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Below Cost Legislation – Did it matter and would it really matter today?

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Abstract. This paper traces the emergence, evolution, and demise of below cost legislation in the grocery industry in Ireland. The paper explores retail buyers' views of the Grocery Order (1987) and the effect, if any, it had on grocery buyer behaviour, competition among retailers, and vertical competition along the food chain until it was repealed in 2006. It addresses the matter of buyers' likely response to the Order, had it remained in effect, in the current depressed market environment. Views of independent retailers are also provided on the Order. The paper finds that grocery buyer behaviour was determined by the buoyant consumer market and that the Groceries Order acted to depress competitive forces and direct supplier-buyer negotiations to off-invoice variables. Had the Order remained in place, the effect of the rapid decline in the economy, accompanied by the rapid rise of the discounters' share of the market, the growth in cross border shopping, and the dramatic fall in the value of sterling would have ensured that buyers developed new sourcing models which would have made the legislation redundant. The paper concludes that the legislation did not work to the benefit of shoppers but assisted the imposition of a form of quasi-resale price maintenance by suppliers, which suited suppliers and retailers alike in a time of economic buoyancy. The paper endorses the Government's decision to rescind the order and remove an important constraint in both vertical and horizontal competition.

Keywords: Below cost legislation, Grocery Buyer Behaviour

1. Introduction

Given the frequency of purchase and their share of household expenditure, grocery products and their prices act as a significant determinant of the level of satisfaction enjoyed by households. Despite this, below cost legislation on grocery products has occupied the minds of legislators in many European countries for a considerable period of time. The motivation for such an intervention frequently involves the preservation of the existing retail structure and the protection of competitive forces against possible predation by larger competitors. This paper traces the emergence and the debate surrounding evolution of below cost legislation in the Republic of Ireland. It will trace the steps that led to the introduction of the legislation in 1989, and the emergence of a definition of below cost that was to result in unanticipated responses that served to limit the downward pressure on grocery prices, introduce inefficiencies in both retail and supplier organisations, and stifle sourcing innovation. Interviews with current and former buyers from the main grocery buying organisations will inform the debate on the effect of the Order on buyer behaviour.

Cost versus price

We are concerned with below cost legislation. However the term cost is not as clear as it might initially appear and this fact can have undesirable effects on the way legislation is implemented and the behaviours it induces among businesses. In particular, it is useful even at this early stage to consider the distinction between cost and "net invoice price". For the purpose of clarity we shall ignore taxes. The cost a retailer incurs in selling a product is made up of two components. The first component is the amount of money paid to the supplier of the product. This in turn can be broken down into two elements; The first element is the price on the invoice which may contain discounts based on the size of the order or other economies associated with the transaction. The difference between the retail price of the product and this cost yields the products gross margin. The second element, sometimes referred to as supplementary terms, may involve incentives and take the form of rebates paid to the retailer based on future performance perhaps achieving certain sales targets. These supplementary terms must be added to the gross margin, yielding an adjusted gross margin. Deducting the supplementary terms from the price on the invoice yields the real price paid by the retailer. The monetary amount of these supplementary terms are unknown at the time of the sale. Further difficulties arise because supplementary terms are usually paid on the basis of the totality of business done over a period of time. In general this is not product specific as many suppliers deal with multiple products.

Consequently it is not possible to calculate the real price paid by a retailer to a supplier for a specific product at the time of invoice.

However this does not equate to the cost of the product to the retailer. There is the second cost component to be considered. Retailers by necessity incur costs when selling a product. These include overhead costs and variable costs. Variable costs can display significant differences even when we compare very similar consumer products. For example, take a steak butchered and prepared in-store versus the same product prepared and pre-packed by the supplier. These direct product costs are difficult to apportion to specific products.

The “below-cost” legislation embodied in all the variants of the Groceries Order is concerned almost solely with our first component of cost which is the amount of money or purchase price paid by the retailer. This might be termed as the real price of a product. The legislation does not, for practicable purposes, attempt to consider the costs the retailer incurs once title to the product is transferred from the supplier.

