Trade Practices Used in the Canadian Grocery Industry

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The grocery industry has been changing rapidly in the last few years and retailers have become increasingly creative at finding new types of fees to request to their suppliers. The purpose of this paper is to examine the various trade practices used by supermarket chains which go beyond the trade promotions used collaboratively by retailer-manufacturer to market grocery products to the consumers.

Trade promotions or more broadly trade practices are often refer as trade programs, trade spending, commercial programs, Over & Above (O&A) or simply programs within the grocery industry. Food manufacturers, distributors and retailers do not refer to these various business tools or fees as trade promotions per se. The subtlety of trade promotions from the retailers perspective can range from simple demands for manufacturer discounts to outcome based performance activities. For the purpose of this article, trade promotions and trade practices will be used interchangeably.

Trade promotions are as controversial in Canada today as they were back in 1980 when the Ontario Royal Commission of Inquiry in to Discounting and Allowances in the Food Industry in Ontario made its report. The main reason for the controversy rests in the following areas:

§ Misunderstanding of the purpose of trade promotions.

§ Growing magnitude and importance of trade promotions.

§ Uses and misuses of trade promotions.

In addition, trade promotions are controversial because they are often seen as a barrier to entry for smaller suppliers.

Trade practices have changed in recent years in the grocery sector. However, there is no formal documentation on retail trade practices as they tend to vary from one retailer to another, and from one category to another. Nevertheless, there are some trade practices that are similar among retailers.

1) Over & Above (O&A)

Today, Over & Above (O&A) is a part of marketing or merchandising programs that manufacturers put together to support sales of a product into a supermarket chain. O&A is basically a percentage of a manufacturer’s sales given back to a retailer usually by auto-deduction on payment. There is no formal definition of Over & Above. It can be defined as deals and allowances (percentage of sales give back to the retailer) that are part of a supplier marketing program prepared in order to obtain listings, keep listings or increase sales made to a retail chain.

It can be seen as extra profit margin made over & above the profit margin made the retailer. Marketing programs are typically composed of deals and allowances such as O&A, coop advertising, marketing funds for ads in flyers or in-store specials, in-store demos, rebate volumes and payment terms. The deals and allowances required in a program vary from one retailer to another, and by department.

Historically, O&A has been put in place by retailers to increase the marketing funds paid by suppliers. For example, retailers were increasing the cost of advertising in their flyer from year to year. Therefore, the fixed amount invested by a supplier as Coop Advertising was allowing a decreasing number of ads from one year to another. The concept of O&A was originally extra money paid by a manufacturer to a retailer in a year in order to have the same number of flyer ads as the previous year. In other words, O&A was the price paid by a manufacturer for the increasing cost of flyer advertising.

Today, O&A is essentially a percentage of the sales of a manufacturer deducted by the retailer for marketing support and distribution fees. The percentage of O&A is relatively similar within a category to create equity among suppliers. This means that long time suppliers pay about the same percentage as the newcomers to a category. These days, O&A is basically money given by the supplier as right to sell into the stores of a retail chain.

Over &Above is now internally named *Vendor Revenue* in Loblaw's financial reports. Just to highlight the importance of O&A, Loblaw has created a management position named *Director, O&A Finance*. The role of this position is to provide financial control and reporting over vendor trade revenues generated by *Manager, O&A Finance* and the category manager.

O&A typically represents 1% to 15% of a supplier's sales given back to a chain but again can vary from category to another. The main problem with O&A is that it tends to grow over the years. It could start at around 2% but within a few years it would reach 4% and 5%. Eventually it can even reach 10% to 15%. While that amount is very large, it is also very difficult to refuse a demand to increase the O&A from the retailer. The reason is that in such a case a retailer would promote increasingly a direct competitor to the manufacturer that would refuse to increase O&A funds. In addition, a manufacturer refusing to increase O&A could face a delisting of several stock keeping units (SKUs).

In late 2015, Sobeys initiated a new movement regarding O&A which was to request its vendors to lower its list price by the amount of O&A given back to Sobeys and instead sell at a dead-net price. For example, if a vendor had an O&A of 10%, it would be requested to lower its regular price by 10%. This initiative was made in order to reduce Sobeys regular price and stop its High-Low promotional program to better compete with discount merchants such as Walmart and Costco. This initiative was implemented by Sobeys Quebec in March 2016 in its IGA banner with a promotion campaign named *GIGA price reduction*. It is expected that Sobeys West and then Sobeys Ontario will implement this commercial policy before going to the national level with

Sobeys Maritimes. However, this initiative has also brought Walmart to request price reduction to its vendors in order to keep its lowest price promise in the marketplace. In the end, this initiative is putting again financial pressure on manufacturers.

