IPLC The Retailer Brand Specialists

RESEARCH REPORT 2023

The Evolving Balance of Power

How private label suppliers and buyers can win through collaboration

IPLC

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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, Germany, Belgium, Italy and Portugal.

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Executive summary

We're all so busy dealing with today's challenges that it is easy to forget just how much change and volatility we've seen in the last three years. Brexit, pandemic, the Russian invasion of Ukraine and the consequent inflation crisis mean that all private label manufacturers have been required to negotiate cost increases with buyers, many of whom had only experienced cost deflation in the previous decade. These suppliers were operating in markets where limited range discounters had redefined their model and were leading a revolution in private label perceptions and penetration. And they were dealing with retailers who had developed a corporate memory loss on how to manage an inflationary cycle.

At IPLC we have seen the balance of power subtly shifting back and forth between manufacturers and retailers. Two years ago, some manufacturers could foresee the emerging inflation cycle and were requesting initial cost price increases. Not surprisingly, the retail buyers deployed the inevitable delay tactics but, following the invasion of Ukraine, these inflationary pressures only heightened. Between spring and autumn 2022, retailers were forced to accept unprecedented cost increases and there was no other option if they wanted to maintain on-shelf availability. But the retailers didn't like it. It sat uncomfortably with a historical perception that suppliers need retailers more than retailers need suppliers. Since then the retailers have been actively working on ways to find cost savings, improve their margins and regain momentum as the power player in the grocery supply chain.

Between January and April 2023 we carried out four phases of research uncovering some powerful insights in the process.

There have been some very challenging conversations between buyers and manufacturers in the last two years. Retailers pushed back hard but the inflation challenge was too big to ignore. Most suppliers were forced to place a question mark over their ability to supply without appropriate costs increases and this is when things started to get moving as it was a signal to the buyers that it wasn't sustainable to continue supplying. Some suppliers even had to resort to ceasing deliveries, which would previously have been considered a nuclear option. But very few reported any damage to their key relationships. Empty shelves certainly focus the attention for retailers and there's a sense that stopping deliveries was as much about helping the buyers to manage their internal negotiations, to highlight the enormity of the problem and facilitate sign-off on a new cost price. In fact, most suppliers are reporting that the tone has changed significantly. Buyers are much less confident in their ability to guarantee continuity of supply and a new era of collaboration and mutual respect has emerged. Unfortunately it looks like elevated prices will be a problem for some time to come. The

rate of inflation will reduce as we overlap the initial sharp inclines of mid-2022 but there is no genuine confidence that costs will return to pre-crisis levels since many of the causative factors are still at play. The challenge will be for retailers and suppliers to maintain trust and transparency and to be able to demonstrate that they are collectively doing everything possible to mitigate cost increases for shoppers and certainly not profiteering. If they don't, then there is a real danger of widespread government interventions via price capping which will be messy and likely not have the desired result. At the same time the grocery sector must find ways to manage and mitigate the inflationary impact of other government policies

So, if elevated food prices are here to stay then shoppers are going to continue looking for ways to save money. Depending on the market, discounters may use this inflation pressure to entice shoppers into their model. However, in more mature markets where discounter and private label share is already high, then we may see some new competitive strategies.

Even if shoppers don't switch to a cheaper store, they are certainly switching to cheaper options. And depending on their financial situation this could bring sales growth to all private label tiers, entry, mid and premium. Private Label will continue to take market share from the brands but buyers and suppliers must be careful to avoid repeated value-engineering phases. The buyers will move category and not be around to see the long-term results of diminishing quality. So it is as much a role for suppliers to play the guardian of quality because they have much greater continuity and long-term memory.
Quality is just one factor though. Where previously the value equation was 'Value = Price + Quality' it is now apparent that 'Value = Price + Quality + Sustainability + Availability'. But there are major challenges on the horizon. Managing volatility, finding efficiencies, implementing sustainability strategies and retaining talent are some of the biggest. To achieve this ever-demanding balance it will be necessary for suppliers and buyers to collaborate at levels never seen before. End to End supply chain visibility, digital transformation and collective problem solving will be the new ways of working. This will require trust and commitment which can be enabled by longer term, more transparent deals possibly underpinned by open-book arrangements that remove the conflict and allow everyone to focus on category, supply chain and production innovation.

Research methodology

IPLC is a strategy consulting group specialising in the unique world of private label consumer goods. We help our clients to develop an ambitious vision for their business and strategies to bring it to life using private label as a key strategic lever. With a presence in 9 countries across Europe, IPLC has created an ecosystem of thought leadership and sharing best practice on private label. Our key asset is our network of private label supplier groups (PLGs). These groups are organised in each country where we have a partner presence and are a place for private label manufacturers to share their challenges and find out what's working in peer companies. Despite the various covid lockdowns, our PLGs enabled us to stay on the pulse of this very dynamic and buoyant sector. Through 2020 we saw heavily disrupted supply chains and by mid-year we were observing the first signs an inflation cycle. Through 2021 and 2022 we observed retailers deploying new strategies. Some were long-term, collaborative and partnership focused. Others were short-term, tactical and aggressive. The objective of our research was to explore this apparent new world of buying and selling, to understand the emerging dynamics, to look into the future and share ideas on how best to manage risk and realise opportunities. The research was conducted in four phases.

PHASE ONE: The IPLC partners shared their observations across diverse European markets. We brainstormed these dynamics and collectively identified ten topics to probe further in phase two.

PHASE TWO: The IPLC partners interviewed 35 private label suppliers in 10 different European countries exploring the ten topics we had identified in our initial brainstorming exercise. This qualitative data was then validated in the next phase.

PHASE THREE: An online survey was created to collect quantitative data on the key questions. We collected data from more than 140 companies from 12 different countries with a combined annual turnover greater than €90bn. The final survey question challenged respondents to identify their three greatest business challenges between now and 2030. We distilled the interview feedback, combined with the survey responses to create a shortlist of the key challenges for private label businesses from 2023 to 2030.

PHASE FOUR: We then convened a panel of six private label suppliers including both SME and larger multinational companies representing diverse categories from 5 different countries. IPLC facilitated a horizon scan workshop where we discussed the key challenges on the horizon.

1

Brainstorm

2

Interviews

3

Survey

4

Horizon Scan

We wish to thank all of the suppliers who took part in the interviews, poll and the Horizon scan.
Contact IPLC for private label insights, strategy development and private label sales and negotiation skills training.
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Country reports

The starting point in this research was a brainstorm exercise carried out by the whole IPLC consultant team in January 2023. Our team consists of 12 private label experts in nine countries, with a combination of retail buying and sales professionals. Many of the trends we see are common internationally so we decided to create a top-level summary of the unique factors around food inflation, retail dynamics and buyer-supplier relationships in each country.

Country	Private label Share	Private label Growth	Market Growth	Inflation Food	Discounter Share	Comments / date of data
United Kingdom	52.3%	14.1%	+9.4%	19%	17.7%	Value tier +46%, but only 4.7% of all PL. Premium tier 8.4% of all PL. Kantar 12 w/e 16/4/23
Ireland	46.9%	+15.6%	+11.5%	+16.6%	25.4%	Value tier +30% but off low base. Kantar 12 w/e 16/4/23
France	36.1%	+17.5%	+10.1%	+16.2%	11.0%	Data Circana End of March 2023 & Kantar 12 w/e 04/04/2023
Germany	46.0%	+9.2%	+10.6%	+19.8%	36,9%	Private label growth driven by value tier
Portugal	44.4%	+12.3%	+9.8%	+19.6%	18.8%	No growth in value tier, Data Nielsen March 2023
Spain	41.3%	16.7%	11.6%	+14.4%	11.9%	Private label growth and discount switching. Data P2/3 2023
Netherlands	51.3%	+18.3%	+10.1%	+17.7%	16.2%	Discounter switching. Data P2/3 2023
Italy	30.1%	+11.0%	+6.7%	+12.1%	22.5%	Discounter and private label switching. Data Dec 22/Apr 23

Source: Data is a mix of Kantar, Nielsen and IRI depending on country.

