IPLC

The Retailer Brand Specialists

RESEARCH REPORT 2022

Surviving the Cost Crisis

An opportunity for Private Label manufacturers

IPLC

About International Private Label Consult
IPLC is a consulting firm specializing in strategic consultancy services and project management support to manufacturers and retailers. With a broad and unrivalled understanding of the Private Label industry we help our clients with a pragmatic and action-oriented approach. Our services include strategy development and private label sales and negotiation skills training.

Founded in 2003, IPLC has been involved in many international assignments for manufacturers, retailers and the supply industry. IPLC has offices in the Netherlands, United Kingdom, Ireland, France, Spain, Belgium, Italy, Portugal and Russia.

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Surviving the Cost Crisis

INTRODUCTION

The cost of everyday grocery items has seen significant inflation in the last two years.
When the global pandemic struck in February and March 2020 we saw an immediate spike in demand for take-home groceries as shoppers stocked up to prepare for anticipated lockdowns. Demand briefly out-paced supply but by May 2020 shoppers had learned quickly that panic buying was not necessary but consumption was being impacted by some 'new normal' dynamics. The key consideration at this point was that the hospitality sector; cafés, hotels, restaurants and bars were severely impacted by lockdowns and restrictions internationally. This had an effect on supply demand dynamics as consumption switched almost entirely into the home.
Food commodity prices fell initially but began ticking back up again from June 2020 and have continued to rise since then.

The shared focus for retailers and suppliers in 2020 was two-fold:

1. Keep Covid out of stores, factories and distribution centers.
2. Keep the retail shelves stocked to prevent shopper panic.

It was a time of great turbulence but was characterised by widespread collaboration between retailers and suppliers. The industry rose to the challenge, but there were new challenges just around the corner.

This report seeks to achieve three things:

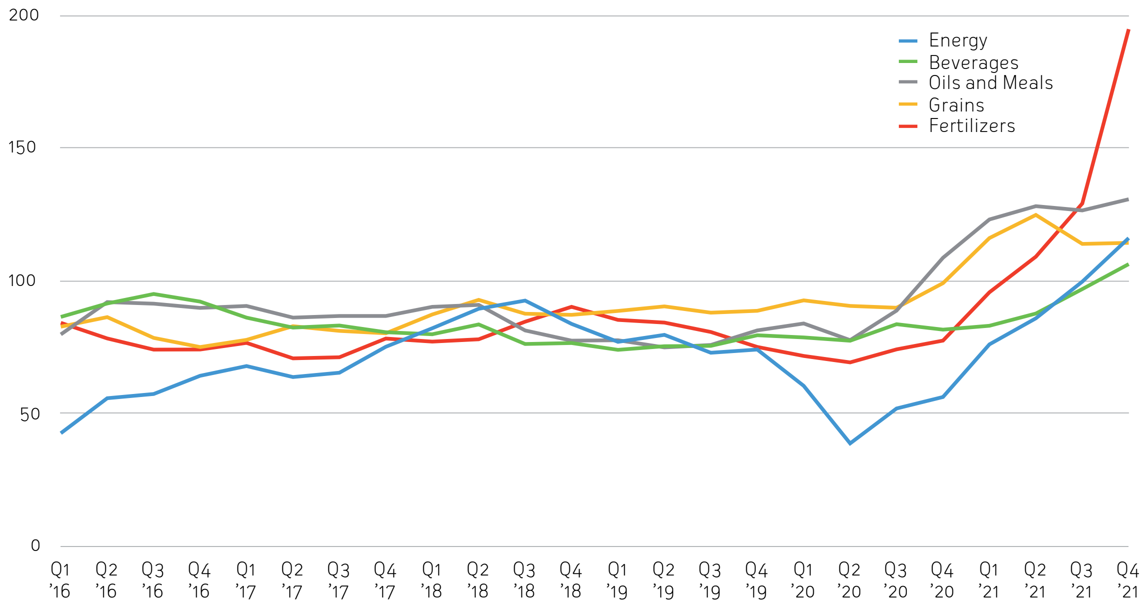
1. To explain why costs are increasing.
2. To share how suppliers and retailers are managing this cost inflation.
3. To help suppliers who are struggling to make progress in achieving cost increases.

RESEARCH METHODOLOGY

To explore the current cost inflation challenge IPLC undertook a series of research and engagement exercises that have enabled us to bring you this report:

- In June 2021, we held an online seminar with 160 attendees to share learnings and gauge sentiment across the grocery supply chain.
- In November 2021, we launched an online survey which was completed by almost 100 companies from 13 countries with combined sales value of over €30bn.
- We conducted extensive desk research during November/December 2021.
- In December 2021, we hosted our second online seminar with 350 registrations from 23 countries, mainly private label grocery product manufacturers.
- In January 2022 we engaged 33 private label manufacturer companies, from seven different countries, in one-on-one interviews to explore their challenges in more depth.

World Bank Quarterly Average Commodity Price Indices 2016-2021[1]



The Inflation Challenge

Having demonstrated strong collaboration through 2020, the grocery supply chain had hoped for some normality in 2021 with the promise of vaccines to tackle Covid, but the year turned out to be almost as challenging as 2020. Whilst countries struggled to manage infection rates and therefore experienced different levels of lockdown restrictions, the grocery industry had to stay nimble and adapt in-store protocols accordingly. With labour and transport shortages, retailers and manufacturers struggled to maintain 'business as usual.' One extra complication was the resulting impact on costs, constantly rising across all the industry's key input categories – raw materials, food ingredients, packaging, energy, transport & labour. Effectively, all of the big-ticket cost items in the manufacturer P&L were seeing significant inflation for a variety of quite complex and interconnected reasons.

