supermarkets, and 2) they can recoup any financial losses incurred through breaches of the GSCOP by transferring excessive costs and risks onto indirect supplier businesses with less market power.

It is true that in such cases, indirect suppliers would be able to submit anonymous complaints – assuming the scheme is designed in a way that gives them access to the Ombudsman.<sup>1</sup> However, indirect suppliers will not be able to receive compensation for breaches of the GSCOP. As such, the greatest incentive for direct suppliers would be to transfer excessive costs and risks to indirect suppliers.

Moreover, because relations between supermarkets and direct suppliers are a matter of private contract, in many cases primary producers and other indirect suppliers will not be aware of, or have access to, the information needed to make complaints. In turn, this would deprive the Ombudsman of information it needs to remedy the AEC. As such, it is important to ensure the AEC is tackled at source, in relations between supermarkets and their direct suppliers.

Major suppliers provide products for many millions of consumers, investing in quality and product range on a large scale. Capping the size of suppliers could therefore be detrimental to consumer welfare.

### **What can policymakers do?**

The CC considered limiting the size of supplier covered by the Ombudsman, but decided it would be unworkable. In order to determine the market power of a supplier with respect to supermarkets, the Ombudsman would be required to access suppliers' dealings in individual products and with individual retailers. This would be overly burdensome and entail significant practical difficulties.

As such, ActionAid suggests policymakers should follow the CC's recommendation that the Ombudsman "would prioritize the resources of its office to focus on those disputes and complaints concerning suppliers without market power over and above those concerning suppliers of major branded products that have market power."

<sup>1</sup> The Government is considering excluding suppliers that don't supply supermarkets directly, such as farmers in the UK and overseas, from the Ombudsman scheme. A short briefing on this issue is available here:  
[http://www.actionaid.org.uk/doc\\_lib/why\\_indirect\\_suppliers\\_must\\_have\\_access\\_to\\_the\\_ombudsman\\_-\\_26-03-10.pdf](http://www.actionaid.org.uk/doc_lib/why_indirect_suppliers_must_have_access_to_the_ombudsman_-_26-03-10.pdf)