CAPI
THE CANADIAN AGRI-FOOD POLICY INSTITUTE

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Supply Chain efficiencies from the perspective of the former UK Groceries Code Adjudicator

Perspective Report Prepared for CAPI by Christine Tacon

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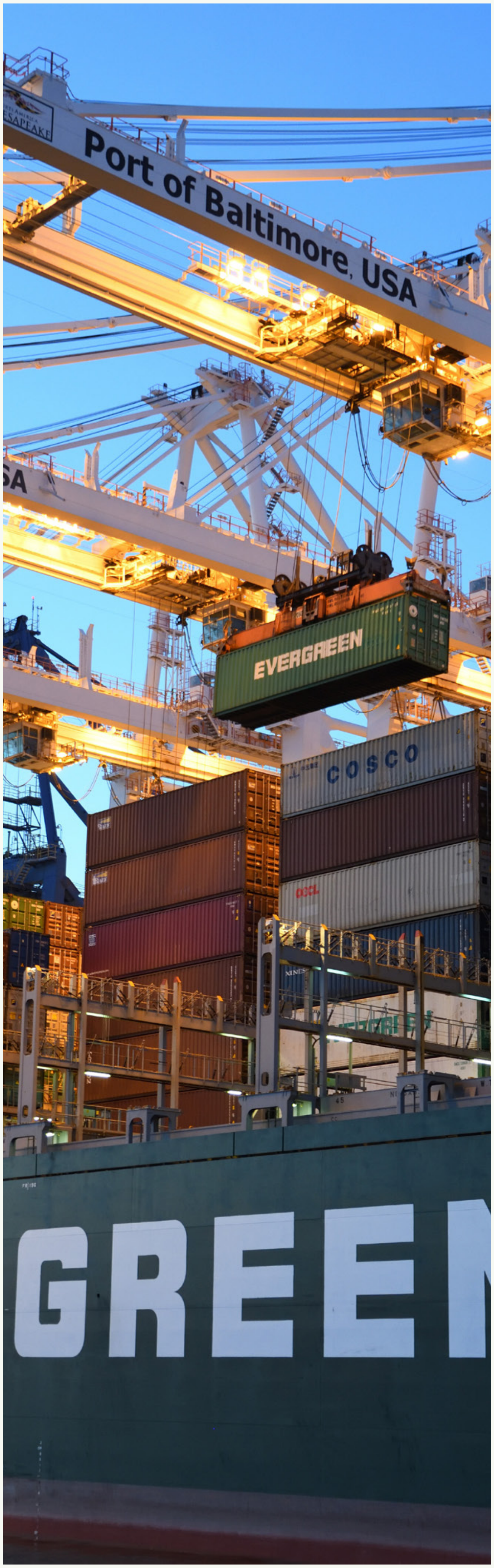


A Note from CAPI

The global pandemic has uncovered fault lines in many supply chains, and agri-food systems have been no exception. Issues ranging from sudden labour shortages to idling of plants, shortages of containers, and freight-traffic congestion have interrupted the production and availability of goods. Droughts and floods have disrupted agricultural production and now there is the worrying prospect of sustained global price inflation.

Fundamental conditions for investment in food processing, supply chain efficiencies and innovation in food systems have not been met as a result. It is impossible to meaningfully discuss the resilience of supply chains without also discussing the interdependence of their component parts, efficiency and investment.

CAPI's recent Big Solutions Forum highlighted four key actions required to maximize outcomes for the Canadian agri-food sector:

- Systems approaches,
- Strategic thinking,
- Public-private partnerships, and
- Aspirational leadership.

This Perspective Report chimes with some of these themes, notably a systems approach and strategic thinking. It offers an experienced perspective on the functioning of agri-food supply chains in the UK and provides critical commentary as to the consistency of our current approach to relationships, management and investment.