2) Listing fees – from $500 to $100,000 per SKU

Listing fees are becoming increasingly expensive. As an example, the dry grocery departments of national chains now request between $10,000 and $30,000 to add a product in this section of the store. It can go up to $50,000 for frozen products and to even $100,000 in other departments. It is possible for a manufacturer to avoid listing fees only if the product is highly demanded and the retailer has no other sourcing alternatives. The reality is that pretty much all suppliers now pay listing fees to supermarket chains. However, alternative retailers such as Costco and Walmart do not charge listing fees. Walmart simply expects the lowest or best price from the supplier and the listing fees are not part of the arrangement. But that does not mean that the American retailer can't request other types of fees.

The challenge when discussing listing fees is the fact that retailers do not seem to post consistent lists or policies pertaining to the practice. Clear business policies of retailers simply do not exist. The retailer will not present a list of fees per category or per department to the manufacturer. In fact, it is more typically a number that is thrown on the table by a category manager as "by the way listing fees are $20,000 per SKU for those products". In some cases it seems possible to negotiate a package deal for a few SKUs and as often heard in the industry, large manufacturers in some cases can get away without paying listing fees when launching a new item. Negotiation skills but most importantly negotiating power can make a difference in this situation.

Listing fees are the most controversial of the manufacturer-retailer trade practices. The arguments on the rationale and concerns are time worn. Manufactures will often assert that listing fees can limit the expansion and opportunities of local manufacturers. It is argued that listing fees limit the possibility for small local manufacturers to access supermarket shelves.

For their part, retailers note that there are 30-40,000 items on their shelves. A new item from a manufacturer has to generate returns rapidly or it is costing retailers unnecessarily. For every new item that they place, another has to give way. There is risk associated with placing new, untried items, especially given the high failure rate of new product launches. In addition, retailers are making more of an effort to keep only high performers or necessary items on the shelf. They are not looking for another 'me-too' item. With that said retailers are also looking for new and exciting products that will differentiate them from other retailers. If a manufacturer truly has an innovative entry, the listing fee is likely to be low or non-existent.

An important point for new vendors to the supermarket distribution is that paying listing fees is often not a guarantee for the manufacturer to see its product on the shelf for more than six months. Furthermore, most often there is no guarantee of volume that the retailer will buy even though the supplier has to pay $10,000, $20,000 or $30,000 in listing fees per item. That

is another reality about listing fees that is not frequently mentioned by the category manager when it comes time to pay listing fees.

3) National agreements or Core agreements

National agreements, also called core agreements within the industry, are contracts concluded at the national level between a retailer and a vendor, often a multinational or Canadian manufacturer supplying a grocery chain nationwide. These types of contracts serve to established annual sales objectives for all items or some specific items supplied by the vendor and include a sales bonus (or cash back) given by the supplier to the retailer when attaining a specific sales volume. For example, a national agreement could stipulate that if a supermarket chain sells $20 million or more during a year the supplier will give back 1.2% of its sales to the retailer which represents $240,000 or more in extra O&A money annually.

National agreements can become a barrier to entry for smaller suppliers for mainly two reasons:

1) Planograms have become over representative of the market share of the supplier owning a national agreement. These core agreements have also the effect to often over represent the shelf-space of a manufacturer in order to maximise the likelihood of attaining its sales objective in order to obtain the bonus proposed by the vendor. In other words, in terms of facing count, the space allocated in the planogram to a manufacturer having a national agreement is often proportionally bigger than its market share of the category. The rational is that a grocery chain wanting to obtain its bonus representing often over $100,000 will be tempted to give a lot of shelf space to a national vendor and not likely to be interested to add new products from a smaller vendor or a new manufacturer.

2) Category managers and other managers in supermarket chains are under financial pressure to increase O&A, listing fees and other vendor revenues. Retailer management have become increasingly innovative at finding ways to request extra money from their vendors. Grocery chains financial demands in terms of O&A and other fees have increased over the last few years with a rational dictated by a negotiation weapon that when a national vendor is giving back to a supermarket chain an amount of over $200,000 per year this can be used in turn by the retailer to set the bar high in term of O&A and listing fees to approve new products. In this way, national agreements can create barrier to entry for smaller manufacturers.

4) Late delivery fees

Late delivery fees are used by retailers when a supplier delivers an order at a later date than what was requested on the purchase order (PO). Even if this is due to a transportation problem the retailer, will often financially penalize the supplier for the late delivery. When the suppliers do not inform the retailer that the order will be arriving at a later date than requested, the late delivery fees can range between $500 and $1,000. And when the vendor is informing its buyer that the shipment will be arriving at a later date than what the PO was requesting, the late delivery fees

ranges between $200 to $500. New suppliers often become aware of these late delivery fees when they receive their invoice and realise that a deduction of $1,000 has been taken off their payment.