The emergence of the groceries order

The 1956 Groceries Order was the first attempt to regulate trading relationships within the grocery sector in the Republic of Ireland. The order emerged in response to changes in the distribution of grocery products and the structure of the grocery supply chain. In overall terms the extent of price competition at the time was very limited; the practice of Resale Price Maintenance (RPM) was ubiquitous with most product prices being specified by the manufacturer or supplier either through price marking, advertising or direct instruction. The Fair Trade Commission’s (FTC) enquiry into the grocery trade during 1955 was very progressive for the time in concluding that the extent of price competition in the grocery trade should be stimulated to the benefit of the consumer. The legislature responded positively to the FTC’s recommendations and the resultant 1956 Groceries Order heralded in a new era in the grocery sector. Amongst other practices, the Order prohibited resale price maintenance and collective price fixing throughout the grocery channel. However manufacturers and suppliers were permitted to withhold supplies in cases where a retailer sold a product at a price that was below wholesale cost before the deductions of quantity discounts.

In 1972 a further enquiry into the grocery trade was conducted. At this stage the structure of the industry had changed significantly. The multiple retailers’ bargaining power had increased noticeably and was such that they could now negotiate terms on a par with wholesalers. This was despite the fact that manufacturers and suppliers incurred higher costs when distributing directly to individual retail stores. Also, multiple grocers were negotiating supplementary terms over and above those justified by economies of order size (FTC 1972). There was also evidence of an increasing use of below cost selling (sale below purchase price) which was usually combined with intensive advertising by the retailer to encourage customer traffic. Despite the fact that manufacturers possessed the right to withhold supplies under these conditions, and indeed were frequently encouraged to do so by certain sectors of the grocery trade, they rarely did. Suppliers clearly disliked the practice of below cost selling but the increasing availability of generic own label products and the fear that the larger retailers would simply source supplies elsewhere conditioned their responses. Multiple retailers’ power had increased to the extent that sanctions designed to counter undesirable trading practices were ineffective.

One of the more interesting features to emerge from the Fair Trade Commission’s (1972) deliberations concerned a possible prohibition on below cost selling. However, even then, the insuperable difficulties associated with regulating retail prices, on the basis of a price paid by the retailer to a supplier when such a price could be partly determined by future discounts, were recognised. The Fair Trade Commission’s (1972) clearly recognised that below cost selling was taking place but rather than deal with it directly they adopted an indirect approach and recommended that a ban on below cost advertising should be introduced. Their view was that widespread advertising of below cost prices might generate a misleading impression of large retailers’ overall price levels (Massey and O’Hare, 1996) and that a ban on advertising would restrict the benefits of below cost selling and reduce its incidence.

This was duly incorporated into the 1973 amendment of the Groceries Order with an important variation. The Fair Trade Commission (1972) recommended a ban on below cost advertising where cost would be defined as net purchase price. Net purchase price would include tax but no reference was made to future rebates (FTC 1972: 225). In the 1973 Order it is stated that the retailer should not advertise at a price which was less than the price after the deduction of any discount (Department of Enterprise, Trade and Employment 2005). The determination of “any discount” was likely to prove difficult but despite this the prohibition was largely adhered to until 1985 when a High Court action highlighted the futility of such legal activity and there were no further prosecutions (Restrictive Practices Commission, 1987).

In 1978 an Irish food manufacturer refused to withhold supplies from a particular retailer who, allegedly, had been selling below cost. Under the 1972 amendment to the Groceries Order, the right to withhold food supplies from a retailer for below cost selling, had been removed. However it appears that this change was not fully appreciated among the trade and a boycott of the manufacturer ensued by wholesalers and independent retailers. The Restrictive Practices Commission (RPC) considered the case and recommended that the right to withhold food supplies from outlets selling at or below cost be re-introduced into the Order. Cost was defined as net invoice price plus value added tax (Department of Enterprise, Trade and Employment 2006; appendix five). Further clarity to this definition of cost was to emerge through a High Court judgement in 1978. Once again the issue of defining net invoice price to include future rebates arose. The judgement ruled that the net invoice price could not be equated with the real price that would depend on the size of future rebates. The implications of this judgment were far reaching: for the purposes of the Groceries Order, net invoice price excluded off-invoice discounts. Any remaining doubt was removed with the addition of this definition to the 1981 Groceries Order.