The Author

CAPI commissioned Christine Tacon, UK Groceries Code Adjudicator from 2013 to 2020, to offer her insights on competitiveness and supply-chain efficiency from her position not only as a regulator, but also from her previous experience running the largest farming business in the UK and having worked in marketing and sales for M&M Mars and Fonterra.

Key UK Supply-Chain Takeaways

- Regulation addressing unfair trading practices between grocery retailers and suppliers can make a positive difference to supply chains, particularly when enforced by a regulator.
- Eliminating inefficient practices allows the supply chain to be more effective and ultimately lead to better value to consumers.
- Parties along the chain are all more productive when they work together towards growth rather than spending time resolving payment and delivery issues that could adversely affect their relationship.
- Collaboration builds resilience and encourages innovative approaches from all parties.
- Suppliers need to be able to challenge their retailer customers despite imbalance of size.
- A whole supply chain approach to forecasting pays dividends for everyone and the environment.
- The Groceries Supply Code of Practice in the UK has made the market fairer and more efficient and those improvements have made the market more civil whilst still being fiercely competitive.
- Regulation in the UK is working for the supply chain.

Introduction

The UK groceries retail sector had by the year 2000 experienced such consolidation that there was a widespread perception of power imbalance between retailers and their suppliers. In 2002 and again in 2008, the Competition Commission conducted market investigations into retailer practices and their effects on consumers. These resulted first in a voluntary retailer code of practice and later a statutory Groceries Supply Code of Practice (the Code), which came into force in February 2010, designating the 10 retailers with a groceries turnover >£1bn. However it was only after the introduction of the **Groceries Code Adjudicator** (GCA) by an Act of Parliament in 2013, to encourage, monitor and enforce compliance with the Code, that real changes started in the way retailers behaved towards their direct suppliers. The GCA has the powers to investigate and arbitrate, and the ability to impose fines up to 1% of UK turnover if a breach of the Code is established.

The Impact of Supply Chain Imbalance

In 2008 the Competition Commission reported that retailers were in many areas taking advantage of their relative market power, such as by not paying on time, de-listing suppliers without reasonable notice and making profit centres out of charging suppliers for consumer complaints. The Competition Commission found that certain practices were preventing the supply chain from working efficiently. These practices risked putting some smaller suppliers out of business and inhibiting innovation and investment by larger suppliers. The ideal situation would be one in which retailers and suppliers were able to negotiate hard within acceptable boundaries of behaviour.

Retail buyers tend to move responsibilities frequently and often have little time to understand the supply chain. They are measured on being able to get better deals from their suppliers and in trying to do so, will often make requests which cannot be met. It is the role of the supplier to negotiate back and try to get something in return, or simply to say, "No." During my term as GCA, I heard many times from suppliers that when a retailer said "Jump" their response was "How high?" when it should have been "Why?" or "What are we trying to achieve here?" At the start of my term of office, suppliers no longer felt able to challenge retailers and I felt there was no overview of the most efficient way for the whole supply chain to operate. It was clear to me that eliminating inefficient practices would allow the supply chain to be more effective and ultimately lead to better value to consumers.

Inefficient Practices in the UK in the Pre-Code Era

Packaging supply, hidden costs and efficiencies

A good example of this was when, prior to becoming GCA, I ran the Co-operative (Co-op) farming business. The Co-op is a major UK grocery retailer. We grew and packed potatoes for our retail stores, but we operated as separate businesses. There was an industry retailer-driven initiative to remove packaging from stores. We used to send the bags of potatoes to store in recycled paper sacks that came 15 miles from the packhouse.

The Co-op retail potato buyer told us we had to use plastic crates that we had to rent from a specified third party, who would then charge us for washing them and delivering them back to us. In fact, they often arrived both dripping wet and with old labels attached, providing a hazard to a processing plant and requiring a person to clean them up before we could use them.