IRELAND

Limited range discounter market share has grown rapidly from zero to 25% since 1999. This is one of the highest market shares for discounters globally. Both Aldi and Lidl harnessed the last recession to form an emotional bond with Irish shoppers through communications and range strategies focused on Irish provenance, supporting local and winning quality awards. Ireland has a discounter store for every 14,000 head of population compared to 21,000 in the UK, despite a much less dense population distribution. The multiples (Dunnes, SuperValu and Tesco) have all responded to discounter growth by countering with a mix of e-commerce, discounter price-matching, private label range expansion, loyalty card rewards and money off vouchers. And as a result, shoppers don't have a burning reason to switch to the discounters, who already having 95% shopper penetration, have less scope to win big during this current cost of living crisis.

In fact, Aldi currently is struggling to gain any market share growth. Shoppers in Dunnes, SuperValu and Tesco can feasibly decrease their weekly grocery spend by purchasing more private label. But Aldi, who were previously the price leader, have delivered a bill shock to their more price sensitive shoppers. Price inflation combined with a significantly expanded brand presence has eradicated the 'thrill at the till' which was the basis of their proposition. We could therefore see expanded entry price ranges but this will dilute margins and prompt mitigating actions such as expanded branded and premium private label ranges. Alternatively we might see a price war but only if it is enabled by cost input reductions.

Irish supermarkets generally don't reveal their annual profits and there is an emerging narrative from politicians around price gouging and potential government intervention via price capping. But intervention is complex, possibly counterproductive and unlikely to happen so shoppers will likely continue to buy more private label and carefully manage their purchases to generate less food waste. But the single greatest saving on food and drink spend will not be achieved in grocery stores, but in the HORECA sector as people spend less money out of home.

PORTUGAL

There are two dominant retailers collectively controlling over 50% of the grocery market. Continente at 28% share is the number one player, with Pingo Doce number two at 23.5%. The discount sector is dominated by Lidl with a market share of 12.5% and they have grown share by 0.8% in the last two years. Spanish retailer Mercadona entered the Portuguese market in 2022 and has already achieved a 3.5% market share. In some regions where they have established good store coverage, they are near to a 10% share driven by an extensive private label range combined with a real focus on the consumer.

Private label share has increased dramatically, from 39.7% in December 2022 to 44.8% in March 2023. This phenomenal growth clearly illustrates the pressure on Portuguese household budgets but the growth is being seen mainly on mid-tier Private label ranges. Budget private label has only 0.5% share of sales and has not grown despite the cost-of-living crisis. Portuguese retailers run price promotions on both branded and private label product ranges. Historically brands have promoted more heavily to defend their market share versus private label. Decreased promotional activity on brands is allowing private label products a greater competitive advantage.

On 28th March the Portuguese Government agreed to scrap VAT on 43 essential food items. The Portuguese Prime Minister estimated that "Between support for production and loss of tax revenue as a result of zero VAT, this programme has a total cost of around €600 million". This has increased the focus on price increases by the media but it is also complicated for manufacturers to recover the VAT from Government.

SPAIN
Government legislation has added cost pressures, including truck loading & unloading regulations, the Food Chain Act, the Single-use Plastic law for the Foodservice sector and a new Plastic tax for non-recycled plastic. On the other hand, from 1st January 2023 the Spanish government has abolished VAT on basic food items such as bread, milk, fruit, vegetables, and eggs and reduced VAT on products like oil and pasta. Grocery volumes for Q1-2023 are declining -0.7% in Spain, which is lower than many other EU countries, but with brands declining more than PL. There is value growth, but only because of inflation. However, private label sales are growing at twice the rate of the manufacturer brands. Retailers have shown more willingness to agree to commodity market trackers for raw materials, and the price gaps between A-Brands and private label have reduced thanks to private label inflation hitting 17.8% compared to 14.8% for brands. Retailers in Spain are focusing on sustainability, healthier products, and new culinary trends.

ITALY
As of April 2023, Italy's market has experienced a 5% decline in volume, but value growth continues. Discount operators Eurospin, Lidl, MD Discount, Penny Market, Aldi and others now account for 22.5% value market share. To offset rising costs, retailers are focusing on improving production and distribution efficiencies through range rationalization. But this is a threat to smaller Italian retail chains who face challenges in securing production of private label due to their lower volumes and the manufacturer's desire to cut the range tail. Italian food exports are in high demand, with a growth rate of 15%. Italian retailers are also running marketing campaigns with a focus on price and convenience. Carrefour is expanding through franchising. The government has launched an investigation into the significant increase in the price of Pasta compared to the general inflation rate which continues the recent trend of EU governments intervening in grocery pricing.

GERMANY
In Germany, the government has reversed the VAT reduction that was implemented during the Covid pandemic and this has contributed to an even higher inflation rate. The market dynamics are largely shaped by the fact that Germany has the largest discounter market share in Europe.

Retailers are concerned about losing shopper loyalty if they do not carry the key private label products. Branded sales are declining, requiring promotional efforts to move volumes. To reduce costs and improve sustainability, value engineering and packaging reduction are being implemented.

NETHERLANDS
The grocery market is experiencing changes driven by demographic shifts, including the increasing number of single-person households, more women participating in the workforce, and the growing impact of young consumers who spend more on out of home consumption whilst prioritizing quality and convenience in their eating habits. Retailers are placing more emphasis on sustainability and local heritage, so when a supplier is capable of meeting their complex requirements it is much less likely that they will be delisted at the next tender. Some smaller suppliers in private label have gone out of business, and market consolidation is occurring with retailers Deen, Coop, and Jan Linders all being acquired by competitors. Despite holding a 6.5% market share, pure online grocery retailers are struggling to match the overall growth rate of the market.

The minimum wage increased by 10.15% in January 2023 and will be further increased by 3,13% in july. However, government policies aimed at reducing nitrogen emissions will have a long-term negative impact on Dutch farming output since fertilizers and animal waste are two of the prime sources.

The Dutch government plans to publish a list of 3,000 most polluting farms with a plan to close them in 2023. A €1.5bn support will be provided to farmers to reduce nitrogen emissions. This is more of a hard stop than a transition to less intensive agriculture and it should be closely observed for two reasons. Firstly, it is possible that other EU nations will follow suit. Secondly, the Netherlands is a significant exporter of fresh produce so closing 3,000 farms will have an immediate impact on availability and cost prices that will be felt in other EU nations. As an example, in Ireland the discount supermarkets have created iconic promotional programs based on cheap fruit and vegetables. The products were often sold below cost and continuous downward cost pressure gradually undermined the viability of the less intensive Irish Horticulture sector. So there will be ripples felt well beyond the Netherlands.