COST INFLATION BY CATEGORY OVER LAST 12 MONTHS [2]

Cost Input Category	Average % Cost Increase in 2021
Raw Materials	19.3%
Packaging	18.8%
Transport & Logistics	15.2%
Electricity	25.3%
Labour	8.4%
Other costs	12.2%

The thirty-three suppliers we spoke to directly and the 95 who completed our survey pointed to overall in-bound cost increases of between 11% and 14%.

SO WHY ARE COSTS RISING? [3,13,14,15,16]

Harvest yields on key commodities like wheat have been mixed in 2020 and 2021. In addition, weather conditions have not always been ideal so, even if yields have been good, quality has been compromised, driving up the price of premium quality wheat for flour.

After an initial drop due to reduced consumption, oil prices have been strong since the early days of the pandemic when the OPEC countries strategically reduced output volumes. Higher oil prices create a knock-on effect on other energy sources such as natural gas and, in combination, higher energy prices impact on production and logistics costs.

The various lockdowns around the globe effectively showed just how fragile the supply chain was. Lockdowns meant that migrant workers could not move around, which put significant pressure on growers and their cost to harvest.

Then, we saw the emergence of domestic labour shortages. This has had a serious impact in the food processing and logistics sectors where, for example, eastern European staff who had settled in western European countries, travelled home to reunite with their families after the lengthy lockdowns.

There have been other supply chain dynamics with shipping container shortages due to port closures and imbalanced trade patterns. Animal health added additional complexity with 2021 seeing avian flu, swine flu and mad cow disease impacts internationally.

Geo-politics has added another layer with sanctions against Russia following their activities in Ukraine prompting export duties on wheat.

Now we are looking at prolonged turbulence in 2022 thanks to high fertiliser prices prompting lower harvest yields.

Additional Cost Factors [4]	% Agree
We are still carrying costs in relation to covid hygiene protocols	81%
Unpredictable demand planning is an ongoing cost	68%
My customer's evolving sustainability demands are leading to increased costs	66%
Administration costs have increased in the last 12 months	45%
We are still carrying increased costs in relation to remote working	13%

HIDDEN BUSINESS COSTS

In addition to these direct and mostly well documented costs there were also more hidden costs impacting manufacturers. Covid is having an ongoing impact on business costs thanks to the business continuity protocols that have been required. The pandemic, and consequent lockdowns have also created unpredictable demand planning challenges which create costs due to the increased inventory requirements to maintain service levels.

Food Price Index - 2006 to 2022 [5]

HISTORY REPEATS ITSELF?

Some of us will remember that a similar food commodity cost spike happened in 2007-8 around the global crash, and again in 2010-11. The 2007-08 commodity cost spike reversed within a year, but in 2011 it took 5 years for the cost inflation to fall back, so who could predict what might happen this time? This is an important consideration both for the retailer's competitive position and the manufacturer's anxieties around relationship management and long-term financial stability.

THERE ARE FIVE KEY DIFFERENCES THIS TIME AROUND

1. Limited range discounters have grown strongly in most markets. In 2007, suppliers seeking a cost increase from their biggest customers were probably negotiating with a full-range, large footprint, multiple supermarket. Back then, multiples were more focused on back margin, rebates and long-term agreements. They were less focused on the actual cost of the product. But in the intervening fifteen years, the discounters have penetrated strongly and private label is a much bigger part of the picture. The biggest customers are now often discounters who have considerably more control and visibility of the costs. It is going to be more difficult for suppliers to negotiate a cost increase in this context. Taking the Irish market for example, in 2008 Aldi and Lidl had a combined 10% share whereas in 2022 they will have over 26% share of the market. Thanks to this, Ireland currently has one of the lowest rates of food inflation globally, which indicates a tough environment for suppliers with cost inflation challenges.

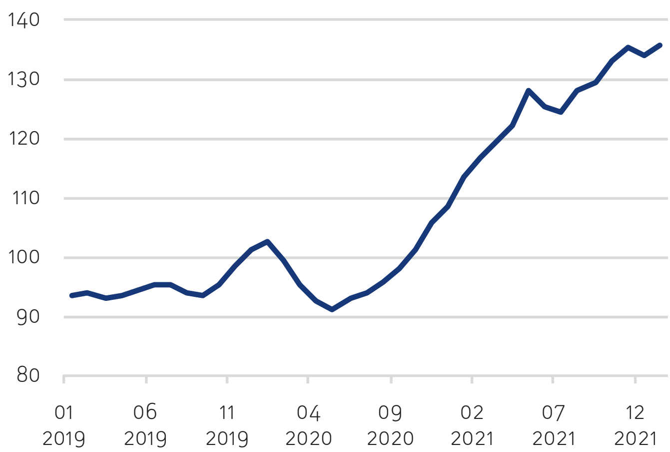
2. Over the last 15 years, in an environment of rising discounter penetration, the established multiple retailers were losing market share and had to respond. And those competitive strategies consisted largely of refocusing on a bigger and better private label range and a sharpened price position. The impact of this is that most retailers stock the same core of 1,400 high volume, low margin products. They are highly price sensitive and it is especially difficult for the relevant suppliers to negotiate a cost increase because the retailers feel that they cannot pass on a retail increase. The market for these commodity products can almost be considered as a 'perfect market'. It is structured to have no anomalies that would otherwise interfere with the best prices being obtained. From a competition law point of view, there should be no link between cost prices and retail prices, but all the players know and understand that some products are more price-sensitive than others and that applies to both the cost price and the retail price.

