Buying and Selling Practices

of

Retail Societies

A FOREWORD

A crucial question for Co-operative commercial success - or to put it more starkly and still truthfully - for commercial survival - is whether retail Societies can and do buy from suppliers on terms competitive with multiples and independents and, if so, whether the advantages can be and are passed on to the consumer in the selling prices in shops. We put the question to authorities in various areas of experience, both inside and outside professional Co-operative service and to illustrate it quoted from a recent report by the Monopolies and Mergers Commission "Discounts to Retailers"* which summarised a very incomplete "area price survey" and within that mentioned these items:

"a) For each of the products in the survey (10 in a all) the average buying prices of the independents were higher than the average buying prices of the multiples and the Co-operatives. Over all the products the average buying price disadvantage of the independents was 10%

d) For most individual products the average selling prices of the Co-operatives were higher than those of all multiples but below those of the independents. This result is based on a particularly small sample of Co-operative retail outlets.

f) The gross margins of the Co-operatives were materially higher than those of either multiples or independents. This result is based on a particularly small sample of Co-operative retail outlets."

* HC311 HMSO - £7.50

Editorially we are accustomed to the occupational hazard of silent response sometimes to our most eloquent overtures - but the silence seemed wider and deeper this time. Anyhow this made us all the more grateful to the contributors who have written so relevantly:-

RODNEY ASPRAY Chief Executive since 1969 of Norwest Co-operative Society, prior to that from 1965 was Deputy Chief Executive Officer/ Secretary of the former Manchester & Salford Society; previously spent two years as accountant to C.W.S. Retail Trading Group and two years as Management Accountant in private industry; served six-and-a-half years on the Monopolies and Mergers Commission and is currently a Director of the C.W.S. and Co-op. Bank Limited.

JOHN GALLACHER At present Parliamentary Secretary to the Co-operative Union and a member of the Economic and Social Committee of the European Economic Community.

LORD JACQUES A former student and later a tutor at the Co-operative College; for 20 years (1945-65) Chief Executive of the Portsea Island Co-operative Society; Chairman of the Co-operative Union 1964-70; Government spokesman for the Treasury and Department of Employment in the House of Lords 1974-77; since 1977 a Deputy Speaker.

November 1981 R.L.M.

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1. R.G. ASPRAY

It would be a very reassuring thought to all of us in the retail Co-operative field if we were confident that we bought at the very best prices and passed those benefits on to the Co-operative consumer in the selling prices in our stores. This would satisfy most of our Co-operative ideals in this sphere and justify even those who believe or claim that the way to return Co-operative dividend is not in the traditional way or by stamps but by actual lower prices in our shops - the instant dividend concept which of course has much merit and attraction.

For the purpose of expediency it is perhaps better to refer in an article on this subject to the Food sector only as the Co-operative Movement is not a real force in any other field of retailing with the possible exception of the Electrical sector, and therefore nationally does not justify "best" national buying prices.

Although I include no concrete evidence to support the view only because the evidence is confidential, I do believe that nationally buyers of the Co-operative Wholesale Society do purchase at prices which are on par with those obtained by our national multiple competitors. Indeed, according to the small survey in the recent Monopolies Commission Report on "Discounts to Retailers" this is true, just as from the same source it indicates we buy at better terms than our independent competitors.

Failure to Pass on the Benefits

Unfortunately, it would appear that once having procured our goods at the best terms available we largely endeavour by a combination of structure, performance (or lack of it), and ideals to avoid passing that benefit on to our customers. The very basic structure of our Movement is, in modern retailing terms, the first hurdle of ours, as it demands that we have two balance sheets to service:

a) that of the Co-operative Wholesale Society, our procurer, and

b) each individual Society.

Without going into great detail it is obvious that this fragmented approach must mean slightly higher prices than otherwise would be the case as there must inevitable be an oncost however small for the procurer to service our needs and still make a profit. In our multiple competitors' situation vertical integration means that every available "best buy" benefit is passed on to the consumer via the lowest prices in the shops or remains as "extra" (compared with ourselves) profit in the balance sheet at the end of the day; from, it must not be forgotten, the same starting point.

Variations: Small/Medium Stores

Performance and its effects on consumers falls into two fairly distinct categories:-

a) small/medium sized stores, and

b) large stores.