UNITED KINGDOM

The Big 4 have undergone significant changes in the past two years, with Asda and Morrisons being taken into private ownership. The discount channel has experienced remarkable growth in the same period with Aldi surpassing Morrisons in value terms to become the UK's 4th largest retailer in 2022. To prevent consumers from switching to discounters, both Tesco and Sainsbury have launched Aldi Price Match campaigns. Furthermore, Tesco and Sainsbury now offer promotional prices linked to their loyalty cards, a strategy that has been successful for Tesco since 2019 and is now being imitated by other retailers such as Co-op, Boots, and Morrisons, who plan to launch in 2023. Asda and Morrisons have expanded their entry price range and lowered prices, resulting in budget tier private label accounting for 4.7% value share and 7.8% volume share. Tesco no longer uses its name on the budget tier, with Tesco Value being replaced by their 'Farm Brands.' Tesco faced considerable criticism in 2016 when they launched a series of produce brands from non-existent farms. But this strategy was based on Aldi and Lidl's use of 'exclusive brands' and is now being emulated by Sainsbury. UK consumers are facing some of the highest food inflation in Europe and Brexit may be playing a role. Immigration controls have tightened labour supply and the UK pound has depreciated so imports are more expensive. UK shoppers are managing their weekly grocery budgets by changing where they shop, changing the types of products they purchase, and buying less overall.

FRANCE

Early 2023 has seen a continuation of the volume declines of 2022. Unit sales for Q1 2023 are down -4.2%, with branded volumes at -8.5% seeing steeper declines than private label where volumes are down -6.6%. Inflationary pressures are prompting French consumers to find ways to save. Brands are losing market share to private label. Fresh categories have seen both value and volume move into ambient categories. But even Premium Tier private labels are struggling with a decline of -13.3% primarily impacting Organic and Regional Specialties. However, the budget tier has grown by +5.5% albeit from a low share of 5% of total private label sales. The French Government has introduced legislation enforcing a minimum margin of 10% and restrictions on promotion mechanisms, such as 'buy one get one free' for most food products under the Egalim legislation. This has added significant complexity especially for private label negotiations and contracts between suppliers and retailers.

The last 3 years have been deeply challenging. The coronavirus pandemic created significant supply chain disruption, made worse by Russia's invasion of Ukraine. As societies were beginning to reopen after lengthy lockdowns the war led to further disruption and dramatic inflation through rising energy, transport and food & drink commodity costs.

Scarcity of certain raw materials, along with retailers and suppliers trying to navigate their way through surging cost increases, soon led to availability issues and sharply increased retail prices. 2022 saw significant changes in consumer behaviour across all spending channels, with FMCG industry players having to react quickly simply to ensure survival.

Both retailers and suppliers have had to step up throughout this exceptional period, firstly ensuring that products were available to consumers in safe store environments, and secondly ensuring that high quality products remained available to the consumer at competitive prices.

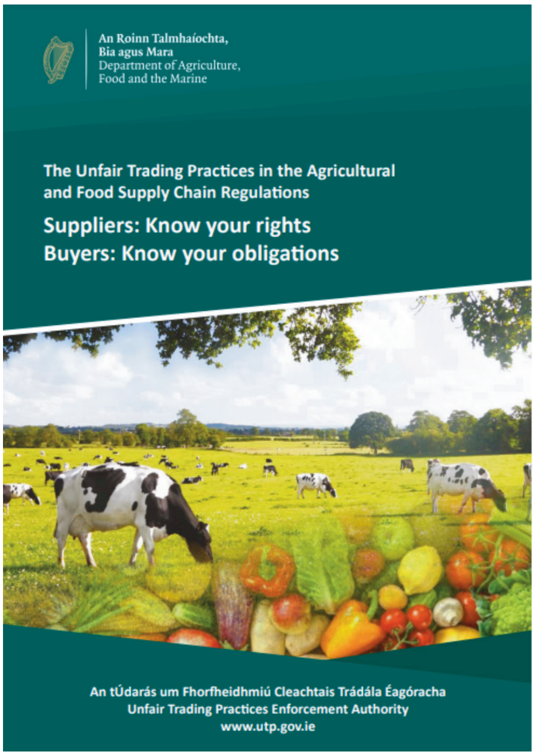
In order to achieve this, both retailers and suppliers have had to adapt their ways of working, both within their own organisations and between each other. Private label has played a significant part in this. To explore the changing dynamics between suppliers and retailers we carried out interviews with 35 industry leaders and collected online survey results from over 140 companies internationally.

> *"We do not live in an era of change but in a change of era". (Supplier, Germany)*

THE EVOLVING BALANCE OF POWER BETWEEN RETAILERS AND SUPPLIERS

In highly evolved retail markets we have historically observed a gross imbalance of power between grocery suppliers and supermarket retailers. For evidence we only need to look at the UK's 2015 Grocery Supplier Code of Practice, Europe's 2022 Unfair Trading Practices legislation and other country-specific laws that are designed to protect suppliers from the bad behaviour and abuse of power that have become standard practice for some supermarket retailers.

However, the market has changed in the last 3 years. When circumstances coincide to the extent that they have since 2020, it's simply not tenable for retailers to say 'not our problem' to suppliers who are dealing with force-majeure inflationary pressures. Whilst many retailers initially reacted with disbelief, there was nowhere to hide from this inflation crisis. If buyers were not willing to pay the required price then they quickly saw negative impacts, with reduced availability and sometimes empty shelves. And every other supplier was in the same difficult position so retailers could not simply switch to another source. In fact, most suppliers were deeply reluctant to take on a new retail customer because they had supply issues and capacity constraints to contend with regarding their existing customer base.



“Our buyer actually asked me to stop supply. This allowed him to demonstrate the seriousness of the situation and to justify internally to accept the price increase. It allowed him to deliver proof the price increase just had to be accepted.”
(Supplier, Netherlands)

After the initial shock, most retailers began working in a more collaborative manner. For buyers, it was as much about understanding the driving forces so that they could explain it to their business and manage their internal stakeholder negotiations. There was a realisation that the cheapest price on paper was of no value if the shelf was empty and shoppers were switching to competitors. This sense of collaboration should not have been so surprising given the degree of close cooperation seen when grocery retail buyers and suppliers worked together to manage the massive uplifts caused by covid lockdowns. But we have seen before that retailers can 'talk' collaboration but ‘act' differently. It took some time for many buyers to get to grips with the enormity of the inflation caused by the pandemic and the Russian invasion of Ukraine.

Our interviews indicated a strong sense that the balance of power had tilted towards suppliers. There's no doubt that retailers are still more powerful but the imbalance has been corrected somewhat.
The engagement between retailers and suppliers is much better now than before the pandemic. But the mindset of both parties took time to change. Suppliers were, at first, almost afraid to approach their retail customers with cost increases as the level of increase was so high. Retailers' initial position was always going to be refusal since many younger retail buyers had only experienced cost deflation during their short careers and simply did not know what to do when faced with cost increases.

But as the cost crisis became widely reported through the media, retailers started to show more understanding and consideration, realising that suppliers were only trying to recover genuine cost increases. Suppliers then started to feel comfortable keeping their retail customers informed about further cost increases and managed their expectations accordingly.

In our follow-up online survey we found that a small majority (51%) feel that suppliers still need retailers more than retailers need suppliers. This percentage doesn't change when we strip out the responses that came from retailers rather than suppliers. But it gets really interesting when we dive a little deeper. 60% of respondents felt that private label suppliers have more power now compared to before the pandemic, war and inflation crisis. This makes some sense given that private label is the key strategic lever that retailers can use to demonstrate innovation, differentiation and value, which are especially important factors in a cost-of-living crisis. Our interviews revealed that Private label suppliers have a unique opportunity to build a deeper relationship with retailers since they are not solely focused on delivering their brand plan but are more inclined to think about the overall category and the holistic needs of the retailer and shoppers. But the key dynamic that has caused this shift has been supply chain volatility and the associated inflation and availability challenges. 62% of survey respondents agreed that retailers now prioritize on-shelf availability over having the lowest cost price. Further, when problems arose, 63% of respondents felt that there was a much more collaborative approach to shared problem solving by retailers and suppliers. 66% agreed that communication had improved and 69% felt that retailers were actively interested in suppliers being sustainably profitable.