The prohibition of below cost selling

It is notable that even at this stage, there was no prohibition against below cost selling. In its 1980 review of the grocery trade, the Restrictive Practices Commission maintained the view that the prohibition on below cost advertising was sufficient and that a ban on below cost selling was not justified. However there was mounting evidence that increasing competition among the multiple retailers was leading to widespread below cost selling (Yates 1984). By 1986 the matter had reached a stage where the then Minister for Industry and Commerce requested that the Restrictive Practices Commission explicitly investigate and review the issue of below cost selling. In its report, the Restrictive Practices Commission (1987) recommended a ban on below cost selling for four reasons. First, and most importantly it was clear that the prohibition on below cost advertising was not proving effective in reducing the extent of below cost selling. Second, the growth in the multiples' share of the grocery market was causing concern and was believed to threaten the viability of the independent sector. The share of trade accounted for by the top three multiple operators was 44.4% in 1983. This rose rapidly to 56.1% by the end of 1987 (Table 1). Third there was evidence of the growing power of the multiple retailers within the relationship with suppliers. The shift in power was partly reflected in manufacturers' practice of providing additional allowances to retailers as an incentive not to sell below cost. These allowances were considered undesirable and discriminatory. In particular, they were most likely to discriminate against the independent sector and continue to fuel the concentration process. Fourth, the practice of below cost selling caused considerable difficulties to suppliers. On the one hand, suppliers had to contend with inefficiencies in production and stockholding to cater for the irregular demand patterns resulting from below cost promotions and, on the other hand, they faced considerable pressure from other customers who wished to match their competitor's prices.

The Commission's recommendation, that there should be a ban on below cost selling, based on the view that the practice was “intrinsically unfair”, were incorporated into the Groceries Order 1987 and came into force in December 1987. Below cost was defined in terms of net invoice cost including value added tax. That this could lead to a form of resale price maintenance was recognised but the view taken was that competition would depress invoice prices (RPC 1987:49). The ban was to extend across grocery goods, defined as “goods for human consumption (excluding fresh fruit, fresh vegetables, fresh and frozen meat, fresh and frozen fish which has undergone no processing other than freezing with or without preservatives) and intoxicating liquors not for consumption on the premises and such household necessities (other than foodstuffs) as are

ordinarily sold in grocery shops and includes grocery goods designated as ‘own label’, ‘generic’ or other similar description” (SI No 142 of 1987).

Table 1. Concentration in the Grocery Market: Market Share by Company

Retailer	Dec 1983	Dec 1987
Dunnes Stores	17.4	25.4
Power Supermarkets	18.5	24.5
SuperQuinn	6.6	6.2
Tesco	8.4	0.0
Multiples (CR3) ¹	44.3	56.1
SuperValu ²	6.3	7.0
Total (CR3)	44.3	56.9
Total (CR4)	50.9	63.1
Source: Taylor Nelson AGB. Multiple (CR3) refers to the share of trade attributable to the three largest multiple outlets. The Total CR3 refers to the share of trade attributable to the largest 3 buying organisations including SuperValu. SuperValu stores are independently owned but trade under a wholesaler controlled trading fascia.		

In summary, the prohibition of below cost selling was introduced largely as a result of increasing retailer concentration and buying power, the demise of the independent sector and the “views of manufacturers and retailers that it would make a significant difference to them”. On the consumers’ side, one argument presented in favour of the ban was that it would “seem likely that a wider range of products would be sold at cost or just above cost as a substitute for below cost selling so that there would be no net additional cost bearable by the consumer” (Restrictive Practices Commission 1987).