3. The market has seen three food commodity price spikes in the last fifteen years. But the last ten years have been deflationary across all food commodities. Ten years of cost deflation has fed into continuous reductions in retail prices and consumers have come to expect cheap food.

4. When suppliers broach the issue of cost increases with their retailers, they are likely to be dealing with buyers that are 30 years-old or less. They are young, ambitious millennials, and they communicate differently to their predecessors. This is a real challenge for suppliers, who are older on average, at a time when communication and collaboration is so important. The biggest challenge with this new breed of buyers is that they have no memory of the previous price hikes in 2007 and 2010. Some retailers have a corporate memory loss. They have lost the skills needed to manage a cost increase. They do not know the tricks of the trade around reducing pack sizes, managing their investment in promotions, reformulating products or optimising the supply chain to look for efficiencies. Those tactics have been partially lost so it is up to suppliers re-educate the young buyers.

> *"We face inexperienced young buyers with no memory of price increases in the past. Prices only went down over the past decade and they got used to this as being normal. But it is not!"*
>
> All quotes are from participants in the interviews

Food Price Index - Jan '20 to Jan '22 (6)



5. The current cost inflation has continued for almost two years. In 2007 the price spike was quickly followed by a drop in 2009. But this time, between March 2020 and March 2021, food commodity prices increased by 25.3%. Suppliers may have negotiated price increases with their customers at that point. The problem is that between March and December of 2021 food commodities have continued to inflate by a further 14.4% so suppliers will need to review this again.

The Inflation Challenge

ARE SUPPLIERS ACHIEVING COST INCREASES FROM THEIR CUSTOMERS?

In June 2021, over 70% of polled suppliers had already requested a cost increase from their retail customers. Many were successful, but 54% were actually feeling downward cost pressure in response from their retailers. And for those that achieved a cost increase in mid-2021, it quickly became apparent that they would need to go back and request additional increases. We asked this question again in December 2021 and found that 93% of companies had achieved some degree of cost increase but they flagged many challenges with this.

"We first sent our clients a letter 4-5 months before the first talks… 'we see major cost influences appearing and want to warn you of what is coming'. A few clients, notably retailers, responded aggressively and a few others such as industrial clients said: 'we see the same'.

DIFFERENT EXPERIENCES OF SUPPLIERS SEEKING COST INCREASES[7]

Statement	% Agree
We will reflect cost increases at the next tender	78%
We will need to request a second or third cost increase from our customers	65%
We are currently supplying below-cost on certain products/customers	54%
Our key customers have refused to engage on cost increase discussions or are using delay tactics	43%
The retail prices in our category are increasing to reflect the cost inflation	41%
We have achieved cost increases but our customers are not reflecting these in increased retail prices	35%
Our company is experiencing severe financial strain currently	35%
We will cease trading if we do not achieve the necessary cost increases	28%
We have agreed cost increases with our smaller accounts but not the bigger customers	21%
Our key customers are demanding cost decreases	20%
We have not requested cost increases because we are in a contract and fear damaging our relationship	12%
We have an open book / cost-indexed relationship with key customers so cost changes simply flow through	9%

From these answers we can see the scale of challenge facing manufacturers currently. The big retailer customers are often using delay tactics or are refusing to engage with their suppliers, sometimes using contracts to stave off the inevitable. But as contracts are reviewed in Q1-2022, nearly 80% of companies said they will be increasing their quoted costs.

When polled in December 2021, suppliers had agreed cost increases averaging +6.8% but 43% of respondents had achieved only an increase between zero and 5%. So, looking into 2022, 95% of suppliers told us they will need to achieve further cost increases averaging +8.8%.

In the meantime, 54% of companies are continuing to supply below cost on some products to selected customers with the effect that 35% of manufacturers are under severe financial strain and 28% will cease trading if an appropriate cost increase is not agreed. The implications for the P&L are too dramatic for suppliers to cross their fingers and hope for the best. Here is an example of a simplified P&L for a food company who is dealing with the cost inflation factors that we have already described.

"We were too early in April 2021 and had some difficulties with this first request, then 1st September we came with another 10% increase that the majority of customers accepted... but only 40% of it."

SIMPLIFIED SUPPLIER PROFIT AND LOSS

	2020	2021
Net Sales	€87.0m	€87.0m
Cost of Sales	€78.2m	€89.8m
Overheads	€4.0m	€4.1m
Net Profit (After Tax)	€4.2m	-€5.8m
NP%	4.80%	-6.70%

With the help of our network we created an example supplier turning over €87m in 2020 and producing a net profit of 4.8% after tax, which would not be abnormal for a private label specialist. That is a cash profit of €4.2m. With all of the increases fed in, the P&L changes dramatically. The cost of sales goes up by almost €12 million and as a result the €4.2m profit turns into a -€5.8m loss or -6.7% net profit after tax

WHAT PRICE INCREASE IS REQUIRED TO MAINTAIN PROFITABILITY?