“We don't know how to use this newly gained power”
(Supplier, Germany)

In countries where sustainability is a greater priority we learned that collaboration on managing cost inflation was almost instant. The buyer/supplier relationships needed to deliver meaningful sustainability programs require real collaboration and longer-term partnerships, which also means that suppliers are harder to replace.

“Historically the buyers have treated us like punchbags.”
(Supplier, UK)

Research findings

"The dynamics of our negotiations have changed dramatically. Previously we didn't feel like we had much power, but in 2022 it felt as if we were going in with a Kalashnikov whereas they sat there with a water pistol." (Supplier, Belgium)

There are different perspectives though. For example, 58% of suppliers felt that buyer/supplier interactions were less confrontational than before but only 37.5% of retailers agreed, possibly because they didn't feel they were being confrontational in the first place! Some suppliers feel the balance of power remains firmly with the retailer, especially in countries like Germany where very few retailers command a large share of the total market. Some suppliers mentioned that the balance of power can change, depending on which category is involved. Where there are many potential private label suppliers in a category the power stays with the retailer who can move business from one supplier to another quite easily. However, if a category only has one or two private label suppliers then the power is with those suppliers.

It seems that the overall power remains with the retailer since it is their investment in distribution and retail store networks that provides a credible route to market for the supplier's product to reach end-users. However, the past 3 years have led to retailers learning to appreciate their suppliers in a different way. It's no longer solely about hitting the lowest price, rather a collaborative approach from both parties is now a necessity, not an option.

But with industry consolidation making the big retailers even bigger, the balance of power may have nudged towards suppliers but the power still sits with the big buyers. The question is, how will they choose to leverage this power? The more effective buyers are already shifting their focus away from 'demanding' the lowest price in favour of 'enabling' the most efficient supply chain. So, forecasting, demand planning, sharing insights and open communication are becoming much more important features of sustainable supply contracts.

PLEASE SHARE YOUR THOUGHTS ON THE EVOLVING BALANCE OF POWER BETWEEN RETAILERS AND SUPPLIERS	Agree	Neither	Disagree
Retailers actively demonstrate that they need a sustainably profitable supply base	69%	21%	10%
We are communicating much more openly now, sharing insights, managing expectations	66%	20%	14%
There is more collaborative problem solving between suppliers and retailers than before	63%	21%	16%
Retailers are prioritising supply security and on-shelf availability more than lowest price	62%	22%	17%
Private label suppliers have more power now compared to 2019	60%	24%	16%
Retailers prefer to stick with suppliers they know rather than take a risk on a new supplier	58%	21%	21%
Discussions between suppliers and buyers are now less confrontational and more mutually respectful	56%	21%	23%
Retailers are less confident in their ability to find alternative suppliers	55%	21%	24%
Branded suppliers have less power now compared to 2019	52%	28%	20%
Suppliers still need retailers more than retailers need suppliers	51%	29%	20%
The balance of power has shifted in favour of suppliers	48%	24%	28%
Retailers have improved their forecasting capabilities to enable service level demands	38%	34%	28%

Source: IPLC Online Survey (141 Respondents, March-April 2023)

MANAGING RETAILER MARGINS

Retailers spent much of 2022 dealing with a tsunami of cost increases and supply challenges. In the immediate aftermath, before they could explore sourcing strategies, their challenge was to ensure that their suppliers would maintain supply, make enough profit to stay in business, whilst maintaining a competitive position in their market. Big supermarket chains are known to work off narrow margins where 2-5% net profit is not abnormal. So when dealing with the cost inflation crisis it is not surprising that the retailer's first instinct was to resist the supplier's requests for cost increases but to eventually pass these through to shoppers. 63% of respondents agreed that this was the number one margin management tactic but we have also seen other tactics deployed.

61% of respondents felt that retailers were using their premium private label ranges to improve the margin mix. This was likely targeted at shoppers who were spending less in restaurants but still wanted luxury when dining at home. In a similar way, 39% of respondents felt that retailers were capping the performance of their value tier ranges since these are generally a drag on margin. Bottom shelf positioning or reduced facings will suppress sales but it's a short-term measure that could be at the detriment of market share. Price sensitive shoppers will vote with their feet, thinking twice about shopping with supermarkets that make it more difficult for them to save money. 53% felt that retailers had reduced promotional give-aways to help mitigate margin pressures.

"It was very frustrating. One retail customer spent many months refusing to give us a cost increase but had already increased the retail prices on our products." (Supplier, Ireland)

It's very encouraging to note that 53% felt that retailers were finding margin mitigations by actively engaging with suppliers on supply chain efficiency projects. Very often suppliers are doing things that are requested by retailers which add cost but don't add value. These end-to-end reviews are a powerful way to explore supply chains with fresh eyes and agree new, smarter ways of working.

And whilst retailers are normally very protective of having differentiated recipes for their private label ranges, 40% of respondents felt that retailers were now open to their suppliers finding efficiencies by using standard ingredients across all of their private label customers. Interestingly, 39% felt that retailers were making their sustainability strategies align with their commercial needs for example by reducing packaging. Also encouraging that only 29% felt that retailers were open to using less sustainable ingredients and packaging to achieve cost savings.

46% of respondents agreed that retailers were revising product specifications to remove costs. Wider specifications and removing use by dates from fresh fruit and vegetables are a practical way to reduce waste and mitigate cost increases but the challenge is to create savings without damaging product performance. This problem is exacerbated by high buyer turnover because shoppers will observe a long-term quality reduction but the buyers don't stay long enough in category to see it. Other subtle changes can be seen that might not have been formally agreed. Packaging films or transit boxes can always be down-graded but can lead to burst packs in-store or collapsed pallets in the supply chain so they are a false economy and QA teams may need to increase the frequency checks.

Research findings

How are retailers managing their margins?	Agree	Neither	Disagree
Retailers have passed on the Cost Price Increases directly to shoppers	63%	17%	20%
Retailers are supporting premium-tier private label ranges to improve their margin mix	61%	30%	9%
Retailers are actively engaged with suppliers on supply chain efficiency projects	53%	28%	18%
Retailers are doing less promotional activity	53%	20%	27%
Retailers are revising product specifications to remove costs	46%	28%	26%
Retailers are open to suppliers using more standardised ingredients & recipes for different customers	40%	41%	18%
Retailers are capping their value-tier offer to minimise margin dilution	39%	40%	21%
Retailers are reducing costs through their sustainability strategies e.g. reducing primary packaging and shelf-ready packaging	39%	30%	30%
Retailers are open to using less sustainable ingredients/packaging to ensure availability and competitive pricing	26%	35%	38%
Retailers are supporting the big brands to help improve their margin mix	24%	47%	29%

Source: IPLC Online Survey (141 Respondents, March-April 2023)

Food fraud should also be on everyone's radar during times of extreme inflation. In October 2022 the UK's Fraud advisory Panel published their special report on alcohol fraud which they estimated to cost UK businesses £200m per year and up to 3,000 jobs. In January 2023 police raided a property in the Chinese province of Fujian discovering more than 40,000 bottles of fake Lafite and Penfolds. In February 2023 Paraguayan police seized 6,000 kilos of horsemeat being sold as beef. Italian Maritime Police also seized two tonnes of illegally caught sardines. Also in March, British authorities announced an investigation into the mislabelling of imported meat as British. In December 2022 the UK's National Food Crime Unit's annual report called out the cost-of-living crisis as a specific risk where cost-cutting by businesses may lead to fake or unsafe products being offered to consumers or other customers.