Contrary to most of the fees mention here, general merchandisers such as Walmart and Costco also impose late delivery fees that in some case are much more heavier than those requested by grocery chains.

5) Lumping fees (Unloading fees)

Unloading fees or more often called lumping fees sometimes can get very expensive. Those fees vary from $50 to over $500 depending on the number of pallets and the time it takes to unload the stock from a truck. Basically, the retailers' distribution centre lift operator normally unloads pallets of stock, but now some retailers ask the manufacturer to unload the merchandise on the dock. The main problem is that often suppliers are not aware of the policy from retailers. Also, often suppliers are not equipped to unload their shipment. In this case, they have to request and pay for a helper to assist the truck driver to unload the merchandise on the distribution centre's dock.

Unloading fees also take the form of waiting fees at grocers' distribution centre. It is commonly know that retailer such as Loblaw have a waiting time that often reaches two, three and four hours for truckers to wait in line before unloading a shipment. These waiting fees are charged by transportation companies to manufacturers can often reach $200 to $400 per order when waiting at the retailers' distribution centre.

6) Unsalable merchandise fees

Usually manufacturers have to reimburse the retailer for all unsalable merchandise and the damaged goods are thrown away or sold at discounted price. Now some retailers are charging to the supplier on pretty much each order some unsalable merchandise fees. This is even the case with dry grocery products, for which shelf life and packing solidity is not a problem. A note is sent to the manufacturer by the retailer and the amount of the unsalable merchandise is deducted from the payment. That amounts sometimes up to 1% and even 1.5% of dry grocery supplier annual sales.

7) Ad Collision fees

Ad collision fees have been charged by retailers when seeing a competitive banner advertising in its flyer the same SKU during the same period. These types of fees are more recent than the other fees discussed in this paper and they also apply on fast moving items such as bottled water, juices, and soft drinks sold by large manufacturers or multinational companies. The collision fees varies but they can go up to $50,000.

The use of ad collision fees by Loblaw were been under investigation by the Competition Bureau in 2014. In October 2015, the Globe and Mail reported that Loblaw confirmed that it will drop its

ad collision policy. Even if Loblaw may have stopped using this trade practice, it is important to be aware that it has been existing and that a some related practices may emerge in the future.

8) Ad out-of-stock fees

Another trade practice used by supermarket chains is ad out-of-stock fees which are requested by a retailer when a supplier is running out of stock during an ad in a flyer. For example, if a vendor runs out of stock during an ad period, the retailer could replace the product featured in the flyer by a similar product from a competing brand. At the end of the promotion period, the retailer charges back to the supplier the cost difference between the supplier competitor regular price and the discounted price offered for the ad. In other words, the ad out-of-stock fees represents the cost between the regular price and discounted price for the retailer to sell a similar item to the out-of-stock product during a flyer ad.

9) 2%/10 days or Net 30 days terms becoming a 2% fees

Payment terms are usually 2%/10 days or Net 30days but it seems that 30 days are becoming more often 60 days or even 90 days. These more common late payments could have been influenced by alternative retailers such as Walmart which has standard terms of payment of 90 days. For manufacturers, payment terms of 60 to 90 days instead of 30 days mean that the supplier is financing the retailer during the first 30 to 60 days. Furthermore, that means that the supplier has to use funds other than its sales to finance its own operations.

Some retailers even take off the 2% of the payment while paying in 20 days or even in 30 days. The problem for the supplier is that this is a complex issue for the merchandising department as it requires input from the accounting department. From a practical perspective, Canadian suppliers have found it challenging to get the accounting right on this issue. In the case of Loblaw, for example, it’s pretty hard to argue with the fax machine of their payable account office located in Winnipeg. Also when it takes up to 60 and 90 days to receive payment from Sobeys or Metro, its often because the request from the manufacturer is going from one desk to another at their head office. It seems like a small problem but it is irksome and costly.

10) Price freeze period

Price freeze from September to January has become a norm over the past few years as grocery chains do not want to see any price increase in their stores before and during the holiday season. During the 2016 summer Loblaw, Sobeys, Metro and Overwaitea have informed their suppliers that a price freeze was effective from September to January 2017.

For example, on August 27, Sobeys sent out to all its suppliers a letter mentioning that the supermarket chain will not accept any price increase from August 28, 2016 to January 29, 2017. This means that a manufacturer receiving a cost increase on ingredients is requested to wait until February 2017 before being able to pass on to the grocery chain a price increase. Furthermore, Sobeys has also indicated in its letter a minimum lead time notice of 12 weeks to pass on a price

increase. In other words, this means that Sobeys is not accepting price increase from August 2016 to end of May 2017 which represents a period of nearly eight months.