When I challenged the point and annual cost of doing this, which I estimated to be about £1m, I was told by the buyer that other suppliers hadn't complained, the implication being that if I didn't comply, others would readily supply in our place. I was in a safer position than many in that we were part of the same business and I was able as a result to show the overall business and environmental impact of the decision that had been made. In the end, we compromised and only smaller packs went in the crates while larger ones stayed in paper sacks.

Another small example is that measurement of service levels, with a target of 97.5% of fulfilment against orders, replacing basic economics and common sense-for example, periodically driving suppliers to ship only one case on a pallet out of fear of violating the service standard. I asked the buyer to amend orders to the nearest pallet layer, which saved a considerable amount of wasted space in haulage vehicles.

Another example, again relating to packaging supply and taken from my time at Co-op, is that as a supplier of fresh produce to retailers, we were told from whom to buy the printed bag wrappers, but this was often at a price that was twice what I could buy them for elsewhere. I was certain that there must be an incentive payment going back to the retailer for specifying the supplier in this way and when I challenged on this, asking whether the incentive they were receiving was more than the cost saving I could make by buying more selectively, the buyer immediately put the packaging out to tender.

This was a lesson I took with me to my role as GCA. The practice of making a profit out of mandating a third-party supplier was prohibited by the Code. I asked all the retailers to look internally at their business practices to establish whether they were receiving sums from packaging suppliers. I suggested that they offer at least two choices of packaging supplier to ensure they were getting the best prices on behalf of their groceries suppliers. Within 18 months, this whole practice of suppliers feeling as though they were being ripped off by packaging suppliers was resolved.

Who pays to deal with consumer complaints?

Most retailers in the UK were charging up to £45 ($90) per consumer complaint. This could be for a bruised apple, damaged packaging, not liking a product and at the extreme for the consumer having found a teabag inside an egg! Suppliers were billed for these complaints and the money deducted from payments made for goods supplied. I asked each retailer to explain how the cost of £45 had been arrived at and many struggled to do so. The Code allows charging for consumer complaints, so long as the retailer is not profiting from it.

When retailers started to look at the cost of tracking each complaint back to the supplier, applying charges and resolving challenges, many of them decided there was little point in continuing the practice. The system wasn't very thorough (suppliers high up the alphabet tended to receive disproportionately large bills as store operators needed to select a supplier from a drop-down list). It was slow and I told them they couldn't charge a supplier if the product was made to specification, but the consumer simply didn't like it.

I required that if charges were made, information as to the nature of the complaint should be received by the supplier within five days, so that steps could be taken to put things right. Some had been taking 40 days, making it impossible to correct any underlying issues in a timely way. Because they weren't allowed to profit from it and I was asking questions, it was interesting to see how many decided it was not worth the hassle of charging, but nonetheless it introduced a very fast way of informing suppliers when there was a problem. Interestingly, those retailers with the simplest business models had never charged for complaints – it simply wasn't a good use of their time and resources.

Promoting accuracy and efficiency: drop and drive

Because of the speed of goods moving in chilled distribution, the industry had moved to a system of "drop and drive" where goods were not counted on arrival, just unloaded. This was liked by all parties and it was very efficient. However, a supplier may say they supplied 1000 units, but the retailer didn't count the load, distributed it between depots, fulfilling orders by depot and then found it was, say, five cases short at the end of the receipting process. It was always assumed by the retailer that the supplier had short delivered; not that people working at speed had maybe put the odd extra case on another load in error.

I worked with the retailers, using data provided by a group of suppliers working with a consolidation warehouse, and established that supplier accuracy, often delivering full pallets, was often as good as only three cases that couldn't be accounted for in 10,000. However, when it came time to be paid, about 47 in 10,000 were being deducted for not having been delivered. This was clearly a breach of the Code, as goods received were effectively not being paid for.

