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Tesco scandal could spark a long overdue shake-up of the retailer-supplier relationship

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The £250m shortfall in profits for the six months to the end of August was equal to roughly a quarter of Tesco's expected profits Photo: Bloomberg News

The Tesco accounting scandal has thrown the spotlight on the murky world of retailer and supplier relationships, and it is not flattering.

Many people's reaction to the discovery of a £250m black hole in Tesco's accounts has been astonishment – not just at the chaos engulfing one of Britain's biggest companies but the fact that a retailer can rely so heavily on income from suppliers.

The £250m shortfall in profits for the six months to the end of August was equal to roughly a quarter of Tesco's expected profits, which turned out to be pure fantasy. In time, we will discover whether this was because of fraud or, as appears more likely, a highly aggressive approach towards suppliers from a desperate management team trying to prop up falling sales.

However, for many consumers, the revelation that suppliers pay retailers to hold promotions and place their products on prominent shelves was eye-opening in itself. The assumptions that supermarkets simply pay suppliers for each batch of products delivered have also been destroyed. Tesco and its main suppliers operate through credit accounts, where the supermarket can remove and pay in cash at will.

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This crisis is an indirect result of the woeful oversight of retailer supply chains in the UK. Perhaps something can be salvaged from this sorry mess: regulation of the relationship between retailers and suppliers needs to improve dramatically.

Last year this lack of regulation resulted in the horse meat crisis – which was caused by fraud – this year it is Tesco's accounting crisis.

There is currently no code, regulator or set of rules controlling the relationship between suppliers and retailers in the UK. In addition, there is nowhere to turn for a supplier if it feels it is being bullied by a retailer. Many suppliers are too scared to speak out against a larger retailer for fear of being delisted or replaced by a rival, so they suffer in silence and agree to the unreasonable demands being placed on them.

Last December, a Groceries Supply Code of Practice was introduced with an independent adjudicator who has the power to name and shame retailers who break trading agreements with suppliers.

This is a welcome step but it may be too little, too late.

Some of the worst examples of suppliers abuse in the past two years have come from non-food retailers.

In May, we revealed that **Halfords had sent a letter to suppliers** asking them to pay up to 10pc of their annual sales with the retailer to help fund its £100m turnaround plan.

This effectively amounted to a rebate on already agreed contractual payments. Suppliers claim it came with a warning that if they did not agree, they risked being delisted.

Matt Davies, chief executive of Halfords, was unapologetic about the letter, claiming that the retailer was “making sure that everyone carries their weight”. He argued that because Halfords' investments in improving its stores would boost sales for suppliers, they should contribute.

However, suppliers saw it rather differently, with some fearing the demands would push them into the red. In the end, because Halfords is the largest bicycle and car parts retailer in the UK, most small businesses decided they had to stump up the cash.

It is not beyond the realms of possibility that a similar request was made to Tesco suppliers – perhaps in return for prime shelf space – and the company then booked all the rebates as income before suppliers had even agreed to it.

Unfortunately, Halfords is by no means alone in making these kinds of demands. John Lewis – yes, even John Lewis – **told suppliers last year they would be subject to a rebate of up to 5.25pc on annual sales**. Again, it justified the letter by saying its sales were only rising due to spending on new stores, refurbishments and its growing ecommerce operations.

Last December, in perhaps the worst example, **Debenhams demanded a one-off fee from suppliers worth 2.5pc of its outstanding payments** and said it would apply a 2.5pc discount to orders it had already agreed with suppliers. Argos and Homebase, which are owned by Home Retail Group, joined in on the act in February by **applying a 2pc rebate to future orders**.

Home Retail stands out in this debate because it takes 60 days to pay its suppliers, one of the longest waits in the retail industry.

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The variation in payment days between retailers is, quite frankly, remarkable. An analysis by The Telegraph in January showed that in 2013 the average number of days it took the top 25 listed retailers to pay suppliers grew from 40 to 42.

However, this swung from just 15 days for Mulberry and 24 for Marks & Spencer, to 60 for Home Retail and Debenhams and 59 for Asos and Topps Tiles.

Apart from the Forum of Private Business, which has spoken out admirably about the pressure being applied to small businesses, no one is fighting the corner for suppliers or making an effort to set a standard for payment terms.

It was heartening, therefore, for Adrian Bailey, chairman of the Parliamentary Business Committee, to say on Thursday that the Tesco scandal could prompt MPs to look at the relationship between retailers and suppliers. He said: "Depending on the train of events, we may well as a committee want to look at this. Not just at Tesco but at what is going on in the retail industry and in the relationship with the suppliers to see if problems haven't been addressed, because they should have been."

It must be said, of course, that many retailers have a far more enlightened attitude towards suppliers and take efforts to nurture new talent in the UK. Sir Philip Green, who oversees the Fashion Retail Academy, certainly falls into this category.

Battering your supply chain is a remarkably short-term approach. It can have severe long-term consequences if it discourages small businesses from investing and innovating. Look at manufacturing: its decline in the UK was in a large part due to the disappearance of suppliers. The automotive and aerospace industries now realise the key to growing their industries is developing the supply chain and nurturing new businesses. Companies such as Jaguar Land Rover can only grow if the makers of its key car parts keep up.

Bolstering the supply chain has become a pillar of the Coalition's strategy to rebuild manufacturing in the UK. The Government must talk the same approach in retail too, as should Britain's biggest retailers.

Link: www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11122425/Tesco-scandal-could-spark-a-long-overdue-shake-up-of-the-retailer-supplier-relationship.html