



RETAILERS AND THEIR SUPPLIERS

Tough tactics in the spotlight

Media coverage about the tactics supermarkets are taking with their suppliers has been widespread. At the same time, there is recognition that all parts of the food and drink supply chain are under tremendous pressure. At issue is whether these understandable stresses are causing retailers to breach ethical or legal guidelines.

FTI Consulting surveyed organisations that supply retailers in the UK to the tune of £12 billion in annual sales. The research found that retailers are increasingly squeezing suppliers in contractual negotiations. Food and drink retailers, including supermarkets, are seen as most likely to impose financial pressure on counterparties, with purveyors of electrical household items being cited second most often.

Key Figures

62% of suppliers believe food and drink retailers have a reputation for being demanding

1/3 are under significant pressure to lower product costs and offer discounts

80% believe large retail stores are protecting profits at the cost of suppliers

A closer look at the survey results suggests lessons for both suppliers and retailers with regard to the reputational damage that can occur from the way in which retailers are being forced to compete, and the factors that are contributing to market pressures.

Reputations at risk

Some high-profile players have clearly earned more of a reputation for being demanding than others. When asked about which retailers had such a status, 40% of suppliers named Tesco as being known for taking a tough stance. The magnitude of this when compared to the second most cited (12%), highlights the extent of the view.

Tesco's high score is likely exacerbated by recent reports of the company's admission that it had overstated pre-tax profits for the first six months of 2014 by over £250 million. A recent article in Retail Week opined that Tesco's "bullying tactics towards seeking rebates from suppliers is at the heart of the accounting scandal."

More broadly, recent reports have also described stiff competition between the major supermarket chains, as well as within other retail sub-sectors. Suppliers recognise that this problem of retailers playing hardball with them is not new or confined to a single operator.

“You know, it’s going on everywhere – it’s endemic and [Tesco] just happened to have felt the pressure more and to have flexed the guidelines to breaking point,” one supplier says, suggesting that “the other supermarkets are not that far behind.”

And it’s not just the supermarkets that have been caught in the fray. In early December, a large British food manufacturer was under the spotlight, amid reports the company had in turn asked its suppliers for payments to continue doing business with the firm, a practice known as “pay and stay.”

In response to this latest report, the UK’s Financial Reporting Council served notice on retailers that they will need to be more transparent about the nature of payments they receive from their suppliers in their accounts, and that this will be a key “area of focus” in 2015.

“**58%** of those surveyed said supermarkets and other food retailers had a reputation for being difficult, and **39%** had direct knowledge or suspicion of significant pressures in the food and drink category.”

The pressure is on

The survey’s focus on food and drink retailers is reflective of the number and diversity of suppliers within this category (62% of survey respondents supply this sector). It also echos both the volume of recent news coverage of individual retailers and the direct experience of some suppliers.

More than half of those surveyed (58%) said supermarkets and other food retailers had a reputation for being difficult, and more than a third (39%) had direct knowledge or suspicion of significant pressures in the food and drink category.

More than two-thirds of those surveyed reported that retailers were exerting at least some degree of pressure on them to lower product costs, provide money for product promotions, or offer discounts for sales volumes, as well as comparing them to other suppliers. In the case of retailers’ efforts around the first two, almost a third of those surveyed (32% and 30%, respectively) said they were under severe or unreasonable pressure to comply with these requests, while an additional 28% said they were coming under severe or unreasonable pressure through comparison with other suppliers.

In addition, more than half of those surveyed (60%) reported some degree of pressure to provide rebates to retailers in exchange for their performance of certain tasks.

“You’ve agreed terms and traded together the previous year and made investments based on that. You’re doing what you need to do and all of a sudden they turn around and require extra money for historic sales”.

“**Over half of those surveyed also said their retailer clients were asking for longer invoice payment terms...**”

Over half of those surveyed also said their retailer clients were asking for longer invoice payment terms and 44% said they were being pushed into providing money to retailers in exchange for favourable positioning of their products.

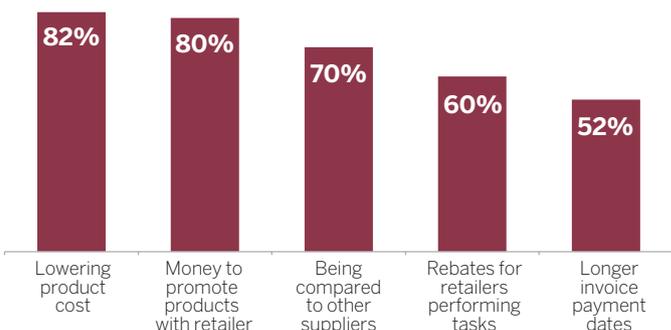
One self-described “small to medium-sized” supplier said 90-day payment terms creates a particularly tough cash flow situation and makes it difficult for them to compete with large global manufacturers that are able to meet such terms.

“Another major concern for us is the inability of the retailers to submit specific forecasts: e.g., they can say I want twenty thousand cases this month and it can either quadruple or go down to zero a month after,” the supplier added. “It has a knock-on effect on the buying of the ingredients, as we have to make the products to their ‘margins’.”

Many of these practices, whilst hardly new, have received media coverage in recent months, and they illustrate the understandable pressure retailers are facing in an increasingly cutthroat market. Meanwhile, there is clear evidence in the research that suppliers are aware of the myriad forms that this competition can take.