	2020	2021	+6.8%	+8.1%	+13.9%
Net Sales	€87.0m	€87.0m	€92.9m	€94.0m	€99.1m
Cost of Sales	€78.2m	€89.4m	€89.5m	€89.5m	€89.5m
Overheads	€4.0m	€4.1m	€4.1m	€4.1m	€4.1m
NP (After Tax)	€4.2m	-€5.80	-€0.6m	€0.4m	€4.8m
NP%	4.80%	-6.70%	-0.70%	0.40%	4.80%

So, the average 6.8% cost increase that suppliers have negotiated so far has not been enough to cover the costs that are flowing through this P&L. A 6.8% increase would still leave this supplier losing €600k over the course of a year. An 8.1% increase would see a net profit of 0.4%. And it would require a 13.9% increase to their customers to get them back to 4.8% net profit.

"We are now in the 3rd round of increasing prices: 2 times raw material price increases and 1 time freight price increase."

ARE COSTS FLOWING THROUGH TO SHOPPERS?

Grocery retailers are facing a tsunami of cost increase requests currently and they do not like it. They work off low net margins and they are hyper-aware of their competitive position in the market so it has always been the case that prices rise like a feather but fall like a brick. But this time it is different. There are genuine capacity and availability challenges so some suppliers are in the unique position of giving 'take it or leave it' cost increases whilst others are stuck in the mud, trying to make contact with a buyer who is avoiding their calls and who is delaying the annual tender because they know it will bring bad news.

This is a global issue but food inflation is increasing at different rates in different countries[11,12]. We can see wide variance across the world in terms of current food inflation. In the US, for example, food inflation sits at +6.3% year on year. In Poland it is up +8.6% , in Germany +5.9% and in the UK +3.8%. However, in Ireland and the Netherlands food inflation still sits at less than 3.0%, which would suggest that even if the retailers are taking some cost increases, they are holding back on passing them on to consumers. This is as a risky strategy because we do not know how long it is going to take for these costs to reduce.

So, why are the cost price increases for food so variable around the world? There are a number of reasons:

1. Suppliers are not requesting the necessary cost increases, possibly because they are stuck in a contract. This would seem a risky and unsustainable strategy given what we know about tight margins in food and drink production. Very few manufacturers have the reserves to indefinitely postpone cost increases of this magnitude but they are very wary of damaging the relationship with retailers.

2. Retailers are paying cost increases to their suppliers to help maintain good long-term relationships and on-shelf availability, but they are holding back on passing these on to consumers for fear of losing their competitive position. Unless retailers can find additional margin in other parts of their business, this would seem unsustainable, especially if the cost inflation has not yet peaked and could take several years to fall back.

3. Retailers are delaying or refusing to accept supplier cost increases and suppliers are selling below cost and crossing their fingers, hoping for their input costs to fall during 2022.

In reality there is a mix of all three options happening but all are risky, even in the short to medium term for five reasons. If the supply chain does not find solutions to pay the prices that are required, then there are risks.

RISKS

1. **Business failures:** If suppliers do not achieve cost increases with their customers then their financial position is weakened. If this is allowed to continue, then there will be industry consolidation and some companies will cease trading.

2. **Loss of trust:** If retailers and suppliers push back too hard on cost increases then someone, somewhere in the extended supply chain could cut a corner. After the cost spikes of 2007-8 and 2010 we observed an increase in high profile food fraud and food safety incidents. If your company gets caught up in one of these incidents the reputation impact could be even more damaging than the commercial and relationship fallout of walking away from low margin contracts.

3. **Sustainability:** We know that 66% of supplier companies are carrying additional costs as a result of the retailers' ambitious sustainability strategies. Sustainability is the new competitive territory for retailers and some of the initiatives come with bottom line benefits due to reduced waste and reduced consumption of energy and raw materials. But some of the initiatives comes at a cost, one that many retailers are unwilling to pay. There is a risk that these sustainability initiatives will be cancelled or postponed by hard-pressed suppliers because the commercial position does not allow them.

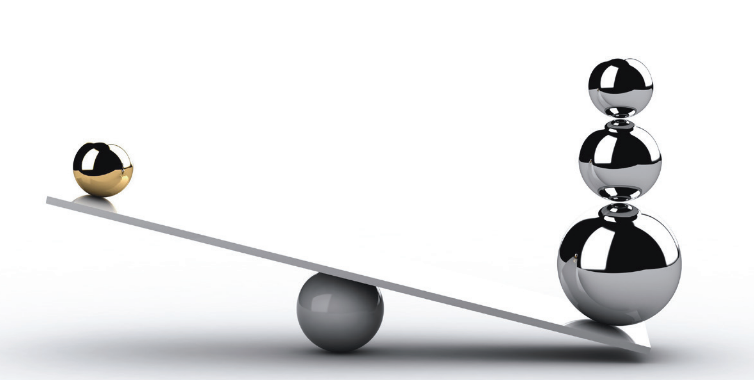
4. **Supply Security:** In some cases the risk is that retailers will push the supplier too far, presuming that there is no risk to availability. But this is not the case, especially in the current climate. Many suppliers are ceasing supply if it no longer makes commercial sense. In a period of limited capacity, suppliers are often prioritising availability to retailers that are paying them the required price.