Gradually retailers started to see that there had to be a better way, and many moved towards a Good Faith Receiving standard, where the retailer always paid for what the supplier said they had delivered, with an independent spot-audit conducted on a percentage of loads, and if an error was found a penalty was applied, calculated on the basis that this could have happened on multiple loads. Suppliers were suspicious at first that this was another way of retailers making money from them and a bacon supplier later told me they ran three months of double-checks before agreeing to it, and then found their reported shortages fell by 90%. This one initiative, though it took a while to change and gain the confidence of suppliers, ended up saving vast amounts of paper-chasing, account-management and retail-administration time, to the extent that some retailers found they had no use for whole teams employed to settle disagreements over delivery quantities.

Resolving delay in payments

In my time in office, I only conducted two investigations. The first was into Tesco for delaying payments. This was all tied up with a >£300m profit misstatement for which they were simultaneously investigated by the Serious Fraud Office. I established that they had breached the Code by delaying payments to suppliers in a variety of ways. Generally, they paid suppliers on time, but there were multiple deductions from the payments for anything from drop and drive shortages to duplicate invoices, unresolved pricing disputes and margin maintenance demands and if deductions were contested by suppliers, they were not getting resolved fast enough.

Following the investigation, I made it clear that a retailer could not deduct unless they had given a supplier 30 days' notice, so that they had time to check and, if necessary, raise a challenge. If challenged, the retailer could only deduct when it had been agreed. I required Tesco, among other things, to introduce a finance-to-finance helpline so that any delay in payments issues could be resolved without having to involve the buyer. I then asked all retailers to do likewise, levelling up across the sector.

Doing Away with Inefficient Practices Supports the Effectiveness of the Supply Chain

The time cost of complex business practices

The examples I have given above were practices that mushroomed into a complicated way of doing business, that were perceived to be making money for the retailers but required administration on both sides to raise and resolve challenges. Not only were they demanding in terms of time, but they were not the focus of what either side really wanted to be doing. Both parties actually would have preferred to have been working together to grow categories rather than getting stuck in trying to resolve payment and delivery issues that adversely affected their relationship. One account manager supplying Tesco told me they spent 60% of their time chasing money that was owed.

The arrival in the UK of the discounters: a challenge to established business models

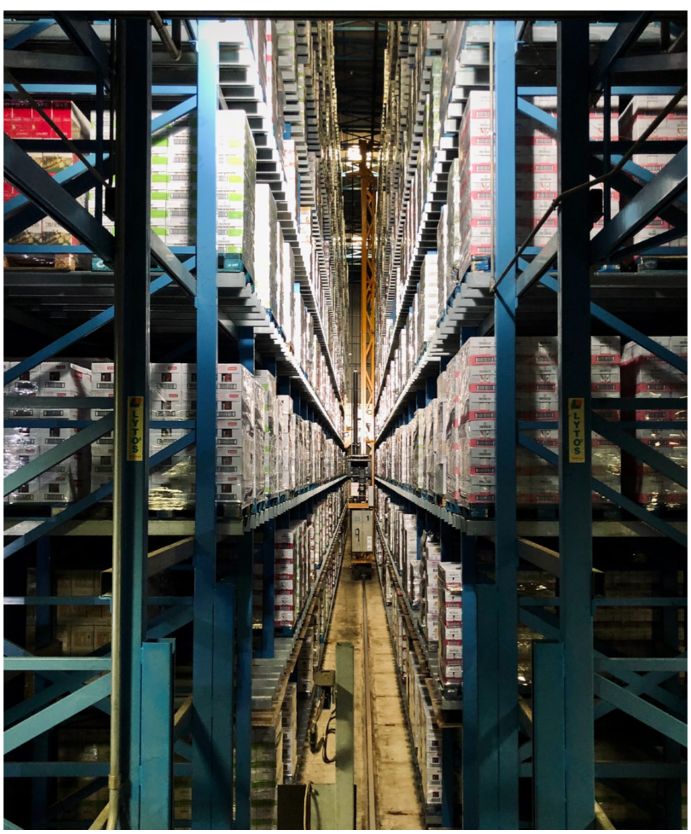
The arrival of discounters in the UK, most notably Aldi and Lidl, with a limited range and very low overheads, showed us how business could be done more efficiently. It was interesting when I was challenging practices like the ones above, that I had to explain to the discounters what many of these practices of concern actually were and how far they were from Aldi's and Lidl's simpler business models. When I explained some of the practices I was aware of happening elsewhere and cautioned people to avoid them, the discounters would simply look at me in horror and say "But we haven't got the time to do that!" The focus on efficiency spoke for itself as their UK market share grew rapidly.