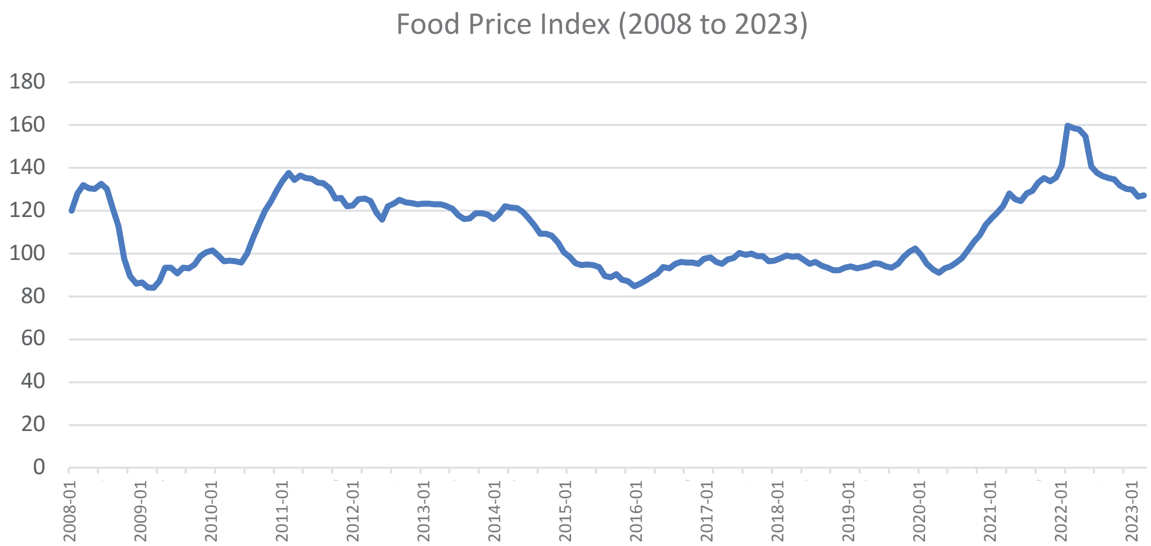
THE PROGNOSIS FOR FURTHER COST INFLATION

The inflation challenge has meant that many supplier-buyer relationships have been characterised by a spirit of transparency and collaboration, albeit driven by the retailers feeling increased supply insecurity. But this spirit will be tested in 2023 and 2024.

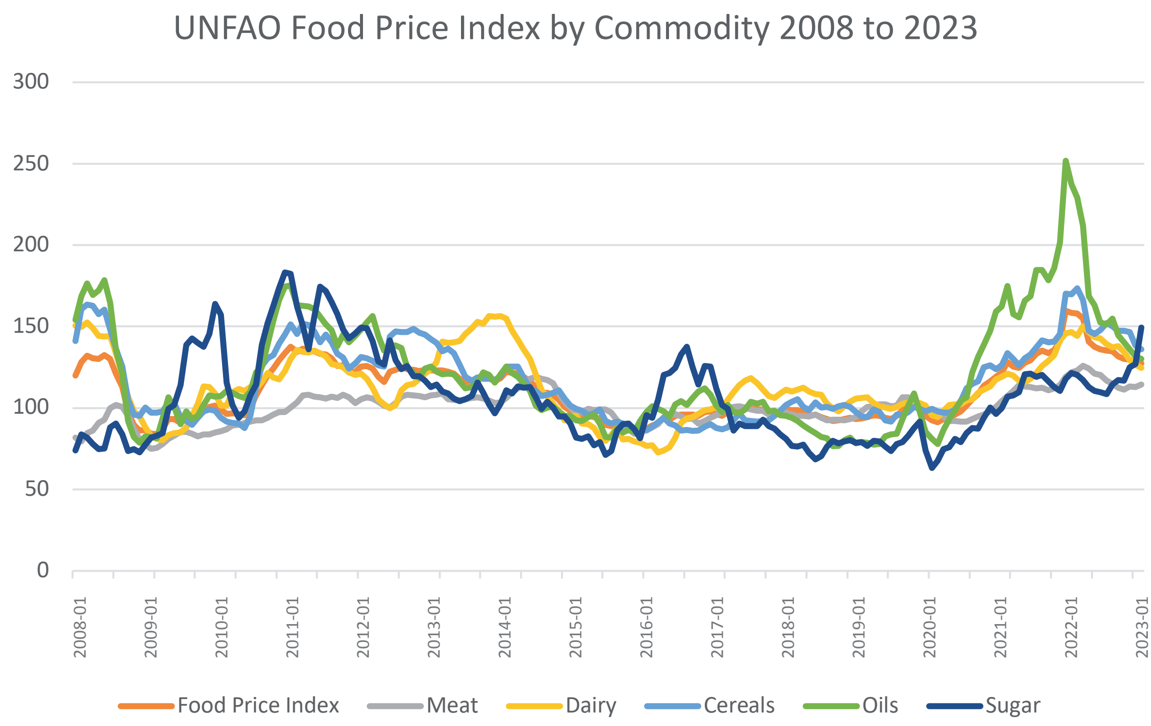
In last year's IPLC research report we identified the key inflation pressure points prompted by the pandemic. Reduced labour supply, increased oil prices due to production caps by OPEC nations, disrupted supply chains, increased shipping costs and rising food commodity costs all combined to put manufacturers under cost pressure. But there was hope that this unprecedented situation would normalise in 2022 so many suppliers did not take a militant stand on securing the necessary cost recovery. Last year's research found that whilst the average private label supplier had negotiated a 5% cost increase by the end of 2021, it was clear that increases closer to 15% were actually needed. The hope for a 'normal' 2022 was shattered on February 24th when the Russian Federation launched a full-scale invasion of Ukraine.

If the pandemic taught us about the interlinked but fragile nature of global supply chains, the Russian invasion quickly demonstrated the capacity of nations to deliberately weaponize energy and food supply. We learned the extent to which we depend on Ukraine for products like sunflower oil, and how it's black soil makes it the breadbasket of Europe. And we were reminded that fertiliser costs and low-cost food production were dependent on cheap Russian natural gas imports. Overlay this with the effects of climate change and extreme weather events impacting crop yields which are pushing up prices further. The inflationary impact of the war on top of the unrecovered costs of 2021 meant that suppliers had to take a more determined and uncompromising stance in 2022. But can we hope for an improvement in 2023 and 2024?

The first quarter of 2023 has seen some reduced commodity costs. The dairy category which saw phenomenal inflation in 2022 driven by increased global demand has deflated somewhat. But both manufacturers and farmers were quick to point out that their production costs were still deeply challenging due to elevated feed, energy, labour and logistics costs. And even if global commodity costs turn downwards, many manufacturers had implemented risk management strategies, hedging currency and key food ingredient costs to insulate their customers from the extreme volatility of 2022.



Source: UN Food & Agriculture Organisation (https://www.fao.org/worldfoodsituation/foodpricesindex/en/)



Source: UN Food & Agriculture Organisation (https://www.fao.org/worldfoodsituation/foodpricesindex/en/)

It is clear that retailers are actively investigating their product costs in more depth. Suppliers have reported being approached by retailers for cost reductions where raw material costs have apparently softened or where the retailer claims they can now source a product elsewhere at a cheaper price. Lower freight costs, increased Asian production and improved Dollar exchange rates are also giving confidence to buyers to create some downward cost pressure.

It is vital that suppliers prepare strategies as to how to handle the potential cost reductions. Some have said they are being pro-active with reductions, offering them to their retail customers before being asked, seeing this as an opportunity to build trust and transparency which should underpin more long-term and collaborative trading relationships. Other suppliers are taking a more cautious approach because there are so many unknowns that could lead to renewed inflation and there is a need to recover the losses incurred due to retailers refusing to engage in cost increase discussions in 2022.