"One customer completely ignored the price increase for the raw materials. By the time they realised there was no escape, they were too late. There was no availability for the 3,000 tonnes of a key ingredient because they had not listened to the market. A range of SKUs had to be delisted."

5. **Innovation & Business Development:** If retailers will not pay the necessary cost increase, some suppliers are opting to maintain supply whilst slashing costs. This means reducing the resource available to maintain collaborative account management. Senior account managers, product development and category insights team members can often be let go in a desperate short-term effort to hold the cost price of the product. However, this will impact business development in the medium term since there may be insufficient experience within either the supplier or retailer teams to identify and realise opportunities in the categories.

Our recommendations

"We created a new team composed of purchasing, finance and commercial due to the very pressing situation. The objective has been to prepare very well the new prices and arguments for when we are in front of our customers."



1. MITIGATIONS

Securing a cost increase is not the only solution. There are other mitigations. And again, from the survey, we found out that suppliers were already engaged in various cost mitigation activities.

- 42% of suppliers are already working on reformulating products.
- 38% of companies were reducing pack sizes.
- 49% had reduced their investment in promotional activity.
- 42% were saying that they had limited capacity to supply, so they were prioritising that supply to the more profitable accounts.
- Half of the suppliers that responded said they were simplifying their range to add efficiency in their factories.
- 43% said that they were looking at collaborating with their industry peers and potentially their competitors to find efficiencies.

If you have not done it already, launch a review of the end-to-end supply chain as a priority. Look for efficiencies such as the units per case or cases per pallet. Look for areas where the established ways of working are adding costs without adding value. If less frequent deliveries could be managed, then think about taking this saving. If longer shelf-life can be achieved then bring this to your customers as a mitigation. Or if a cheaper print technology could be applied to shelf ready cases then really ask if the shoppers would rather have shiny boxes more than a retail price increase?

NEGOTIATION SKILLS

The current inflation has forced suppliers into some particularly tough negotiations. On one hand they are negotiating with their own raw material suppliers. But often the raw material suppliers have capacity issues so these are often 'take it or leave it' discussions. If they want to maintain service levels to their retail customers, then suppliers are forced to pay the price being asked. On the other hand, suppliers are facing into tough cost increase negotiations with their big retail customers. The bottom line is that even the smaller retailers are significantly bigger than most suppliers so there is an immediate imbalance of power. Here are a few more reasons why suppliers find it so hard to negotiate with retailers.

1. Firstly, sellers love selling, but they do not always love negotiating with retailers. Only 40% said they enjoy negotiating and 65% of respondents said they found it stressful. This is not surprising since their opponents, the retail buyers, love negotiating. They are ultra-competitive in almost every waking moment and when these personalities work together in a buying team, they create a strong culture of always-on negotiation and competition.

2. The retail buyers are also negotiating with much greater frequency. A sales manager might have a few key accounts but the buyer has ten times as many suppliers to deal with and can be managing negotiations for hundreds of products. This gives them an advantage because they negotiate much more frequently and are more match-fit.

"We did negotiation training last June and when we did it, we understood clearly that we needed it."

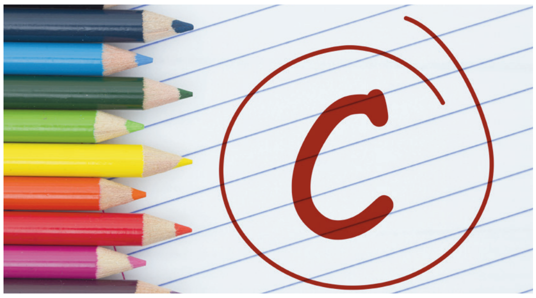
"I do not believe our sales managers are well enough trained for this situation. The negotiations are very tough and we do not have a formal training or toolbox."

3. Buyers work for big, powerful retail organisations. They have ambitious expectations and they expect to achieve them. They are aware of their leverage advantage because if the relationship breaks down with one supplier, they have learned that there is likely another to step into their place. This gives them a powerful mindset advantage which they project onto their opponents. Suppliers are aware that they need their customers, more than their customers need them. Only 14% of respondents felt that they had more leverage than their opponents which introduces a significant mindset disadvantage even if this is not the reality.

4.. Suppliers are highly collaborative in nature, it is their natural inclination. But they are aware that the buyers are negotiating competitively. Given this competitive nature and their leverage advantage, retail buyers are much more likely to be unfair, to bluff, to negotiate aggressively and stretch the truth. This undermines the confidence of sellers who can often reduce their own ambitions even before they have pitched a proposal. In many countries, regulations have been introduced to stop retailers from abusing their power, but the problem still persists and most suppliers would be hugely hesitant to make a formal complaint to a Groceries Ombud or Competition Authority for fear that they would be black-listed or targeted in some other way by retailers.

5. The retail buyers are trained on negotiation skills much more regularly than their supplier counterparts. Retailers understand how important it is for buyers to constantly sharpen their swords, to deploy new tactics, to develop new skills as their experience develops. A third of supplier respondents said they had never received any formal negotiation skills training. Only 24% were currently investing in upskilling their teams with negotiation skills training. Half of respondents had done some negotiation skills training in the last five years, but that means the other half have not. Some rely on the past experience of their sales team – but times move on and, with it, the playing field of negotiation has changed.