Our small stores do by and large have average selling prices below those of the "independents" (facts again by courtesy of the Monopolies Commission Report "Discount to Retailers") and because we do buy from suppliers at terms better than the "independents" it would seem to suggest that the benefit of our extra buying power is being passed on to the consumer. Certainly it would be true to say that in this particular marketplace we trade £ for £ as well as our independent competitors and sales and therefore gross profit per square foot are on levels compatible with the best performers in this field. We are thus in the small shop able to acquit ourselves well because we have lower buying prices from which to start, and even when selling at a higher than average gross margin than our independent competitors, end up with a selling price which is better than theirs.

Though not wishing to digress too far from the main theme of the article one might query therefore, why we are forced to close small branches. If one follows through carefully the factors following small shops closure one finds that it is the cost of running small shops compared with our independent competitors which closes them. It is of course, our rightful maintenance of at least minimum Wage Council levels which I believe at the last count 40% of the small shopkeepers do not adhere to, plus sickness schemes, holidays with pay, pension schemes and uniforms etc. which account for this. The independents run largely by family operators rarely have this combination of benefits which we take as standard throughout our operation, and of course, are not hampered by restricted opening hours and trade union protectionism.

- And Large Stores

In the larger store field regretfully if one is looking at the facts fairly it has to be admitted that our problems are caused by our own lack of performance in terms of sales and gross profit per square foot compared with the major multiples in the various fields opposing us. With some few exceptions the Co-operative performance nationally in the large store category is only 50% or at best 60% of that being obtained by our competitors. It therefore becomes inevitable that we are forced into a situation to survive of having to increase our selling prices albeit marginally compared with our competitors, and consequently have higher gross margins than the average multiple with which we are competing.

In the case of large stores of course, we do not have the excuse of saying that we give better salaries and conditions than our competitors. This is patently not so in the case of Sainsbury for instance, and there are others. It is true that dividend on retail sales is an oncost which our competitors do not have, but surely one would think that with the levels at which dividend is paid these days of less than 1% in the £ on average we ought to be efficient enough to stand this out of profits and thus keep up our basic difference which is perhaps the only true one remaining with our major competitors.

The Problems will Remain

What is true is that times are not going to change. The new competitive climate we have been in for the last few years is going to become even more combative and there is no going back to the high gross profit days of yesteryear. Our sales per square foot are not going to suddenly leap up overnight and only a hard slog for efficiency and improved performance will win in the end. Even then, I doubt with our political complexion whether we will ever across the country achieve sales and gross profits per square foot equal to our best competitors, as there does seem to be (however much we try to deny it) a certain reluctance by sectors of the public to shop in our stores. It has been said many times that everybody will shop at a multiple but it seems to be true that a proportion of the politically conservative public will not, on principle, shop at a Co-operative store. I believe there is a certain truth in this, but would not raise it as a major impediment to Co-operative performance. That I feel stems from our image of old fashioned, run-down operations, past fading now across the country, but still firmly imprinted in the minds of the public at large all the same.

From two different standpoints and for entirely different reasons the Movement is therefore applying higher gross margins to the cost of goods it purchases than it ideally wishes to do, and in so doing dissipates the very basic benefits it started with - of buying on terms comparable with the most efficient.

- And the Answers to Them?

What are the answers to this problem of buying at the most competitive price and selling at the highest?

a) Clearly we must make more efforts to reduce to the minimum the oncost of the central buying function from whatever source.

b) We must increase standards of efficiency and presentation in our stores to make them comparable with the best of those of our competitors.

c) We must also break through the image

factor which we still have in many places of being a second best retailer, slightly old-fashioned and not quite the store to shop in.

There are, happily, a few examples across the country, and the number is growing, where this is starting to happen with the newer modern developments, and also in some cases rehabilitation of existing stores to modern concepts, and these examples give a guide and encouragement to our future.

It would seem summing up that there is little likelihood of the Movement being able to solve its problems short term and we shall continue, due to the various factors indicated in this article, not to pass on the maximum benefit of our buying to our customers. We must not become disheartened however, as the overall package and environment one creates for shopping has a great influence upon the consumer and in the ultimate only they decide the price they are prepared to pay for a given set of standards. What we must do therefore, above all else is improve the standards themselves.

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2. JOHN GALLACHER

If one regards the Monopolies and Mergers Commission as a court then their verdict on "Discounts to Retailers" must be taken as not proven. The case under Section 78 of the Fair Trading Act 1973 took an unconscionably long time to try - from July 1977 to March 1981. The MMC report is a painstaking survey of a complex field, although evidence was mainly taken in respect of the food trades, including those staple articles of diet, beer and cigarettes.