Nevertheless, we are still seeing costs rising due to factors like tightening labour supply and minimum wage legislation. Oil prices are elevated and volatile and the 2023 harvest may deliver lower yields due to sub-optimal weather conditions or reduced application of fertilizers. As a result, cost inflation will most likely remain a challenge despite the retailer's best efforts to find some cost decreases.

78% of our survey respondents said that labour costs were continuing to drive cost price inflation in 2023, whilst 73% believed raw materials were also still driving inflation. Energy & distribution costs were still a source of continuing inflation for 66% and 67% of respondents respectively.

> *It was like a crime drama where the arresting officer reads your rights saying, "everything you say can and will be used against you". (Supplier, Ireland)*

How are the following factors impacting your current price proposals?	Inflationary Impact	Neutral Impact	Deflationary Impact
Labour costs	78%	21%	1%
Raw material costs	76%	12%	12%
Energy costs	67%	23%	10%
Distribution costs	66%	29%	5%
Packaging costs	61%	29%	10%
Extreme weather events	45%	53%	1%
Supply/Demand dynamics	45%	52%	4%
Unpredictable currency conditions	29%	67%	4%
Unpredictable retailer ordering patterns	25%	72%	4%

Source: IPLC Online Survey (141 Respondents, March-April 2023)

New national policies and legislative interventions will continue to add cost to the supply chain across both private labels and brands. Minimum wage increases across many countries have resulted in labour costs increasing by over 10%. Curiously, it is the drive by retailers like Aldi and Lidl to pay the best hourly rates in the market that are driving wage increase expectations in the factories that are supplying them. Sustainability targets have resulted in packaging taxes being implemented in Spain, the Netherlands and the UK. These are mainly borne by retailers but are impacting suppliers because they are required to invest in new packaging solutions to help retailers mitigate these taxes.

And there are hidden and rarely discussed sources of inefficiency and therefore costs. 31% of suppliers see unpredictable retailer ordering patterns as a source of ongoing cost inflation since there are increased inventory and other costs involved in hitting the 98.5% service levels demanded by retailers. Again, there are different perspectives here. For example, 75% of retailers who responded to our survey felt they had improved their forecasting capabilities, but only 32% of suppliers agreed with this.

"The old world of low prices has gone." (Supplier, UK)

Forward thinking suppliers are now reaping the benefits of previous investment in automation and energy self-sufficiency. And some are seeking to further integrate their supply chains to help increase their supply security and business resilience. Some suppliers anticipated some price stability, albeit at an inflated level, but this could prove to be wishful thinking - an unpredictable world thanks to climate change and aggressive geo-politics will convert into continuing unpredictable pricing.

As suppliers enter into further cost negotiations, either up or down, Commercial Sales Managers will need to be fully up to speed with cost dynamics: Was the price hedged? When and for how long? Is the buyer looking at spot market pricing and expecting the same in longer term contracts? Was there an agreed baseline at the last negotiation?

Throughout the recent cost increases suppliers were forced to give the buyers a crash-course in commodity cost and global supply chain dynamics. The buyers are now actively using their newfound knowledge, deploying the supplier's logic against them to seek cost decreases. If 2021-22 was about being on the offensive, successful suppliers will need to think hard about how to engage with buyers who are hungry for downward cost movement in 2023-24.

"the retailers are not quite as brutal as before" (Supplier, UK)

“We lost a contract in one of our key clients due to price. They went out of stock for 7 months because the new supplier could not deliver. We got back the contract at our conditions again.” (Supplier, Germany)

RETAILER-SUPPLIER CONFLICT

Buyers and suppliers are well used to having tough negotiations especially on private label contracts. However, no one had experienced the scale of inflation faced since 2020. Buyers and suppliers have had very difficult discussions through 2022 and our interviews explored just how dramatic some of the outcomes were.

Most suppliers found that the bigger retailers were willing to find a solution, even if it was after significant delay, because they could see the bigger picture through their international footprint and global sourcing teams.

“We realised either we resist or we’re going down, we have been well behaved for too long. We became more assertive and have more courage now. Unfortunately, the old normal is returning again.” (Supplier, NL)

Some suppliers were forced to cease supply or threaten to cease supply, or more subtly place a question mark over supply security. However, this was more likely when dealing with smaller, more local retailer operators who lacked the massive buying power and global insight. In many countries, suppliers had no option but to threaten stopping supply of a product to their retail customer unless the cost increase was agreed. Whilst in most cases such actions resulted in an eventual agreement over the new cost, some suppliers did cease supply, on occasions causing out-of-stocks on the retailers’ shelves.

Although this appeared to be a nuclear option likely to damage trust, many suppliers who did stop supplying claim that this has not harmed the long-term relationship with the retailer concerned. If anything, they feel it may have improved with both parties having more respect for each other. One reason for this is that private label suppliers explain the reason for the cost price increases in detail to the retail buyer, helping that buyer seek approval from their senior management. This was seen as being more transparent and collaborative than many of the bigger, branded suppliers who simply asked for cost increases without providing any back-up information.

A final point to note is that many suppliers have taken the lead on simplifying their ranges and stopping supply on lower volume, higher complexity SKUs. This was a key strategy during the early months of the pandemic where factories applied the 80/20 rule and focused on producing larger quantities of the products that shoppers really wanted. This created efficiency gains which partly offset the cost input inflation and maintained good service levels on key products.

“Nowadays it is more important than ever to have a good spread in the client portfolio. It is important to weed-out low margin products. We are a family-owned company and played open cards. We did not want to deliver with loss-making conditions and we could afford to lose a few contracts. In fact it allowed us to clean our product portfolio and weed out products that did not make sufficient contribution” (Supplier, Netherlands)

EVOLVING RETAILER BUYING STRATEGIES

Buying has always been about **leveraging volume** and creating competition. Bigger retailers have more volume to work with and can expect better pricing as a result. Smaller players need to use other levers such as more agile operations or less complex ways of working. As a retail buyer, if your overall volume is static or declining then the trick is use it differently. So, if your private label volume is split between multiple suppliers with similar capabilities then the opportunity is to reduce your supply base and award higher volumes to the remaining suppliers.

Alternatively, if you are partnered with a sole supplier then the opportunity is to split supply and create competition. 59% of survey respondents agreed that buyers were actively seeking new suppliers to re-inject a competitive element to their tenders. Successful suppliers will get visibility of these dynamics by doing a 360-degree SWOT analysis, looking at their own business, and those of their key competitors and customers. Our survey has shown that these basic strategies have not changed but we are seeing some new dynamics emerging.

It's an inconsistent picture when exploring the **contract lengths** that retailers are agreeing with suppliers. Our interviews had suggested that retailers had largely moved toward shorter-term contracts to protect themselves during inflation, but only 34% of survey respondents pointed to retailers still using short contracts and 42% reckoned that they were moving back to standard annual agreements. Obviously, this will be influenced by the type of retailer and category specific dynamics, but there is a strong clarity among suppliers that short-term supply contracts are not helping the bigger picture challenge of tackling inflation. There are hidden costs to this short-term approach. If a supplier can only be certain about supplying a particular contract for three months, then this will flow down to how they manage their own procurement. Factories will always be more efficient if they can leverage their buying power on an annual or multi-year basis. Three-month contracts arguably give false assurance to the buyers but do nothing to help reduce costs overall. 64% of respondents agreed that short contracts reduce their ability to supply efficiently, and 84% agreed that longer-term contracts allow them to invest in their businesses and to ultimately be more efficient as a result.