Combine all of these factors and it appears a mammoth challenge for suppliers and sales organisations. And the results back this up. When we asked suppliers if they normally achieve their negotiation objectives, only 53% agreed. In an exam, this would be a C grade.



It is a pass, but it is not a great result. And this is how too many supplier organisations go about their business. They pass but do not excel, they stay in business but they are not so profitable that investors are banging on their doors to offer their money.

SO, HOW CAN SUPPLIERS TRY TO EVEN UP THE POWER IMBALANCE?

We think there are 3 core skills for any negotiation: Preparation, Game-planning and Aiming higher.

But we also know, from training hundreds of sales professionals that these skills are often redundant without two other factors: Belief and Culture.

In this report we will focus on Preparation. This is all about researching and understanding the background to the negotiation. This requires you to ask the right questions:

1. How is the market performing, and your opponent specifically?
2. What are the key market dynamics?
3. What are the key outcomes we want from this negotiation?
4. What will our opponents want from this negotiation?
5. What stakeholders should we consider?
6. Who is my opponent, what is their profile and motivation?
7. Is this likely to be a competitive or collaborative negotiation?
8. What is my fall-back plan?
9. Should we meet face to face, through video or will a phone call suffice?
10. At what point will I walk away?

Our recommendations

UNDERSTANDING INFLATION DYNAMICS

Specific to the current cost inflation crisis, your focus should be on understanding the dynamics impacting your cost increase request. This requires suppliers to use all the resources available:

- Independent sources like Mintec, IndexMundi or the UN Food & Agriculture Organisation track a wide range of commodity prices globally. Comtell focuses on fresh meat price trends, XE.com is currency focused whilst Kairos looks at both commodities and currencies. There is so much great information available publicly – ignore this at your peril!
- Internal experts like your logistics and procurement colleagues can provide customer facing salespeople with vital insights.
- Your own suppliers who are experts in their field can give useful information.
- Companies House or Dun & Bradstreet provide useful information on the financial stability of both your customers and suppliers.
  Do not think for a second that retailers would not research your financial position to prove that you are too profitable for their liking.

> *“We feel that, more and more, it is necessary to support what we say with data.”*

Always remember, whilst understanding the current dynamics, do not forget to consider the likely future picture. Understanding the reasons for specific ingredient inflation will help you form a view of the possible future dynamic. And make sure that all of the cost inputs are captured in your cost models.

Too many companies have basic cost models where previously insignificant or ‘constant’ factors are not captured. But in a time when everything is costing more, you need to get an accurate picture of your true costs and these insights must be shared across the organisation so that all functions can be part of a mitigation plan. And finally, be aware that many retailers will have created their own models so that they can get an alternative view on your cost request logic. Mintec provide such a model but it still may not reflect your actual costs since it does not know your specific dynamics in terms of forward-purchasing materials, hedging currencies or the specific pressures of your labour market as opposed to national averages. Be ready to defend your positions on these factors.

> *“This time, given the significant variation in both the raw material and the packaging and energy, we had to negotiate a step-by-step increase with periodic checks”*

SWOT ANALYSIS

A SWOT analysis is possibly the single most fruitful exercise you can do in preparation for a negotiation but it is important to do it right. A good SWOT analysis has some important ingredients:

1. Utilise some diverse thinkers in your organisation. Make sure you have a mix of genders, cultures, age profiles, and functional expertise. This will bring cognitive diversity and can help avoid blind spots.
2. Look at everything in depth. Break your organisation down into all of its constituent functions, everything from procurement to innovation, HR to sales and marketing. SWOT each of these individually before moving on to SWOT your key customers, suppliers and competitors. This will give you a robust 360 degree view of the markets and key stakeholders
3. Take your time and allow a full day for the exercise.
4. Use a facilitator to provoke discussion and join the dots to identify the emerging themes.

> *"For our sales force it is more important than ever to have solid and sound arguments in the negotiations. Product and market knowledge as well as a good explanation why a price increase is justified is key."*

COMMON TACTICS

We have already demonstrated that there is an imbalance of power in the majority of supplier/retailer relationships. And we know that the retailers tend to invest much more in their buyer's negotiation skills training. For these reasons, its vitally important to be aware of the tactics they may use and how you can counter them: Here are some examples that came up in our research.

1. **Delaying:** This is where the buyer ignores your contacts. You have sent several emails, left many voicemails but they have gone into hiding. Equally, they may eventually communicate but will space out the meetings such that progress is painfully slow. In this case, do not hesitate to escalate quickly.

2. **Excessive Detail:** The customer requests increasing levels of detail from your accounts and cost models to decide whether your request is valid or not. On the upside, requests for back-up data are a recognition that the cost inflation crisis is real. The retailer may simply want to be sure that they are paying the correct increase.

   But beware, just like when the movie detective reads a suspect their rights "anything you say can and will be used against you", good buyers will use your own data against you when the tide turns and they are hunting for cost decreases.

   Make sure you are 100% transparent or else it will surely come back to haunt you in the future. And if you are questioning the level of detail you need to provide, think about it in terms of your relationship with that specific customer. If you enjoy an open and collaborative relationship then you might share more. If it is a competitive, transactional, hard-bargaining relationship then you might share less. And if a retailer is asking you to effectively open up your books to them, then consider that this can be leveraged as part of a multi-year partnership deal.