It should be stressed that the issue concerned preferential treatment as regards terms of supply. Quantity discounts available to all were excluded. Expectations as to verdict differed greatly. Small shopkeepers and food manufacturers wanted a UK equivalent of the US Robinson-Patman Act. Dominant multiples prayed to be left alone to pass on benefits of strong-arm buying tactics in a gross profit mix which would ensure continued queues at their check-outs. Co-operative societies, who continue to ham-string themselves by separating buying and selling functions, maintained a stunning silence, while consumer groups continued to hope for the best of all worlds, namely, lowest prices from all shops, open all hours on all days. In such diverse and compelling circumstances how wise of the Scots to devise the not proven verdict!

M.M.C. Finding and Recommendation

This is not to say that the MMC burked the issue. They found preferential treatment for large multiple retailers widespread, but also that discounts obtained by these multiples from manufacturers were passed on to consumers and this practice had encouraged competition among both manufacturers and distributors. At the time of the report manufacturers had not been harmed, but the possibility of economic detriment was acknowledged.

The MMC recommended against specific legislation to control these discounts at present, but emphasised the changing nature of the retailing scene and warned against further concentrations of market power by means of take-over bids. The Minister, not having been responsible for initiating the case, welcomed the report and left options open with a reference to new powers under the Competition Act. In subsequent correspondence with the Co-operative Union she washed her hands of the MMC's reference to the role of consumer societies in maintaining retail competition.

Trade response has been predictable. Food manufacturers and small retailers, including those in voluntary buying groups, are disappointed. Large retailers, who share with farmers the ability to conceal deep emotion, are not unhappy. Co-operatives have no views either way while consumer groups currently appear more concerned with trivia such as bargain offer claims.

A somewhat related reference has recently been made to the MMC under the Competition Act concerning refusal to supply and since a timetable exists under this legislation we can expect a report much sooner on this case which involves Raleigh Industries.

The Relevance of R.P.M.

Any consideration of discounts to retailers must be concerned with the position before and after the abolition of resale price maintenance in 1963 during Mr. Edward Heath's tenure of the Board of Trade. Little was heard before then about discounts. If they existed they were necessarily concealed from consumers because manufacturers had and used the legal right to maintain retail prices. The broad effect of this was to give a fair profit margin to small retailers and perhaps a large one to multiples. The right of supply was with manufacturers and whereas Co-operative societies experienced few supply difficulties in food retailing, where they were strong, they were refused supplies of leading brands of non-food merchandise upon the grounds that dividends on purchases constituted a price cut even if payment of these was deferred.

Unsavoury practices had grown as a result of the protection afforded by resale price maintenance. For example, in the retail motor trade, garages which declined to maintain prices had a system of private courts with fairly stiff powers. These were, however, on the fringe. The main objection to R.P.M. was that it stifled competition and multiple retailers backed by consumers and, more mutedly, by retail Co-operatives campaigned for its abolition.

Results of its Abolition

As not infrequently happens with legislative change, the results turned out somewhat differently from what advocates of change expected. In non-food price competition for branded merchandise became a reality, but consumers claimed that certain manufacturers' recommended prices, which are still legal, were sometimes inflated to mislead shoppers about the extent of price cuts being made. In radio, television and electrical goods, servicing charges were increased so that after-sales costs were higher following the abolition of rpm than before it. The garage trade continued merrily with trade-in selling so that two transactions had to be considered before motorists knew whether they were better off.

Retail food provided the most ingenious examples of the way a victory over suppliers was used by retailers to serve their own ends. Instead of a rash of price cuts of brand leaders in the food trades there was a rapid development by large multiples of own brands, usually retailed at prices below the brand leader, and often giving a better rate of gross profit than leading makes. Food manufacturers were, and are, at the receiving end of this change in merchandising style. Consumer organisations, over-joyed at the abolition of R.P.M., found own-branding acceptable and concentrated on the demand for unit-pricing of foods. Manufacturers promoted brands by coupons giving so much off either a current or future purchase. These are of doubtful validity and are disliked by shoppers and retailers.