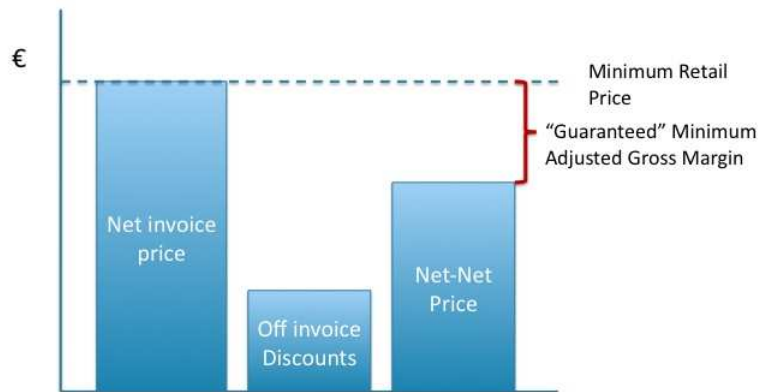
However, there were problems with the legislation. The first concerned unintended consequences and the behavioural responses made within the trade. The RPC (1987) held the view that while the net invoice price would ideally be the real purchase price paid by the retailer, they acknowledged that all discounts, rebates, allowances, and longterm agreements (LTAs) did not appear on the invoice. Despite this, they took the view that competition among retailers would result in these supplementary terms appearing on the invoice and that forces would ensure that the net invoice price would equate to the real price of the products. By 1991, in its review of the 1987 Order, the Fair Trade Commission¹ recognised that there were difficulties. The Commission in its 1987 report had recognised that by defining cost in terms of net invoice price there was the potential for suppliers to re-introduce a form of resale price maintenance through the use of off-invoice discounts. By 1991 it was becoming apparent that both the frequency and magnitude of off-invoice discounts (up to 25-30%)had increased considerably (FTC 1991).

By removing discounts from invoices, suppliers could in effect raise the minimum retail price, thereby dampening the extent of price competition at the retail stage of the channel. This is demonstrated in figure 1. This may have had an interesting effect on bargaining processes between retailers and their suppliers. If retailers believed that a common net-invoice price was being paid throughout the trade, they may have had the incentive to negotiate for larger off-invoice discounts instead of negotiating for lower net invoice prices. With the minimum market price being determined by the supplier, the off-invoice discount became a quasi-guaranteed minimum adjusted gross margin. In addition to causing retail prices to be higher than they might ordinarily be, this opened up the clear possibility of substantial discrimination among retail customers which could threaten the competitive structure of the industry. As Grant (1987) proposed, the “principal effect of buying power is not to depress prices across markets but rather to induce price discrimination in favour of large buyers through discounts”.

¹ The Restrictive Practices Commission was renamed the Fair Trade Commission in 1987.

Figure 1.

The Relationship between Net Invoice Price, Off Invoice Discounts, and Minimum "Guaranteed" Adjusted Gross Margins



In an attempt to ensure an equitable treatment of their retail customers, the 1987 Groceries Order contained a provision requiring all retailers with more than five outlets and wholesalers to supply the Director of Consumer Affairs, who was responsible for enforcing the Order, with details of all supplementary terms negotiated with suppliers on a monthly basis. However this provision proved to be a totally ineffective monitoring mechanism as it was impossible to implement administratively due to the volume of material (e.g. a typical retailer might have 20,000 products) and the way supplementary terms were paid.

The three members of the 1991 Commission did not arrive at a unanimous view on the need to revoke the ban on below selling (FTC 1991). The majority view held that the ban was a serious restriction on competition and that, due to off invoice discounts, minimum resale prices were higher than they would be without the ban. The Commission was however unanimous in its view that net invoice price was an unsatisfactory definition of cost. Despite this, no further changes were made to the 1987 Groceries Order until 2006.

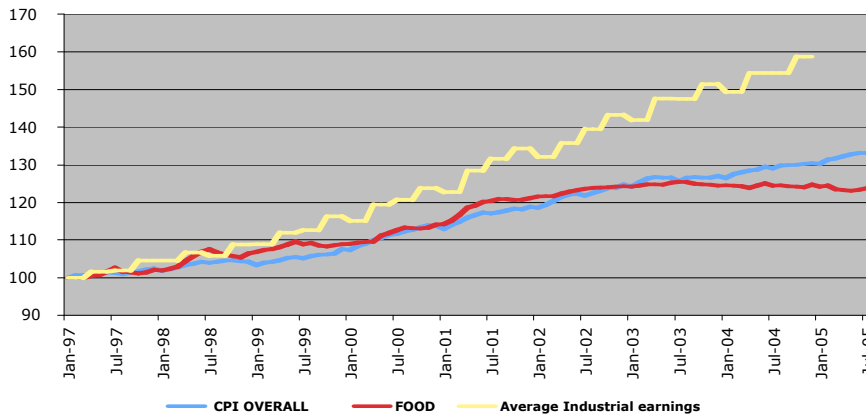
Turning tides

Given the foregoing, it is not surprising that a considerable degree of uncertainty surrounded the continuing existence of the Order. Grocers, manufacturers and producers all exercised strenuous lobbying activities for the retention of the Order. In a rather peculiar twist of events, the Consumer Association of Ireland supported the retention of the Order and the ban on below cost selling. Even though the failings in the legislation had been apparent for so long, the evidence suggests that there was no clear political motivation for change.