"Whilst resistance to cost increases is often experienced from buyers, more collaboration can be achieved once the buyer's superiors become involved. The more senior you go the more sympathetic they are"

"Industrial clients understood, we work with them more in a partnership. But retailers simply denied it and kept on saying no, no, no!"

3. **You are the only supplier asking for a cost increase:** This is the first level of response from a buyer who is overwhelmed and unprepared to have a negotiation. They know that suppliers are notoriously bad at sharing insights with each other so they try to convince you that you are the only company coming with cost increases. Perhaps it is true that you are ahead of the game, that you can see what is on the horizon more clearly than your peers. But more likely is that the customer is simply gas-lighting you with a make-believe scenario that you are the only one with these problems and that you should go away, run your business properly and solve them on your own.

   This is where benchmarks and independent references become necessary. Sources like the UNFAO, Mintec and IndexMundi provide verifiable and credible evidence of raw material cost trends. Farming newspapers regularly publish the prices paid for agricultural produce. National government statistics offices will track inflation across various cost inputs. And if you put yourself in the shoes of your customer, they will also be under pressure to pay increased costs for their own electricity, labour, transport and packaging needs.

   Always look out for signs of inflation in your customers business. If they operate in-store restaurants or delicatessen counters, this is where you will often see inflation first. Do not be surprised if the core 1,400 high volume, price sensitive SKUs do not show any signs. But look in the peripheries and you will see it in price increases on non-food in/out promotional SKUs or food and drink SKUs that are not discounter-matching. It could be that the retailer softens their promotional activity to save investment. Or they could cut back on operational expenses. The stores may start to look just a little less sharp and the till queues might be a little longer in peak trading because the store is trying to hit tougher KPIs on productivity. Use all of these signs to help neutralise the argument that it is only your business experiencing cost increases.

4. **Contracts:** Retailers will often refer to the agreed contract pricing as a tactic to delay cost increases. You should seek your own legal advice but remember that in many countries the contract was only there as a means to protect the supplier from a retailer's continuous downward cost pressure or threats of pulling the volume. The contract should not be regarded as a weapon that forces suppliers to supply below cost because of unforeseeable, 'force-majeure' scenarios like a global pandemic and a supply chain meltdown.

   Make sure your team is fully trained on local laws and regulations such as GSCOP in the UK and the The EU Directive on Unfair Trading Practices in the agricultural food supply chain. And if the retailer is out of line, you can gently remind them of the risk to their own business. If the situation is critical, then there may be a risk to your overall business if you do not break the contract and seek a cost increase. There is no overwhelming evidence that the cost increases of 2020 and 2021 will be rapidly reversed in 2022 so you will need to make a call.

   Just take some comfort that you are not the only one renegotiating costs mid-contract, and do not hesitate in approaching your customer with new required cost prices.

> *"Do not postpone, do not worry. Not to do is more dangerous. Loss of market share or brand awareness you can recover. A bad economic situation of the company can be fatal."*

> *"Private label is different because you're more than a partner so it's better to be transparent"*

5. **Extreme Positions:** if you try to be in the customer's shoes, you will see that the buyer is under incredible pressure to hit previously agreed financial targets. Therefore their objective is to hold the current costs and maintain supply. In negotiations we often talk about the ODA positions.

- The Optimal best case scenario position
- The Desirable position that you would be happy with
- The Acceptable position which is the least you would accept

We know that a basic rule of negotiation is to ask for more than you need. This allows both parties space to concede a little to their opponent. So if the buyer wants to hold current costs (their desirable position), to achieve this they will likely ask for a cost decrease (an optimal position). You can be sure that whatever your opponent opens with, it will be an extreme position that they are willing to move from.

That said, in these recent exceptional circumstances, some suppliers believe it has been better to be totally transparent and went in with exactly the cost increase they needed. As the rising costs have been so widely and publicly reported, retail customers have at times struggled to argue the case.

> *"Negotiations have never been so easy - everyone is aware of the extreme cost increases"*

6 **Nuclear Options:** This is where the retailer threatens to stop ordering, to pull the contract away from you, delist your products and switch to one of your competitors. You stand to lose potentially all of your business with that customer so it forces you to think really long and hard about pursuing your cost increase request. Equally the supplier can threaten to stop supplying since a below cost scenario is too damaging for the supplier's long term financial position. Both sides can use nuclear options in a negotiation but historically it has normally been the retailer that has sufficient leverage to consider it. And often they deploy this tactic towards the end of a negotiation to wring out the last few concessions: "Do you really want to risk losing all €20m of business because of one cent per unit?"

"Security of supply is key, and therefore we see a shift in negotiation power, retailers become more dependent on suppliers."

Again, make sure your negotiators are up to speed with local regulations. The retailer may not be allowed to simply pull the business if it represents a certain percentage of your total turnover. And always remember that a good SWOT analysis could give you the confidence to call your opponent's bluff, but make sure to have overall business alignment to allow you to negotiate with confidence and empowerment.