The holiday season and the minimum lead time of 12 weeks are not the only reason for retailers to request a price freeze. For example, in October 2012, Loblaw sent a letter to its suppliers to indicate them that it will not accept price increase from vendors effective immediately through calendar year 2013. The reason justifying this price freeze period was to compensate for the implementation of a new SAP system.

Bearing a cost increase for food processors from four to eight months without being able to pass it on its customer could become extremely costly and can negatively impact annual profits of an organisation.

11) Extra terms of 1%, 2% and even more

An recent example of extra terms requested by a supermarket chain is the request made by Loblaw to its suppliers. In a letter sent to vendors, the largest Canadian supermarket chain told suppliers it would start applying a 1.45% deduction to shipments received as of September 4 and the decrease will be regarded as accepted if the suppliers continue to ship.

Overwaitea also sent out a letter to inform its suppliers that the supermarket chain will request a 1% to 2% deduction explaining that it is to match the recent request made by Loblaw. Consequently, Metro also sent a letter to all its vendors to request 2% deduction.

Another example of extra terms is Loblaw's automatic deduction fee, which was imposed on manufacturers in late 2008. The major grocer requested its suppliers to sign a form in which each of them had to agree to an extra deduction fee of 1% for national brand and 2% for private label and to confirm by letter that they agree to these ongoing incremental rebates for all purchases, based on invoice costs. It was applicable across the entire listing base including new items.

In this case it was to support the store renovation program. It should be noted that this was forced onto suppliers with little or no choice. The alternative was to see the grocer stop buying their products. The problem is that negotiation is not a promising option. It is possible to argue and debate about these increasing costs but it is likely that the retailer will favour the most cooperative suppliers in its merchandising activities.

Also, retailer reorganization fees have been charged to suppliers with after the recent acquisitions in the Canadian grocery industry. For example, when Metro took over Loeb, it requested a 1% deduction from its suppliers. Sobeys also imposed a 1% deduction to its vendors when the company acquired Safeway Canada.

These extra terms of 1% or 2% represents manufacturer's profit margin given back to the retailer.

Estimating total cost of changing trade practices

All those extra trade costs presented above represent significant revenue lost for manufacturers. It is possible to estimate the effect of these changing trade practices within two to four years of the business relationship. Those estimates represent percentage of sales given back to the retailer:

- 1% to 2% increase of marketing programs (O&A);
- increase in listing fees, representing 0.5% to 2% of sales;
- extended payment period from30 to 60 days representing 1% to 2% of revenue lost;
- lumping fees, representing of 0.25% to 1% of sales and
- unsalable merchandise representing 0.5% to 1.5% of sales
- price freeze period of 12 to 24 weeks representing 1% to 3% of sales
- extra terms of 1% to 2%;

Changing trade practices can represent additional 4% to 12% of sales given back to the retailer within two to four years. These changing trade costs of doing business with national supermarket chains can significantly impact a manufacturers' profit margin. Manufacturers are probably accepting those changing trade conditions because they simply do not have the negotiation power to refuse them. Again, it is possible to debate these increasing costs, but it is likely that the retailer will favour the most cooperative suppliers in its merchandising activities.

Conclusion

Trade marketing terms and practices have been a source of controversy in the industry for at least the last forty years. The issue now is the effort by grocers to generate more margin and returns from the practice. In the end, those arbitrary and confused terms of trade can diminish the willingness of suppliers to collaborate with retailers on merchandising activities. As seen in the last few years, trade practices have contributed in some cases to adversarial relationships between manufacturers and retailers.

The irony of course is that for the most part, manufacturers are increasing their list pricing in full knowledge that the grocer is going to be making these extra demands. It can become a sort of a shell game. The problem now, however, is that it is a moving target, at least until expectations and practices become clearer. The manufacturers that are able to produce and market the best brands and products that are in high demand will be the least affected. Everyone has to market Tide, Coke and Heinz. Also those suppliers, and even new suppliers, which can provide unique and innovative products will also be the least affected. Every grocer wants to have a good, new product. However, if it is another "me-too" product, line extension or another can of peas, the grocer demands will be great, and rightly so.

The bottom line is that it is important for emerging suppliers and new account managers to the supermarket trade to be aware of those changing practices. Awareness of this business context by planning trade marketing budgets realistically can only enhance the chances of success for manufacturer-grocer relationships.

This paper is an update of a compilation of articles that first appeared in the Grocery Trade Review in 2010.

About the author

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Simon received a Bachelor's degree in Agricultural Economics form Laval University and a Master's in Food Business Economics from University of Guelph. His graduate research project was awarded Outstanding M.Sc. Thesis in Food Distribution & Marketing by the Food Distribution Research Society (United States).

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