The abolition of R.P.M. coincided with a generally high level of economic prosperity world wide and in Britain multiple retailers discovered the operational benefits of employing self-service methods in large units. Until the Fair Trading Act 1973, mergers were unrestricted and indeed the Labour Government from 1964-70 encouraged size for its own sake. Individual retailers succumbed to offers for their sites in the High Street and multiple market dominance was intensified. Having achieved this dominance, certain retailers were able to negotiate further sites, particularly in many development schemes, from positions of strength and both planning authorities and property developers succumbed to the proposition that "without Messrs So-and-So it will be difficult to let the smaller units".

Still Further Concentration in Retailing

These developments need to be seen in context because the MMC report warned about further concentrations of power in retailing. Mistakenly they saw this happening as a result of further take-overs and wanted investigations of bids under the Fair Trading Act to control it.

The MMC overlooked the fact that leading retailers are now expanding by reason of success in gaining planning consents for superstores and hypermarkets rather than expensive take-overs of shops in now crowded city centres. The nature of our planning system is that individual local authorities grant consents without reference to other than very general criteria suggested by central government.

The outcome of this situation can now be measured, admittedly at a time of recession, by the fact that half-a-dozen food retailers are dominant in Britain in terms of both sales and, more important, profitability. In general these firms occupy the best sites, including car-parking provisions, and their announced expansion proposals do not appear to allow for possible refusal of planning consents. On present trends they will have market dominance of the type against which the MMC warns. This is not to say that consumers will necessarily be disadvantaged, but they could be. Meanwhile there can be little doubt that suppliers will be compelled to go on providing discounts and the steady elimination of small shops must continue unless some assistance is given to enable them to remain in business to serve neighbourhoods including the elderly and deprived. At the planning level the Department of the Environment refuses to acknowledge the existence of the problem of too many consents gained by too few retailers.

Assistance to small shopkeepers could take many forms including rate relief and even rent subsidies. Governments recognise only agriculture and industry as necessitous and in the present climate of local government finance any extension of help to the small shop seems remote.

Value of a Modified R.P.M.

In the light of practical experience since abolition, would not a return to a modified system of R.P.M. serve to keep the small retailer alive? The only trades successfully to defend the case for fixed prices were books and patent medicines. The law of abolition outlawed price maintenance across the board unless the Restrictive Trade Practices Court decided otherwise in particular instances. Early decisions were so definitely against that few cases came to court and lawyers advised clients against hearings.

What I have in mind is that an individual manufacturer be given the right to maintain a retail price for either a particular product or a range of products. He would have to notify the Office of Fair Trading of his intention and his reasons for so doing. The OFT would have the right of challenge before the Court, but would not normally do so unless it had reasonable grounds, e.g., the product in question already had, say, 25% of the market. Collusion with other manufacturers would continue to be illegal.

Conditions for being allowed to maintain prices would include the obligation to supply all credit-worthy retailers prepared to observe the price as well as lodging a price list with the OFT showing the profit margin granted to retailers, including quantity discounts. Revisions of the price list would be allowed subject to the OFT being satisfied as to reasons given. In order to maintain the price, shopper discounts, whatever their form, would not be allowed. This would preclude promotional coupons, trading stamps and, I fear, dividends on purchases.

The foregoing may rank as heresy with its implementation being so unlikely that economic side effects are not worth even speculation. Critics must either express satisfaction with the situation as it is now, bearing in mind what is written above, or postulate alternatives. Perhaps a less rigid, more representative inquiry could be sanctioned than is possible under MMC procedures. I have not discussed the implications of modified R.P.M. within the context of our membership of the European Community for reasons of space and personal ignorance.

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3. LORD JACQUES

The recent survey by the Monopolies and Mergers Commission on "Discounts to Retailers" based upon very limited samples came to the following conclusions:-

1. Buying Prices

Based on a sample of ten commodities the multiples and Co-operatives had an advantage, averaging 10%, over the independents.

This is not surprising. Independents normally buy from a wholesaler in small quantities. Multiples and Co-operatives normally buy in large quantities for direct delivery to larger shops or to a central warehouse which feeds smaller shops. They bear the costs of warehousing and delivery from warehouse to shops which, in the case of the independents, is borne by the wholesalers. It is, however, surprising that this advantage is, on average, as high as 10%. If it is, there are, perhaps, two reasons: where there is direct contact of the manufacturer with a large retailer the former often bears much of the cost of promotions to get across to the large market. The other reason is "end of run terms". To secure a large contract which gives additional output the manufacturer is sometimes prepared to accept a relatively small contribution to overheads, because without the additional output he would get no contribution at all.

