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Supermarket wars

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Kiwi consumers get good deals on their grocery shopping but these come at the expense of the suppliers, writes Lesley Springall.

Fabulous Food-makers remembers the days when its sales margins were closer to 50% than 20%. When it was paid regularly each month for its products and didn't have to keep tightening margins to ensure prompt payment. And when it didn't have to worry about its latest product idea being swiped by its customer, re-emerging as a house brand produced by its competitor.

It was tough when there were three supermarket groups but now, with only two carving up a whopping $10 billion worth of sales a year, the situation is more serious. Many of the country's food businesses say the power of the big two to pick winners is driving down quality and pushing suppliers out of business.

Fabulous Foodmakers doesn't exist but its scenario is true. It was put together from discussions with several players - all fearing reprisal if their names were published - supplying our two supermarket chains: Australian-owned Progressive Enterprises, owner of Woolworths NZ, Foodtown and Countdown; and the owner-operated co-operative chain Foodstuffs, whose stores include New World, Pak 'N Save, Write Price and Four Square.

The two chains argue the detail but Progressive - after picking up Woolworths NZ two years ago for a cool $690 million - has roughly 45% of the main supermarket market and Foodstuffs, 55%.

One person behind the Fabulous Foodmakers scenario said the situation was “despicable” and called what's going on “diabolical”.

“The supermarkets couldn't give a toss about their suppliers or their customers. It doesn't matter what their customers want, it's just about screwing as much money as possible out of us. Customers might get cheap prices but they aren't getting the choice they want.”

Another supplier, an ingredients supplier to the food manufacturers, was equally vocal (and insistent on anonymity). More worrying than the threat of falling margins was the threat of food scares, he said.

As the two supermarkets force the food manufacturers' margins down, the manufacturers in turn force their suppliers' margins down. They must then source cheaper materials to stay in business: “It goes right down the line and quality goes out of the window.''

Last month's cornflour scare is a classic example, according to the source.

According to Progressive's own data, released at an industry conference last year, food recalls have jumped a staggering 400% in the past six years, with Progressive saying it handled 130 last year, compared with just two in 1998.

Though he can't cite figures, the food ingredients supplier said the recalls were an indication of falling quality as suppliers were forced to look at less trustworthy markets and suppliers to find cheaper raw materials and transport. “It has always been tough but, because of [Progressive's and Foodstuffs'] size and volumes now, they can simply say we're selling more, 'what about a price reduction or we will find someone who can sell it to us cheaper'.” The big two also use their might to demand better pricing terms, bargaining margin reductions against prompt payment terms, said another supplier. “If you don't agree, you can wait six months for your money.”

One willing to go on the record was Lisa Williams, co-publisher of the food suppliers bible, Grocers' Review. Suppliers' margins are being eroded by as much as 50%, with some fresh produce suppliers being forced to cut margins from 10-15% to as low as 3%, she said.

“The suppliers are certainly getting a raw deal from the supermarkets who - to be frank - are just very, very aggressive.”

The growth of house brands - Pam's and Budget for Foodstuffs and Signature and Basics for Progressive -has also had a marked influence on suppliers' margins, said Williams.

Estimated to be growing at about 10% to 15% a year, house brands - or private labels, as they are called by the trade - now account for about 12% of all supermarket sales.

But accusations that they account for about 30% of shelf space were dismissed as “rubbish'' by Foodstuffs (NZ) head Tony Carter. Shelf-space mirrors sales, he said. In some categories, such as generic items including milk, it could be up to 50%. But then Pam's milk accounted for about 50% of the supermarket's milk sales.

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“But the manufacturers who supply private label tend to be the major suppliers of the branded product as well. So there's opportunity for participation at both ends of the market,” said Carter.

Progressive's merchandise general manager Mark Brosnan agreed the past 12 months had got tougher for some suppliers as both retailers up the ante for market share. But it is being driven as much by the suppliers competing for their own brands' market share and for a slice of the house brand market as by the retailers fighting it out, he said.

“We are the buying agents for the consumer,” said Carter. “It's our job to force [suppliers] to be competitive and efficient. And if they aren't efficient and aren't able to deliver value for the consumer, then clearly they have got a problem.”

Suppliers may be hurting but consumers are seeing the benefits of this war. The consumers price index (inflation) rose by 2.4% in the year to June, whereas food prices rose by just 0.9%.

The world had become more competitive and New Zealand was no exception, said Carter. It lagged behind the UK and US in the growth of private label brands, “but it wouldn't matter if there were two, three, four or five supermarket chains, we'd still be just as competitive”.

Both Brosnan and Carter, however, said the quality issue was a major concern. But neither had heard the concerns raised before, they said. “And suppliers talk to us all the time about pressures in the market,” said Brosnan, questioning the claim's validity.

With the country's largest brand suppliers, such as cereal-maker Hubbards, canned foods suppliers Heinz Wattie and general product supplier Hansells sweeping up much of the private label business, those suppliers most at risk are the middle-sized manufacturers turning out commodity-type products: the breads, milks, eggs and other staples favoured by the house brands. Many of these products are the same, though the packaging differs, according to a supplier.

“The crazy position is that many suppliers supply to people who also compete with them,” said Grocers' Review editor John Corbett.

Many were scared to come forward and talk to the supermarkets about innovative ideas because they feared the ideas would be swiped, said Williams.

Foodstuffs South Island head Stephen Anderson said he was concerned by the lack of research and development, but added that the large players had no intention of swiping suppliers' ideas. “The last thing we want to do is drive people into the dirt so they go bust.”

Hansells Group managing director Stuart Walker, whose private label contract business PLC accounts for about 17% of the group's $70 million annual turnover, said it was about trust and was a two-way street. If one came up with a new product formulation, the other had a good 12 months before it could bring out something similar. “It's a credibility issue, otherwise they wouldn't use you and you wouldn't work for them.”

The trend towards house brands and rationalising shelf space to cater for fewer products had nothing to do with there being just two players in the marketplace, said Walker, but was happening everywhere. “But, yes, the more dominance the two supermarkets have the more they can build [loyalty] for their own private labels.''

That said, Anderson agreed the supermarkets were constantly looking at their shelf space. “We don't have elastic shelves and we need to make sure the products on our shelves are the ones the customers want.”

Walker confirmed there had been some high-profile posturing by the two players when The Warehouse, spurred on by some suppliers, entered the food game. The Commerce Commission even issued a warning to Progressive head Ted van Arkel after he told suppliers at last year's conference that they would have to “accept the consequences” if they offered The Warehouse a better deal than Progressive.

It could be worse, said Tim Morris, head of specialist resesearch house Coriolis Research. If the suppliers think they have it tough in New Zealand they should try dealing with the WalMarts and Tescos of this world. “The New Zealand crowd are puppy dogs compared with them.”

And, if one of those international players bought out Progressive's Australian parent Foodland Associated - a perennial rumour - they would have extra competetition from US and British suppliers.

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