

Briefing Note

(Calling for Fair Business Practices)

Summary:

- The consolidation of the grocery retail sector in Canada has resulted in just five grocery retailers controlling over 80% of what consumers purchase in Canada. These retailers have adopted unfair and unethical business practices not seen or accepted in any other sector and have remained unchecked due to their power over suppliers.
- Most recently, the fees imposed by Walmart Canada, and then immediately followed by Loblaw Companies Ltd, will cost suppliers approximately an incremental \$1 billion, paying for both of these retailers' infrastructure costs. These practices cost suppliers \$6 billion on an annual basis, inflating retailer profitability, with no return on investment or growth for suppliers, no value in reduced prices or innovation for consumers.
- These unfair and unethical practices pose a serious threat to the food, health and consumer products manufacturing sector in Canada, as well as primary (i.e. farmers) and secondary suppliers to the sector. The ongoing sustainability and growth of this sector in Canada requires changes to the current business environment.
- Suppliers and some retailers in the food, health and consumer sector are calling for a UK-style code of conduct to be developed and implemented across Canada to address these unfair and unethical practices.
- FHCP is recommending an F/P/T approach to developing a code that respects the provincial/territorial jurisdictions in this area while also ensuring a consistent, national, approach (see below: Recommendations).

Issue:

Consolidation in the retail grocery sector has resulted in a significant imbalance of power between a handful of large retailers and their suppliers. This has resulted in the larger retailers increasingly engaging in commercially unfair behaviours that pose a serious threat to the viability and sustainability of food, health and consumer product manufacturing and supply in Canada. These practices also negatively impact smaller grocery retailers, in that suppliers may alter how they do business with smaller retailers to avoid or reduce the risk of incurring significant financial penalties from the large retailers.

Background:

The grocery sector in Canada has been allowed to consolidate such that larger retailers have gained significant power over their suppliers. Currently, five grocery retailers control more than 80% of the volume of grocery and pharmacy products sold by suppliers and purchased by consumers in Canada. As a result of this market power, these retailers have adopted a number of unfair and unethical business practices that go well beyond what is considered acceptable in any other sector.

There is also a significant degree of coordinated behaviour by large retailers – whereby a large retailer will implement a program or policy (in some cases this has been done publicly) and other large retailers quickly follow. Similarly, retailers will only accept cost increases if the supplier confirms that the increase applies across the industry and that it has been accepted by other retailers.

Examples of some of these unfair practices are set out in the table below:

Retail Behaviour	Explanation:	Effect
Profit Protection	<ul style="list-style-type: none">Requiring suppliers to compensate retailers for profit shortfalls based on the retailer's pricing decisions or competitor's pricing decisions.	<ul style="list-style-type: none">Reduces supplier incentives to support promotional pricing with smaller retailers to avoid penalties imposed by larger retail customersCreates significant uncertainty, which inhibits investment for innovation, price promotions and growth
Anticompetitive Pricing Demands	<ul style="list-style-type: none">Retailers requesting competitively sensitive information about costing/ pricing arrangements between suppliers and other competitor retailersRetailers requiring that cost increases must be made to and accepted across retailers	<ul style="list-style-type: none">Creates competition law compliance risk for suppliersCreates risk where confidentiality obligations to other retailersForces suppliers to base wholesale price on the highest cost customer
Short Payment/ Late Payment	<ul style="list-style-type: none">Retailers deducting payments from suppliers without their consent and with limited to no explanation	<ul style="list-style-type: none">Creates significant uncertainty, which inhibits investment for innovation and growthUnfairly forces suppliers to finance retail operations and raises supplier costs
Penalties on fulfilling purchase orders	<ul style="list-style-type: none">Retailers issuing fines for unreasonable expectations for on time deliveries and/or fulfilling purchase order quantities	<ul style="list-style-type: none">Forces suppliers to fill orders of large retailers and short smaller retailers where product in short supplyPuts smaller retailers at competitive disadvantage
Product Delisting Practices	<ul style="list-style-type: none">Retailers threatening suppliers with discontinuation of business by removing products of their shelves	<ul style="list-style-type: none">Creates uncertainty for suppliersPrevents suppliers from taking commercial or legal action to protect themselves due to fear of retribution
Requiring Suppliers to Pay for Retailer Infrastructure Investment Programs	<ul style="list-style-type: none">Retailers requiring suppliers to pay for the retailers' capital expenditures	<ul style="list-style-type: none">Forces suppliers to invest in retailer operations that often provide no upside to the supplierReduces funds available to suppliers to invest in promotional pricing, innovation or growth.