Tell us about the kinds of supply contracts you are agreeing currently	Agree	Neither	Disagree
Longer term contracts allow us to invest in the business and be more efficient	82%	14%	4%
Short term contracts give us less security and reduce our ability to supply efficiently	64%	19%	17%
Suppliers are adding new contract clauses to protect themselves around force majeure events and volume forecasts	56%	28%	16%
Open-book or index linked pricing agreements allow us to focus our energy on driving category performance	50%	30%	20%
Retailers are moving back to annual one-year contracts	42%	37%	21%
Retailers are agreeing short-term contracts (1-6 months)	34%	31%	35%
Legislation on fair trading practices is helping us to agree more equitable contracts	32%	47%	21%
Retailers are trying to force unfair/unfavourable terms through their contract small print	30%	36%	34%

Source: IPLC Online Survey (141 Respondents, March-April 2023)

Range numbers are also being leveraged in cost price discussions but not in the old-style fashion where buyers would use the range review process, threatening delists to extract a reduced cost prices. 59% of respondents agreed that retailers are simplifying their ranges but the focus is on achieving increased end-to-end efficiencies. This would suggest that the full range multiple supermarkets are acting somewhat like discounters by cutting the range tails and applying the 80:20 rule. This offers serious efficiency gains for both supplier and retailer right from raw material sourcing to production line speeds and down-time, artwork costs, packaging stock management, warehouse management, demand planning and instore shelf replenishment.

"Long-term partnerships and index-linked pricing require grown-up discussions and I feel we have earned respect over the way we have collaborated" (Supplier, UK)

The ultimate expression of a long-term partnerships are **open book agreements** where there is a model for managing cost price discussions which dramatically reduces the time, emotion and conflict that is normally generated by cost price negotiations. This openness is balanced against a multi-year contract that ensures longer-term security of tenure for the suppliers and on-shelf availability for the retailer. 40% of respondents felt that buyers were more open to doing multi-year supply deals. And this longer view gives the confidence for suppliers to invest in their businesses. The survey showed that 50% of respondents agreed that open-book or index-linked agreements allow them to focus on driving category performance but the other 50% may have good reasons to keep their P&L strictly private.

Tell us about the retailer buying strategies	Agree	Neither	Disagree
Retailers are seeking to simplify their ranges to increase 'end to end' supply chain efficiencies	59%	27%	14%
Buyers are actively seeking new suppliers to achieve more competitive tenders	59%	30%	11%
Buyers are less experienced which adds complexity to our negotiations	57%	29%	14%
Buyers are consolidating their supply-base to concentrate purchasing and help achieve supply security	54%	29%	17%
The role of group/international sourcing teams is increasing	53%	37%	10%
Supplier options are limited by the retailer's sustainability / local provenance requirements	47%	38%	15%
Buyers are more open to multi-year supply deals	40%	36%	24%
Retailers are seeking opportunities for vertical integration (where they own their own supply capability)	33%	41%	26%
We are already using open-book or index-linked pricing models to reduce conflict on CPIs	31%	25%	44%
We are currently discussing open-book or index-linked pricing models	30%	33%	36%

Source: IPLC Online Survey (141 Respondents, March-April 2023)

"Our sourcing department has provided our sales team with fantastic insight. This allowed us to play the game in a very sophisticated way." (Supplier, France)

Vertical integration it is not a panacea for retailers either. Firstly, it exposes the buyer to cost fluctuations much more quickly if they are supplied by their own factory. Secondly, it demands that the retailer starts thinking in much longer time horizons with continuous investment plans for the production unit. This simply isn't how retailers think, being traders at heart, focusing on the half-year report and share price performance can lead to short-term thinking. However, 33% of respondents felt that retailers are exploring opportunities for vertical integration. Retailers are open to owning their own supply capabilities to eliminate margin pockets, get visibility of the whole supply chain and ensure supply security. But the greater opportunity may be for suppliers to explore their own backward integration opportunities. Given that suppliers think more long-term, it might be very appropriate for them to manage volatility and find end-to-end supply chain efficiencies by investing in their own packaging supply, ingredient production, farming operations, and/or their own logistics solutions.

Finally, the big retailers who have an international footprint have all invested in some form of **global sourcing** or group buying solution. But this is playing out differently for different retailers. For instance, Tesco UK closed down their global sourcing team as part of Dave Lewis' restructuring in 2017, but they were still mindful of keeping as many of those experts as possible within the new Tesco product team. At the same time as Tesco were winding up their global team, the German discounters and many others were investing in expanding their global sourcing operations. 53% of respondents agreed that the role of group/international sourcing teams was increasing, but our interviews showed that in some cases these were adding complexity through more cumbersome admin, rather than using the grouped volume and the big picture view to review supply chains and remove activities that add cost but don't add value.

Suppliers have had to organize themselves differently as negotiations have become more complex. **Multidisciplinary account teams** can increase the moments of contact with retailers at various levels, but the situation is not helped by the high turnover and decreasing experience levels in retail buyers.

Both buyers and sellers will need to **upskill** to deal with this new world. And in some cases, the job descriptions and make-up of commercial teams will evolve to reflect where value can be added best. Walmart have already trialled AI-based negotiations on goods not for resale. Retailers and suppliers need to look at the emerging trends to ensure that the right skillsets are in place to stay successful.

"We have invested in setting up a negotiation war room to enhance our negotiations skills and align our commercial team" (Supplier, Spain)

"Sustainability was pushed to the background during 2020 and 2021 but it is back on the table again. And it shouldn't necessarily result in increased costs. We don't believe in the 'no pain-no gain' approach" (Supplier, Netherlands)

OPPORTUNITIES FOR COLLABORATION
The recent turbulence has forced suppliers and retailers to think more creatively about how they can best work together. And many have concluded that more collaborative ways of working are key to providing resilience in these volatile times. We asked our survey respondents to tell us what they thought were the big opportunities for collaboration. And whilst category and product level innovation will always bring the most obvious opportunities to work together, some other factors are becoming increasingly relevant. 88% of respondents agreed that value engineering product specifications was an opportunity with increasing relevance and this may be reflected on shelf through expanded value tier ranges. But the survey feedback indicates that efficiency and sustainability are where buyers and suppliers can find more mutual benefits.

88% of respondents agreed that food waste reduction was increasingly relevant, likely because price inflation has prompted shoppers to change their shopping patterns. Fresh food was a key battle ground for new product development and range extension in the years up to 2020. But expansive ranges have become a liability when food inflation suppresses the rate of sale and increases waste and markdown.

Reducing food waste is a key tool to mitigate cost inflation since both manufacturers and retailers generate waste especially on short-life products. 96% agreed that packaging reduction was increasingly relevant for collaboration, considerably higher than other sustainability areas like eco-friendly products (88%), healthier products (85%) or reducing food miles (77%). Reassuringly, only 26% of survey respondents felt that retailers were open to using less sustainable ingredients and packaging to achieve cost savings, proving how important it remains for retailers to achieve their sustainability goals.

Clearly there's a tension between waste and availability but despite this 93% of respondents felt that improving on-shelf availability was increasingly relevant as a focus for collaboration. Connected to this, 90% felt that demand planning was increasingly relevant as a focus for better collaboration enabled by digital transformation (75%) and artificial intelligence (66%).

98% of respondents identified opportunities to collaborate and innovate to achieve more efficient supply chains, the highest ranked opportunity. There are inflation mitigations to be gained from improved supply chain management but there is a clear hope that these end-to-end reviews will deliver improved transparency since and 76% identified the opportunity to collaborate on achieving more ethical supply chains.