To understand the lack of change it is worth considering the unfolding economic environment. From the mid 1990's the Irish economy was about to enjoy a decade of unprecedented growth. While overall inflation and food price inflation were increasing, average industrial earnings were growing at a faster rate (fig 2). Consequently, it is proposed that grocery prices were not a major issue for consumers at the time. Customers' increasing affluence was also reflected in the product mix developed by retailers. The move to

premium type products was clearly in evidence with high quality premium retail brands developed by all the main retailers.

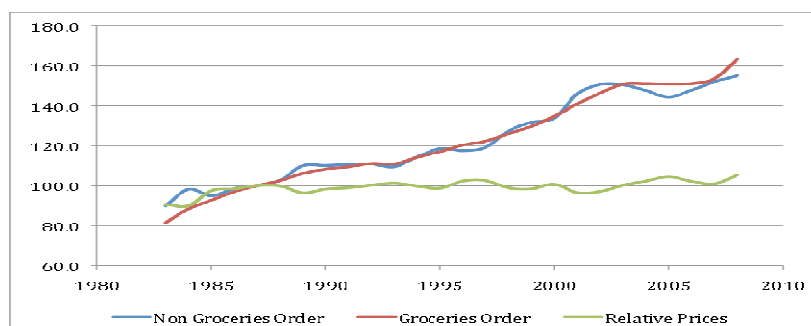
Figure 2. Earnings Growth and Inflation in the Republic of Ireland



Source: CSO

Despite the difficulties in actually determining the precise product coverage of the Order it was held that approximately 75 percent of the typical basket was subject to the Order. Many arguments focused on the change in relative prices between those products covered by the Order and those products that were not subject to its provisions. This data is provided in figure 3. The lack of evidence supporting a clear and consistent divergence in both price series was used by proponents in favour of maintaining the order as a sign that the order was not suppressing competitive forces. On the other hand, periodic differentials in price inflation could be used to suit the case of a particular lobby or interested party at a point in time (e.g. CSG 2005:59).

Figure 3. Price Indices for Grocery Order and Non Grocery Products
Base 1987=100



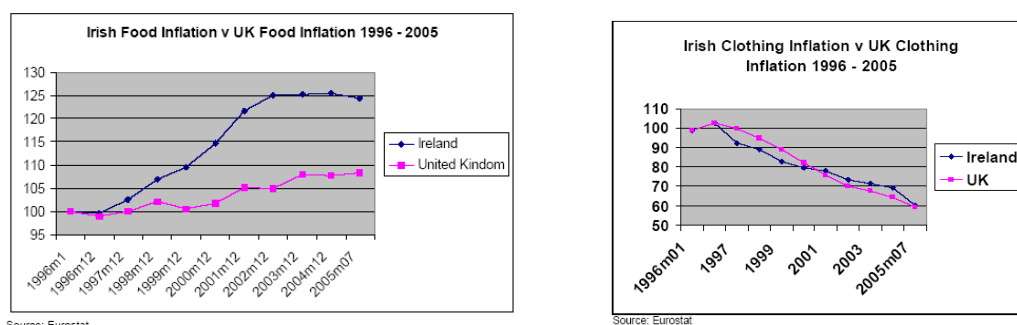
Source: CSO

This was about to change however. In 2004 the then Minister for Enterprise, Trade and Employment established the Consumer Strategy Group which reported on the grocery trade (CSG 2005). Central to the group's critique of the grocery market was the extent of off-invoice discounts. It stated, without any supporting evidence, that these discounts amounted to an average of 18 percent for the largest retailers (CSG 2005:80). Given the legislation, these discounts could not be passed on to shoppers in lower prices. This figure received considerable attention in the media and was reported extensively. It was suggested that if prices were to fall by the amount of the off-invoice discounts, the typical household could save up to €1,000 per annum. The Groceries Order was subjected to ridicule when a large retailer sold disposable nappies below net invoice price. The Director for Consumer Affairs, who had responsibility for enforcing the Order,

took the retailer to court. The retailer did not contest that it had sold the products below net invoice price but rather argued that disposable nappies were not a household necessary and consequently were not subject to the Order. The retailer won its case!