Pressure from retailers upon suppliers (Sum: Any pressure)

Q. For each of the following, please tell me if you are experiencing:



“
Suppliers perceived financial stress to be the main factor motivating retailers to apply such intense contractual pressures...
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A degree of understanding

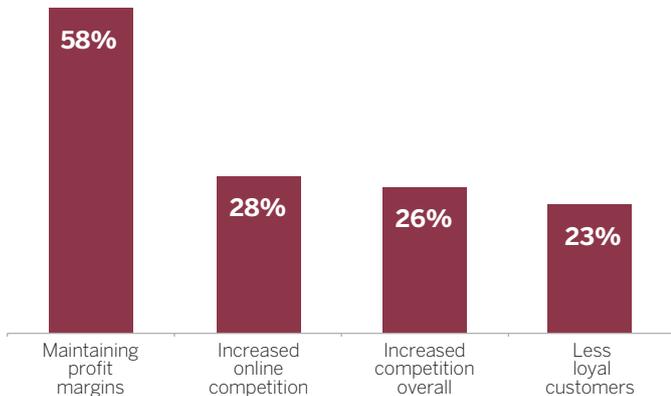
Suppliers perceived financial stress to be the main factor motivating retailers to apply such intense contractual pressures, with 58% saying the need to maintain profit margins was the primary reason for this behaviour.

Increased online competition and falling sales were the next most cited reasons for the pressures both retailers and, by extension, their suppliers, were under, with 28% of survey respondents agreeing this was a major reason for the pressures they were feeling.

More than a quarter of those surveyed (26%) cited an increase in competition amongst stores as a leading factor behind the behaviour of retailers, while a similar number (23%) said that a major factor was less loyal end customers.

Factors exacerbating contractual pressures (Sum: Major Factor)

Q. To the best of your knowledge, what would you say were the most important factors leading retailers to apply these contractual pressures?



These results suggest that suppliers are, to a certain extent, able to understand the need for the incentives retailers demand. This fact is borne out by another finding of the FTI Consulting research: when asked to rate retailers' activities in relation to rebates and payments to them with regard to whether these amounts were deserved or not, 82% agreed that they were deserved overall.

Suppliers also recognise that consumer pressure for ever decreasing pricing bears some responsibility for the current state of affairs in the food retail industry, with one respondent citing the recent horsemeat scandal in the UK as a sad example of what can happen as a result.

“Ultimately, there is a base cost for production of food. The horse meat scandal”, the supplier said, “should never have happened, but I can see how it happened, and we’re only going to see more and more of it until shoppers realise the more you pay the better the value.”

The survey indicates that unsustainable pressures on suppliers have been building over the past several years, with roughly 50% saying that pressures from retailers were seen as unreasonable during the second half of 2011, a number that steadily increased until 88% were saying so by the end of 2014.

Suppliers are also clearly monitoring the tribulations of some of their better known clients: just under half of those surveyed (49%) said they were knowledgeable about the recent reports that Tesco had overstated profits as a possible consequence of not accurately reporting contractual arrangements with suppliers, and a further 45% said they were aware, but not knowledgeable.

Timeline of retailers exerting unreasonable pressure on suppliers

Q. At which year/quarter do you believe the pressures from retailers started becoming unreasonable?



The need for trust

Despite suppliers' awareness of the tough conditions facing food vendors in particular, retailers' approach to contractual negotiations, combined with media coverage of their tactics have left a bad taste.

Survey respondents were asked about their opinions on six different statements about the conflict facing retailers and suppliers. An overwhelming majority of 80% of those surveyed said they slightly or strongly agreed that larger retail stores are protecting profit margins at the cost of suppliers. Three-quarters (76%) said smaller suppliers are struggling to get the same deals and agreements as larger suppliers. Smaller majorities of suppliers, meanwhile, agreed that independent suppliers' viability is under threat from larger retailers (60%).

As one respondent said: “We are a significant supplier in terms of our share of the market, and we have strong brands, therefore we can defend our position better than some of the smaller suppliers”. Another added, “I do know a lot of smaller suppliers that are having to get into distribution so that they can at least survive.”

Two-thirds said there should be greater regulatory protection for suppliers when negotiating with retailers, a finding that could indicate worsening relations down the road.

One supplier noted that the GSCOP (voluntary groceries supply code of practice), now has the ability to levy fines against poor practice, and that retailers must give suppliers the opportunity to respond if they decide to remove a supplier's product. While this change helps to improve things, there is more to be done, the supplier said.

All retailers can learn lessons from the recent contractual skirmishes within the sector and from suppliers' increasingly negative perception of their negotiations with some of the larger supermarket chains. Clearly, retailers are caught between pressures from budget-minded consumers as well as growing competition from both discounters and other traditional rivals.

Suppliers understand, and to a certain extent, respect these pressures. Yet, they increasingly feel they are being asked to take on the lion's share of the risk in a more aggressive retail environment. Meanwhile, as the experience of Tesco shows, perceptions of tough dealings undercut the minimal sense of trust that is vital to maintaining strong relationships between retailers and suppliers.

"I think that everyone is under pressure, but it needs to be a win-win situation for both suppliers and retailers," one supplier said. "There will always be an element of negotiation. It's how the industry is."

**Statements on retailers
(Sum: Agree)**

Q. How strongly do you agree or disagree with the following statements?



RESEARCH METHODOLOGY

This research was conducted by FTI Consulting's Strategy Consulting & Research team in London via a CATI (Computer Assisted Telephone Interviewing) research methodology. Fieldwork was conducted from 29th October to 11th November 2014 involving n=50 organisations who supply retailers in the United Kingdom, representing a sum total of £11.8 billion in annual sales.

Please note that the standard convention for rounding has been applied and consequently some totals do not add up to 100%. For more information on the research methodology, please email market.research@fticonsulting.com

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