Requiring Payment for Ancillary Retailer Services/Programs	<ul style="list-style-type: none"> Large grocery retailers often require suppliers to purchase loyalty program points, shopper data or participate in data analytics programs provided by the retailer 	<ul style="list-style-type: none"> Effectively a form of tied selling/purchasing Services/program may provide little or no benefit to suppliers Suppliers forced to pay for duplicative services/programs
Compelling suppliers to disclose competitively-sensitive business information	<ul style="list-style-type: none"> Retailers routinely require suppliers to provide competitively-sensitive business information such as product costing, product composition, advance knowledge of new product launches, promotional pricing strategy 	<ul style="list-style-type: none"> In many cases, large retailers are both a supplier's largest customers and largest competitors through own-label programs Requiring disclosure of competitively-sensitive information without appropriate safeguards allows retailers to misuse this information to advantage competing own-label products

These practices lead to higher prices and diminished choices on shelves for Canadian consumers. These practices also reduce capital investment in manufacturing capacity, distribution, as well as manufacturing and high paying Canadian jobs.

The concerns raised by Cmanufacturers and suppliers in Canada are supported by the findings of the UK Competition Commission in its 2008 grocery sector market investigation. In that investigation, the UK Competition Commission looked at the same types of practices currently being experienced in Canada and concluded that the: *“transfer of excessive risk and unexpected costs by grocery retailers to their suppliers through various supply chain practices if unchecked will have an adverse effect on investment and innovation in the supply chain, and ultimately on consumers.”*

When Australia and the UK faced similar concerns regarding the consolidation of their retail sectors and the resulting problematic business behaviours, they implemented codes of conduct to address the situation. In Australia, where the code of conduct is voluntary in nature, there has been little improvement in the sector.

In the UK, however, following two competition authority enquiries, a legally-binding code was established in 2010 to protect direct suppliers to the major retailers and a Groceries Code Adjudicator (GCA) to monitor, encourage and enforce compliance with the code in 2013. The GCA is a corporation sole supported by a small team of seconded civil servants; it has the power to arbitrate in disputes and investigate, with penalty powers including fines up to 1% of retail turnover. 13 retailers are now designated by the competition authority, based on having a groceries turnover > £1bn.

The first GCA took a collaborative approach and worked closely with retailers and suppliers on key issues; progress was measured by an annual survey which showed significant improvements in every aspect of the Code. There have only been two investigations and no fines. The regulated retailers have recognised that, by working on issues raised by the GCA, supply chain efficiencies have been implemented to the benefit of all parties and a level playing field has been established between those

retailers. The code and presence of an adjudicator have given suppliers the confidence to expand their businesses, even where they have become much more dependent on an individual retailer. Two 3-yearly statutory reviews of the legislation concluded that the GCA was an “exemplary model of a modern regulator with an international reputation” and “highly effective”. There are calls in the UK for the remit to be expanded and for a similar code and adjudicator between major processors and farmers.

It is important to note that the codes of conduct in the UK and Australia restrict large grocers from engaging in unfair conduct and do not restrict price negotiations or otherwise prevent legitimate hard bargaining. We believe that this is the correct approach and is the one we are advocating for in Canada.

Considerations:

- The current retail environment is having a negative impact not only on manufacturing, but also the primary suppliers to the manufacturing sector, as well as smaller retailers in the following ways:
 - **For consumers:** unfair practices by grocery giants result in fewer, less innovative and more expensive products.
 - **For manufacturers:** the retail practices and resulting costs to business make Canada an unattractive country for innovation, investment, and job creation. Smaller manufacturers cannot afford to expand and larger, global, companies are choosing to invest elsewhere.
 - **For farmers and companies who supply manufactures:** they depend on local manufacturers as primary customers and will be significantly negatively impacted by a decrease in Canadian manufacturing.
 - **For smaller retailers:** unfair practices from large retailers create a significant disadvantage for smaller retailers. These practices force suppliers to disproportionately invest their financial and human resources with larger retailers, leaving less funding for promotions, innovation, and even product supply as budgets and costs continue to get depressed in the Canadian marketplace.
- Canadian farmers, manufacturers, processors and smaller retailers are all aligned in calling for action on this issue and the need for Federal leadership/support.
- Recently, the CEO of Sobeys (one of the top 5 retailers in Canada) acknowledged that the recent fees announced by both Walmart Canada and Loblaw Cos. Ltd. will hurt manufacturers, farmers and smaller grocers, as well as threaten to drive up prices for consumers and indicated his openness for an industry code of conduct based on the UK model.

- There are similarities between what food, health and consumer product manufacturers are experiencing with grocery retailers and concerns that have been raised at the federal (and international) level regarding on-line retailers (Amazon etc.). The experience of suppliers in dealing with the large grocers can inform ongoing federal initiatives to address concerns related to potentially problematic behaviour engaged in by platform businesses (whether on-line or brick-and-mortar).
- Changes to the *Competition Act* may be helpful in addressing some issues, but are not a substitute for a code of conduct, which addresses key issues proactively, rather than through a lengthy, reactive enforcement process.