2. Selling Prices

The average selling prices of Co-operatives were higher than those of all the multiples but below those of the independents.

In general, this is not surprising. The Co-operative is committed to giving a service to a local community, with shops not merely in the town centre, but in the suburbs and villages. The multiple can come in with one large shop and "cream off" the trade. The economies of the larger shops are well-known. It is, however, surprising that the average selling prices of all the multiples were lower than those of the Co-operatives. This is due to the fact that the result was based on a particularly small sample of the Co-operative retail outlets. The sample was too small to give reliable results.

3. Margins

The gross margins of the Co-operatives were materially higher than those of either multiples or independents.

That they were higher than the multiples is not surprising. Retail development in the last 25 years has been dominated by economies of scale. Self-service made the organisation of the supermarket and hypermarket possible and motor transport gave them the market. The multiples have taken full advantage of it. Co-operatives have been inhibited by their commitment to give a service to a local community. Their members want to retain the smaller shops, but do not necessarily accept the higher prices required to cover the higher costs - democracy in practice.

That they were higher than the independents is not just surprising, it is astonishing. It is admitted that the sample of Co-operative retail outlets was particularly small. Not only do the costs and prices of retail societies vary from society to society, but individual societies usually have outlets of different sizes with different costs per unit of sales and consequently may have two or more price levels within the one society. A particularly small sample is not likely to give a true result. There is another possibility. As already explained, societies usually buy in bulk for direct delivery to large shops or to central warehouses for distribution to smaller shops. The costs of warehousing and delivery to shops is borne by the society. The independent does not have these costs. They are borne by the wholesaler. So if the comparison is with the total Co-operative margin, i.e. the difference between buying and selling prices, the comparison is unreal.

Paying for the Co-operative Service

Good buying is vital, but it does not stand alone. Associated with it are the costs to be borne after delivery. Warehousing and delivery to shops can absorb much of the saving of buying in bulk. If the object were to get the goods to the members at the lowest possible cost then societies would trade only in very large shops taking direct delivery in bulk - hypermarkets. In practice, service to the members is an important consideration in a democratic Co-operative organisation and this can cost money. In the competitive world in which societies have to operate there is a very strong case for two or more price levels within a society. Somebody has to pay for service. Should it not fall upon those who receive it? This does, however, raise other problems, such as the advertising of a society's prices in the press and on radio and television.

One of the objects of C.W.S. regional warehousing was admirable. It was to eliminate duplicate warehousing, first by the C.W.S. and

and later by the retail society. In practice, another object is to form voluntary groups based upon a wholesaler on the lines of "Spar". Inevitably, the wholesaler has a vested interest in the perpetuation of wholesaling in an era when an increasing part of the retail trade is being done by retailers with many shops who take direct delivery to their own warehouses and/or large shops and thus by-pass the wholesaler.

Many of us, brought up in the retail side of the Movement, believe that it will get its goods to the retail outlets at the lowest cost by the same method as its principal competitors - national buying directly integrated with retailing. We hoped that it would move to a retail-based national society as outlined in an article I wrote for the "Co-operative News", published 20th March 1971. In C.R.S. there is the basis of such an organisation.

Amalgamate C.W.S. and C.R.S.

However, we have to be realists and to bear in mind three things. First, the C.W.S. has ultimate control over C.R.S. For example, at general meetings the C.W.S. has "as many votes as shall be equal to the total number of votes which could have been cast on behalf of all the regions or branches". Second, many societies desire to keep as much of their independence as possible. For example, they will often accept help from the C.W.S. in return for an obligation to take future supplies from the C.W.S., rather than join up with C.R.S. Third, in the present economic climate C.R.S. cannot be expected to be able to carry the whole cost of rescue operations, it will have to have help from the C.W.S.

Bearing these things in mind and the urge to co-ordinate Co-operative buying power, we should expect amalgamation of C.W.S. and C.R.S. sooner rather than later.

In these circumstances I would urge:-

1. Direct delivery to shops wherever this is more economical.

2. Some local control over warehousing to co-ordinate it with retailing.

3. Adherence to any standard list of goods to be encouraged by price rather than prohibition

4. Capital available to be used to improve retailing rather than providing over-sophisticated warehouses.