Other factors also began to emerge. Food inflation in Ireland was considerably higher than UK inflation. This is despite the fact that Tesco was both Ireland's and the UK's largest retailer. One frequently used argument to support this difference was that the costs of doing business in Ireland were considerably higher and explained the difference in prices. However, as pointed out by the Department of Enterprise Trade and Employment (2006), no such differentials existed in clothing, suggesting that the dynamics of competition in the Irish grocery market were not operating to the consumer's best interests (Figure 4). This made it increasingly difficult for the previously successful lobby groups who argued for the Order's retention.

Figure 4. Differential Inflation Rates Between the RoI and the UK



Source: Department of Enterprise, Trade and Employment (2006)

All in all, the justification for the Groceries Order was being systematically undermined and finally the Order and the ban on below cost selling was revoked on March 11th 2006. The view was that the ban on below cost selling, defined as selling below net invoice price, imposed a form of resale price maintenance. If they had wanted to, retailers could not pass on the off-invoice discounts they received from their suppliers to their customers and consequently it forced prices to be higher than they necessarily had to be.

Developments on the supply side:

On the supply side, the competitive capacity in the Irish Market was also beginning to increase. Tesco had re-entered the Irish Market in 1997 by purchasing the Power Supermarkets chain of stores². This chain held approximately 25% of the RoI market and Tesco's purchase brought a new dimension to the competitive environment. In particular, the fact that its British arm had an own brand participation in the region of 50% compared with 15% in Power Supermarkets, opened up the possibility of a radically new supply chain model with imported products displacing Irish sourced products. To allay these concerns Tesco gave the Irish government a series of undertakings "such as to have a buying office in Ireland, to enhance the amount of resources the company puts into working with Irish suppliers to ensure that they, in turn, can increase the volume of sales in the Irish market. Tesco has agreed to bench-mark those commitments and agreed to their regular auditing, to ensure demonstrable progress in increasing sales of Irish suppliers"³. It must be recognised that Irish sourced products could also include international branded products distributed by Irish agents, wholesalers or local ancillary offices. Tesco also committed itself to honouring the legal obligations as set out in the Groceries Order.

² Most of the stores traded under the Quinnsworth name and a few under Crazy Prices.

³ Dail Eireann – volume 478 – 22 April 1997 Priority Questions – Supermarket takeover

Cullen Paul (2009) Tesco's high prices a strategy to meet profit targets. Irish Times May 12

Further developments ensued. Aldi and Lidl, the German limited line discounters arrived in the late 1990's and early 2000's. Rather enter by acquisition, these companies followed an organic growth strategy, purchasing and developing their own sites. As a consequence, the supply chain models they adopted were not scrutinised to the same extent as Tesco's had been or were similar commitments to the local supplier base demanded. Also, their business strategy was based almost entirely on own brand products much of which would have been sourced abroad. Consolidation of the independent sector continued with chains such as L&N, Roches Stores and Pettits either being sold to or entering into franchise agreements with Musgrave, the country's largest wholesaler.

Over the 2000-2009 period, the number of primary destination grocery stores had increased by 73 percent. The significant inflow of new capacity pointed to a profitable industry.

Table 2 Store Numbers in Ireland among Major Retailers

	1997	2000	2006	2009	% Change 2000-09
Tesco	78	76	91	116	53
Dunnes Stores	54	62	90	97	56
Superquinn	16	17	20	23	35
Supervalu	166	172	178	191	11
Aldi	0	8	40	65	712
Lidl	0	16	82	115	618
Total	314	351	501	607	73
Source: Company Websites and Communications, Submissions to the Joint Committee on Enterprise and Small Business; IGD retail analysis					

Buyers' views.

Throughout 1990's it is clear that suppliers of category dominating branded products covered by the Groceries Order held considerable power in determining the extent to which retailers could compete on price. The dynamics of negotiations across fresh (not covered by the Order) and dry grocery (covered by the Order) differed substantially.