Recommendations:

Recognizing that the constitutional jurisdiction for the development and implementation of a retail code of conduct falls with the provinces individually, and recognizing that the federal government could still take positive steps to help advance solutions, the following are FHCPs recommendations for each level of government:

Federal Government:

1. Federal Public Support:

The federal government can play a significant role in highlighting the issue and in supporting industry's call for a code of conduct. Some of the grocers and their lobby groups have begun a campaign aimed at downplaying the issues that have been raised to avoid similar actions to those taken in Australia and the UK. As manufacturers, farmers, processors and smaller retailers advocate for the provinces/territories to adopt uniform codes of conduct, federal support for these efforts including public acknowledgement of the importance of this sector to Canada's COVID recovery, food and consumer goods supply security, as well as recognition of the legitimacy of the concerns being raised is key.

2. Amendments to the Competition Act:

There are a series of amendments to the *Competition Act* which will improve/expand the Competition Bureau's current abilities to take enforcement action that addresses anti-competitive retailer behaviour. However, these amendments should not be considered a solution to the issue. Rather, they are necessary improvements/updates to the Act to address potential competitive harms that can result from the consolidation of purchasing power, the power of platform businesses over their suppliers/vendors and the fact that platform businesses increasingly compete with their suppliers/vendors through the sale of own-label products. Suggested amendments include:

- Amendments to the abuse of dominance provisions to make them more applicable to conduct of large purchasers or platform operators with market power/the exercise of monopsony power;

- Amendments to the abuse of dominance provisions to allow enforcement action to be taken where there is coordinated/widespread behaviour by industry participants (i.e., signaling/copycat demands, etc.);
- Amendments to the civil provisions of the Competition Act regarding anticompetitive agreements between competitors that clearly allow enforcement action to be taken where there is coordinated/widespread behaviour by customers with market/monopsony power.

3. Facilitating Consistency in Approaches:

The federal government can play a facilitating role in supporting work to develop a common framework identifying key elements of a possible code of conduct to avoid a patchwork of potentially inconsistent provincial codes and enforcement approach. This is in line with the Canadian Free Trade Agreement and the work of the Regulatory Reconciliation and Cooperation Table which aims to eliminate difference in regulatory approaches between F/P/T governments.

4. Conduct a Study into the Issues/Solutions:

The federal government is well positioned to conduct a study of the issues related to the consolidation of the grocery retail industry in Canada and the resulting negative effects on Canadians, suppliers, jobs, smaller grocers and the economy in general. In both the UK and Australia, the governments undertook such studies which informed the development of their respective codes of conduct and supporting systems. Much can be learned from the UK and Australian experiences and a parliamentary study (undertaken by either the agriculture or industry committees – or jointly) could help identify Canadian-specific issues and solutions.

Provincial/Territorial Governments:

1. Leadership amongst Provincial Governments

Provinces in which the majority of head offices for the larger grocery chains are situated could work together, along with other affected stakeholders, to lead the initial development of a uniform code of conduct. This would help to ensure consistency in approach and lay the foundation for subsequent provincial/territorial codes and/or federal coordination.

2. Development of Enabling Legislation:

Since any proposed grocery sector code of conduct would regulate in some way contracts between food and consumer goods suppliers and grocers the authority to establish such a code appears to fall with the provincial/territorial jurisdiction. Our recommendation is that that provinces/territories (alone or together) move forward to enact legislation to establish a code of conduct.

3. Establish Industry Working Table:

FHCP has been convening discussions with a number of industry associations as well as with a few of the larger retailers who support the establishment of a grocery sector code of conduct. Our recommendation is that interested provinces and territories work with this group of stakeholders in developing the details of a regulated code of conduct based on the UK model but adjusted for the Canadian environment.

4. Call for Federal Assistance in Approach:

We believe that, subject to the views of the provincial/territorial governments, the federal government can play a helpful role in supporting the development of a common code of conduct framework that could be used by provinces/territories in their efforts to enact a legislated code of conduct. Federal support would assist in avoiding potentially inconsistent patchworks of provincial codes of conduct or enforcement approaches.

In addition to assisting with the development of a common code of conduct framework, the federal government could be instrumental in facilitating an approach to put in place a common/single regulatory body (including a single code of conduct adjudicator) at a pan-Canadian level. This would help to avoid duplication and promote a consistent enforcement approach, to the extent it can be supported by the provincial/territorial governments.

On the issue of federal assistance, government officials have indicated that the federal government would only become engaged if called upon by one or more of the provinces/territories. FHCP believes that the federal government can play a useful coordinating role in this initiative and recommends that provincial/territorial ministers officially seek assistance from the federal government to support the development of a grocery code of conduct and enforcement framework.

About Food, Health & Consumer Products of Canada:

Food, Health and Consumer Products of Canada (FHCP) is the voice of Canada's largest manufacturing employer. The food, health, and consumer products sector employs more than 350,000 Canadians across businesses of all sizes that manufacture and distribute the safe, high-quality products that are at the heart of healthy homes, healthy communities, and a healthy Canada. Visit: OnEveryShelf.ca to learn more.