Sharing of savings as a disincentive to making improvements

The Institution of Engineering and Technology told me, anecdotally, that they thought one of the reasons for low productivity in the UK, and lack of investment in robotics in the sector, was because retailers demanded a share of any savings, preventing the innovation from being worthwhile from the supplier's point of view. Additionally, manufacturers of this new technology found that the suppliers that had adopted it would not allow them to publicise it at all in case a retailer found out and asked for reduced prices, so they found it hard to advertise their technological breakthroughs. Clearly, if this were the case, it would not support progress.

Working to create supplier-retailer partnerships

Many suppliers told me that they spread their business across several retailers because they were concerned to protect themselves should they lose one of them. In order for the Code to de-list a supplier, a retailer had to give reasonable notice and have genuine commercial reasons. I saw an increasing number of examples where this protection allowed a supplier confidently to put much more of its business with one retailer, in one case as much as 96%. They were, in this particular relationship, jointly so focused on efficiency that they were together investing in new areas where they had no previous expertise in order to extend the range of products supplied. The supplier's business had grown six-fold in the time I was in office, on the back of the confidence that the Code had given them to take their most important supply relationship to the next level. At a recent industry event, I spoke to many suppliers and retailers that were unanimous in saying that the UK market is now a fairer place. Suppliers know where they stand. The Code is being adhered to, yet the market is still fiercely competitive. Regulation is working for the sector.



A look to the future – and the role of forecasting

As the sector continues to grapple with its carbon footprint and true environmental impact, there will be more pressure for food to be grown and sourced locally, whether in fields or vertical farms, and to factor in the use of scarce water resources overseas, transport and so on. The huge advantage of co-locating growing, processing and retailing is to enable operations to work together to reduce costs in the chain. But there needs to be confidence among all in the chain to challenge existing practices and propose investment that is affordable to the supplier or increasingly where the retailer co-invests.

And we have all learned during the pandemic that we need to build resilience into our systems. I have no doubt that the collaborative model that I had encouraged with the major retailers working with their suppliers helped enormously during the pandemic and will continue to encourage innovative approaches from all sides.

A key area of focus for me throughout my role was to improve forecasting. Too often retailers had just relied on the supplier to absorb the weather and the demand risk it presented. As a result, farmers routinely over-produced to ensure they could deliver to order when the time came. I was surprised how few retailers were measuring the accuracy of their forecasts against orders. Some were not forecasting at all and investment in this area was only justified by improving shelf-availability. Improved accuracy in forecasting will benefit the whole supply chain, reducing waste and allowing for more efficient working – there is so much more that can be done using technology, artificial intelligence and machine learning. Looking at the benefits of a whole supply chain approach to forecasting will - I am convinced - pay dividends for everyone and the environment.

Conclusion

As we are now finding in the UK, the growing, processing and logistics industries are having to pay more to compete for scarce labour. This, in turn, is strengthening the case for improvements in efficiency and technology and I am hopeful that many innovations will happen as a result.

The lesson from all this is that it is important that suppliers feel able to challenge their retailer customers despite any imbalance of size. Otherwise, inefficient practices can become embedded and everyone forgets what the purpose of doing them ever was. This requires trust, confidence and open communication between supply-chain partners. This, in turn, can improve confidence and the likelihood of investment being made in innovation and processing where it is most needed.

Doing away with inefficient practices, which means ensuring that things are done fairly, truly allows for a more effective supply chain so that everyone can focus on the right thing, which is to provide more value to consumers.