*"we(in Fresh) were always driving it. We had the best promotions and the best marketing and the grocery crowd did nothing as far as we were concerned because they were completely dominated by **** (international branded supplier name omitted) and everybody else... We thought they (dry grocery buyers) did absolutely nothing, because not alone did they tell them what to do, they gave them their margin. The only big issue they had was once a year with the LTAs. That was their big moment". (Buyer 1).*

In addition to controlling the retail price of their branded products, suppliers also indirectly influenced the price of own brand products. The leading brand on the national market (which could be an international brands) set the price for own brands where a price differential of about 10% applied. *"Everything was dictated by the national brand where a category was dominated by a national brand"* (Buyer 1).

It is noteworthy that the abolition in the Groceries Order did not result in the anticipated increase in broadbased competition. Food prices in general did not fall and indeed continued to rise. On the contrary, figures obtained by the Irish Times from an internal Tesco Ireland marketing plan revealed profit margins of 9.3% for 2008, 50% higher than those achieved in the UK (6.2%). The food price reductions that might have been anticipated by the Consumer Strategy Group did not materialise. One of the reasons was that the economy continued to grow, and it would appear, all elements of the grocery supply chain prospered. Customers continued to willingly pay the prices retailers demanded and there was little reason to change. *"Up to recently everybody was making their margin and as long as you're making your margin there is no incentive to change. Customers didn't care"* (Buyer 2).

Another factor that may have impeded a move to greater price competition was the rigidities that the nineteen years of legislation had introduced into the buying and selling process. The structure of deals

was highly complex. *“Suppliers tried to maintain the list price and negotiation focused on discounts”* (Buyer 2). Discounts mentioned by the various buyers included distribution discounts, promotional discounts, settlement discounts, discounts for joint business planning and marketing, incentive based discounts, and harmonisation discounts and once the buyer had exhausted all the existing discounts *“you became creative and came up with whatever bucket you could”* This was possible because *“when you had growth, things were easier to get”* (buyer 3).

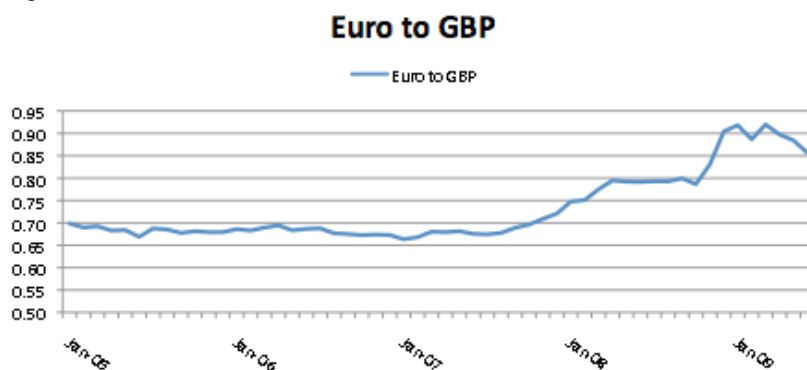
Negotiating deals was a lengthy and involved process. With multiple category suppliers, teams of 6 or 7 from each side would often be involved and the negotiations could go on for months. *“LTAs were separate. They were negotiated once a year. That was a serious process. There were no rules. It was just down to the buyer and their instincts, knowing what they could get.”* (Buyer 1). Sometimes negotiations would be escalated to the very top of the management hierarchy and if they did not go to the satisfaction of the retailer a supplier’s products could be withdrawn.

The terms would last for a year and would have been difficult to unravel quickly. It was put succinctly by one buyer who said *“LTAs had grown into a monster”* (buyer 2) and generated considerable inefficiencies within the businesses. The off invoice discounts were an important part of the retailer’s margin but because of the complexity of deals, *“deal checking had become a little industry in itself”* (buyer 3) using up resources that in other circumstance could be passed on to consumers. For buyers it also meant that their true margin was less than transparent.

The complexity of the deals also introduced rigidities into the evolution of the supply chain: It tended to favour the use of the domestic supply chain over international sourcing even in the case of international brands. The structure and complexities of the deals, and the emphasis on off-invoice discounts, meant that negotiations between international branded suppliers and ROI based retailers and wholesales could be best negotiated on a local basis. This was despite the fact that the top three purchasers of groceries had interests outside the Republic of Ireland. The use of off invoice discounts, and the effect on minimum retail prices, would have meant that locally negotiated deals could yield better returns than those negotiated overseas. This is likely to have suited and sustained Irish divisions of international suppliers by providing them with a clear justification for their existence.