When it comes to suppliers playing this card, it does not necessarily need to be delivered in the form of a threat. It could be that any concessions on cost price will need to be reflected in specification changes. Equally, due to raw material shortages and delayed lead times, many businesses are only ordering key components like packaging once the retailers have agreed to pay the new price. It is not that you are threatening to stop deliveries, rather that your procurement department will simply not order the necessary raw materials. And if nothing else is working, and your buyer is simply not engaging, then the suggestion of deliveries being stopped should get their attention. There are few things worse than an empty shelf for a retailer. In our webinar in December our poll showed that 20% of suppliers had already threatened to stop deliveries if the new prices were not agreed. 66% stated that it was under serious consideration and only 14% felt that it was a step too far since it would damage the long-term relationship.

"I encouraged my sales team to challenge the buyers, to be courageous. One cannot be expected to continue supply if it drives you into bankruptcy."

Remember that a buyer's key KPI is that of availability – it is no good having the lowest possible cost price if you do not have the product on your shelves. Every now and then, the "nuclear option" can be effective from the supplier's side, and maybe the power imbalance is shifting a little as supplier dependency increases.

WHAT ELSE MIGHT HELP?

Our interviews identified a few more strategies that appear to have helped suppliers in their quest for survival through this escalating cost period. A focus on the most important customers and products, whilst ensuring availability is prioritised, has helped.

Being pro-active, as a supplier, both in the past and now has proved worthwhile in building relationships of trust and openness with the customer. Offering cost reductions in the past, without the customer requesting them, builds trust and places the supplier in a stronger position when costs need to rise.

"We have focussed on the most profitable customers/products in order to save the best contracts, and we have bypassed the most basic products, not caring about losing them in order to improve the product/customer mix. Very important also to guarantee a very good service level - being a reliable supplier in the delivery of orders has been essential in this crisis."

"We have been cost mitigating all the time: we have given 4 cost reductions to one customer in the last 10 years and this cost increase is the first in all that time!"

FUTURE DYNAMICS

There is an assumption that pandemic related disruptions will sort themselves out relatively quickly. This is reflected in comments from economists and central banks who are suggesting that the current record level inflation will begin to moderate through 2022 and 2023. But beware, this only means that the inflation rate will reduce slightly. It does not mean that your cost inputs will get any cheaper, just that they will inflate at a more moderate rate. When we asked the participants at our December webinar, here is what they told us.

- Only 11% felt that costs would return to pre-pandemic levels in the next 12 months
- 40% felt it could take up to 3 years
- 11% felt costs could correct within 5 years
- But 38% felt that costs may never return to 'normal' levels

"Some buyers showed anxiety and embarrassment to justify the acceptance of the price increases in their company. In this case, we helped them to make a good impression internally, for example by offering some additional marketing (e.g. category analysis) and promotional services at the same time as increasing prices"

Conclusion

The challenge remains for the overall food and drink supply chain to make sustainable profitability a priority at all levels. And this is eminently possible if all players take an honest and transparent approach. And if retailers claim that consumers simply will not pay more for food then think about how we got to our current situation. Prices have not deflated over the last 10 years because consumers were unwilling to pay. Prices have deflated due to retailers fighting for continuous sales growth and market share. And a portion of the money saved by consumers was simply redirected to spend on food and drink in cafés, restaurants and hotels instead. When we asked shoppers what they would do if their grocery costs increased by 10% here is what they told us[10]:

- 70% said they would save money by doing more scratch cooking
- 63% would shop around and look for special offers
- 59% said they would cut back spending in cafés and restaurants
- 55% said they would switch out of brands into mid-tier private label items
- 47% said they would absorb the increase and make no changes
- 31% said they would switch from shopping in a big supermarket to a discounter

Certainly, the short-term provides some great opportunities for businesses involved in offering good value-for-money. Spending power is reducing internationally, and consumers will be looking to optimise their budget by buying more products on promotion and visiting more low-price retailers.

Private label is well poised to take advantage of this, as it usually does in times of inflation or recession. Retailers will continue to look to differentiate from their competitors and offer great, innovative new products. It is definitely time for private label manufacturers to seize the opportunity.

Looking at the long-term, we know that the human population is forecast to grow by 25% in the next 30 years. That is an extra 2 billion human mouths to feed from our planet's resources. And we also know that there is a climate crisis where global warming is causing the sea levels to rise. Rising sea levels is causing flooding and salination of agricultural land which reduces the crop yield. Flooding and extreme weather events are causing damage to harvests. It feels like the era of cheap food is over.

In future, our grocery retailers are going to have to find new ways to compete other than on price. Otherwise, local suppliers will go out of business, farmers around the world will exist in poverty, and sustainable employment will be lost in the communities in which the supermarkets operate. Remember March 2020 when suppliers moved mountains to keep up with the demand prompted by panic buying and lockdowns? Well, two years later, those same suppliers need their retail customers to exercise that same collaborative spirit, paying a fair price that recognises the inflationary crisis we're in right now.

Conclusion

Finally, there are three themes that emerge in this report: Urgency, Transparency and Collaboration.

1. **Urgency** because suppliers are under extreme financial pressure right now and some will not survive without immediate cost increases.

2. **Transparency** because retailers will not agree to cost increases unless they can fully understand the reasons and driving forces.

3. **Collaboration** because there are always solutions to be found through the supply chain if suppliers and buyers can work together to discover those pockets of waste or inefficiency.

We wish to thank all of the suppliers who took part in the webinar surveys, polls and face-to-face interviews. Contact IPLC for private label insights, strategy development and private label sales and negotiation skills training.
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