According to the buyers, eventually a combination of three factors led to a significant shift in the dynamics of competition and a revaluation of the sourcing models. During 2008, the rapid rise in the value of the Euro relative to the Pound encouraged a growing stream of customers to Northern Ireland where significant savings could be made.

Figure 5. The Rise of the Euro



Unemployment levels with the seasonally adjusted standardised unemployment rate increasing from 4.8% in January 2008 to 11.9% in June 2009 also served to intensify shoppers’ focus on prices. The continued

promotion of the discounters by price comparison surveys undertaken by the National Consumer Agency highlighted the savings to be made by switching grocers. Taken together these forces prompted a gradual geographical rollout of lower prices by Tesco with its “Change for Good” Initiative and Supervalu with its Sterling Price Match programme throughout 2009. “*The discounters had challenged our sourcing model*” (Buyer 2) and this was soon reflected throughout the industry. On Tesco’s part, it involved a redesign of its sourcing practices and a substantial review of its product portfolio. This entailed a greater role for its UK buying office with “Change for Good” programmes sourcing international product directly from the UK.

Dunnes Stores, the second largest of the multiple retailers, responded to Tesco’s border price cuts with a reported 30% cut in the price of a basket of goods throughout its store portfolio. In the period January to June 2009, the National Consumer Agency reported a fall in the price of a basket of branded goods of between 14%-15% in Dunnes Stores and Tesco Stores operating the Change for good pricing initiative. What is interesting to note is that there has been little evidence if any of below cost selling to-date.

Conclusion

The evidence provided by the Irish experience of below cost legislation highlights the intractable difficulties of calculating the “real cost” of an item to a retailer. It was recognised that the net invoice price was a very poor proxy for the “real cost” but had the advantage that it could serve as a basis for legislation. As had always been feared, the use of net invoice price had the undesirable effect of encouraging off-invoice discounts and reintroducing a form of resale price maintenance. The resources expended by companies in negotiating these off invoice discounts suggest that they were substantial.

It can also be argued that the legislation when coupled with Government intervention during Tesco’s entry, impeded supply chain developments and the competition it might have created. More international sourcing, particularly for international brands and own brand products, would have challenged the quasi resale price maintenance model that existed in Ireland. In such circumstances, the Irish model would have failed to compete and would have had to evolve to survive. It is fair to argue that the legislation did not prevent retailers and wholesalers re-configuring their sourcing models. The problem was that neither retailers nor their suppliers had an incentive to change. Times were good and budgeted margins and sales were being met. It took a dramatic change in the fortunes of the economy and the rapidly expanding presence of the limited line discounters to change the nature of competition.

The fact that prices were slow to fall after the abolition of the Groceries Order confirms the view that retailers would rather avoid price competition when possible. The industry had been conditioned. The negotiating processes and supporting structures had been established for almost nineteen years. The industry, and it must be said, its consumers were not price driven. The legislation provided the means for supporting higher prices, through quasi-guaranteed adjusted gross margins, and perhaps even established a business culture that suppressed price competitive forces. It was always within the means of the various retailers to reduce prices while adhering to the legislation. The discounters demonstrated this and the recent reduction in prices also supports this view. However given the rapid decline in the fortunes of the economy and the change in shoppers’ behaviours and motives, it is likely that even had the legislation been retained it would not have prevented the dramatic changes evident today.

So to conclude, did the legislation really matter? The evidence suggests that it did and in a way that policy advisors feared. Primarily, it served to dampen price competitive forces and maintain prices at a level higher than they might otherwise have been. The evidence also suggests that the legislation resulted in unnecessary complexities and inefficiencies to both suppliers and retailers’ businesses. Finally, would the legislation matter today? The downturn in the Irish economy and the emergence of a very price driven shopper has forced Irish retailers to reduce prices considerably to maintain market share. Any artificial constraints to reducing prices such as off invoice discounts would likely be removed and the move to international sourcing and the exploitation of economies of scale would have accelerated.

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