At the lower end, 39% felt that novel foods would be an increasingly relevant opportunity for collaboration. Whilst very few are pinning their innovation hopes on insect protein or laboratory cultured meat, plant-based products are of increasing relevance. 61% agreed that plant-based foods were an increasingly relevant area for innovation. If manufacturers can improve the organoleptic and nutritional performance this might enable more widespread acceptance, just like we've seen with gluten free breads.

"A third of our Head Office resource is now focussing on the supply chain, analysing EPOS data, and constantly reviewing production forecasts with their retail customers".
(Supplier, France)

How do you rate the relevance of these opportunities for collaboration and innovation in the coming years?	an Opportunity with increasing relevance	an Opportunity with decreasing relevance
More efficient supply chains	98%	2%
Packaging reduction	96%	4%
Improving on-shelf availability	93%	7%
Demand planning	90%	10%
Food waste reduction	88%	12%
Value engineering to improve product margins	88%	12%
Product traceability & transparent supply chains	87%	13%
Sustainable/Eco-friendly products	87%	13%
Category/Product Innovation	85%	15%
Healthier products e.g. less salt/sugar	85%	15%
Reducing food miles	77%	23%
Ethical supply chains	76%	24%
Digital transformation generally	75%	25%
Artificial intelligence	66%	34%
Harnessing local provenance	66%	34%
Plant-based products	61%	39%
Targeted innovation for online-only retailers e.g. pack designs and pack sizes	51%	49%
Novel foods e.g. insect protein / lab-grown meat	39%	61%

Source: IPLC Online Survey (141 Respondents, March-April 2023)

Horizon scan

Having conducted 35 interviews and received feedback from 140 companies through our online survey we were able to identify six key areas that will create significant challenges in the coming years.

Priority	Topic	Detail
1	Managing Volatility	Managing input cost volatility, recovery through negotiated CPIs and better Procurement. Reducing risk on key contributors like energy, geo-politics & war, climate change and currency.
2	Maintaining Competitiveness	How do we win business & driving the right value/volume/profit so that we can re-invest and finding production/supply chain efficiencies?
3	People	We're competing for people & talent. How do we find the right people with the necessary skills. How do we keep them engaged and retain them?
4	Creating Growth	Harnessing the insights to create innovation that meets new shopper needs, optimises new formats, channels & export markets whilst adding value and improving margins both for supplier and retailer.
5	Sustainability	How do we find the correct balance of implementing legislation, setting & achieving targets & reporting whilst managing the additional costs and prioritising the activities that retailers want versus those that will make an impact.
6	Digital Transformation	How do we harness technical advances to produce more efficiently & forecast more accurately to give shoppers what they want whilst reducing food waste?

We discussed these red flag topics in a facilitated workshop with a panel of senior executives from expert private label manufacturers. With this shared perspective, we then challenged our panel to focus on answering two questions:

1. Describe the threat posed by these challenges towards the 2030 horizon.
2. In the face of these threats, identify the actions that companies will need to take to ensure business resilience, organisational agility and operational preparedness.

"Energy independence is central to our strategy. We take the view that if our customers are investing in solar cells and wind turbines then so should we." (Supplier, Ireland)

MANAGING VOLATILITY

We live in a VUCA world – volatile, uncertain, complex & ambiguous. Managing volatility emerged as the number one challenge for grocery sector businesses in the coming years to 2030. We asked our panel of leading private label manufacturers how they were positioning their businesses to deal with the inevitable future shocks. Three key themes came up:

1. Customer Mix
2. Purchasing
3. Insights

1. Diversified Customer Mix: This concept is evolving for private label manufacturers and must move beyond a preference for volume-based customer prioritisation. Whilst retailer/supplier relationships have become more collaborative and respectful following the turbulence kicked off by the pandemic, there is a sense that the retailer's tone and demeanour could quickly change back to the previous mode which was characterised by short-term thinking, aggressive negotiation strategies and continuous downward cost pressure. To reduce exposure, private label manufacturers will need to diversify their customer base to include contract manufacturing for 3rd party owned A-brands. These contracts are more sustainably profitable and professionally managed through open book cost calculations, transparent understanding of conversion costs and the expectation of a fair margin. This offers some stablity to a private label manufacturer's customer portfolio.

2. Purchasing: Whilst the focus for most suppliers has been to negotiate acceptable cost increases with largely unwilling retailers, future success will be underpinned by an effective procurement strategy enabling a more effective selling strategy. For smaller companies this will mean recruiting specialist procurement professionals and devising an actual buying strategy that moves beyond the buyer/replenishment role which is effectively just 'going shopping'. This could also mean group-buying cost inputs with other peer companies, allowing them to stay competitive and scale the business rather than becoming a target for take-over or failure.

For larger companies, the existing buying strategy can be enhanced through more active hedging and quality management. Open-book ingredient supply deals can deliver supply security but the business needs to invest in having the expertise necessary to manage the relationship properly. And the scope of purchasing can be widened by taking control of volatile cost inputs. There are opportunities in this space to be both sustainable and commercially advantageous e.g. more companies are establishing part or full energy independence through investing in solar panels or wind turbines. In this case, the company stops purchasing electricity because it is self sufficient.

> *"We can already see signs that some retailers are returning to their old style."*
> *(Supplier, Belgium)*

For all companies, there will be a requirement to invest in cross-functional working cultures and commercial skills training as the realisation lands that the manufacturer's combined buying, production and supply chain capabilities are the key enabler for the customer-facing team's ability to be competitive, win business and deliver profitable sales. Successful companies need to make creative problem solving, brainstorming and blue sky thinking part of their annual and long-termplanning processes.

3. Insights: Alongside the customer-facing insights, successful private label suppliers will need to invest in insights on the wide span of cost inputs and commodity trackers. This step-changed knowledge on key drivers like food commodities and energy dynamics will help keep customers informed and will enable more sustainable price agreements. Integrating the relevant supplier-facing and customer facing insights will require a much more ambitious approach on cross functional project teams. Multi-functional groups will also bring additional benefits as they have less blind-spots and make consistently better business decisions. All of this adds up to much greater business resilience

> *"We have trained over 100 KAMs internationally on how to pitch a price increase".*
> *(Supplier, UK)*

MAINTAINING COMPETITIVENESS

Maintaining a competitive position emerged as the #2 challenge on our online survey but it is closely linked to the #1 challenge in managing volatility. Its effectively the same thought-process whereby the business is always investing in finding better ways to do things, be that to create a financial buffer, to reduce the impact of input cost volatility or simply to maintain a competitive position with ever more demanding customers. The key will be creative and ambitious thinking, coupled with striking a balance between chasing short- & long-term efficiency gains.

1. Long vs short: Being competitive in the short term may require shorter contracts, more tactical thinking. But the problem is that a competitive or tactical approach never allows supply chain players to build the trust and openness required to look at longer-term changes to how we do business. Spot buying may make you competitive today, but will it create an environment for end-to-end supply chain collaboration?

2. Decisiveness & Flexibility: What we can be certain of is that retailers will likely resume some of their pre-crisis demeanour, assertively seeking cost reductions, creating competitive tension. So successful suppliers will need to stay aware of their key cost drivers and retaining the right to be agile, flexible and take the decisions that are demanded by the situation. For example, if the price of shipping containers rises ten-fold and availability is scarce, then maybe it's time to stop using them and move to bulk shipping! Or if the customer's desire to innovate or win quality awards has created a portfolio of low-performing product lines, then maybe now is the time to cut that tail and deliver the efficiency gains to the core products that really matter.

3. Cost ≠ Value: Finally, the concept of competitiveness must be viewed through a lens of value. For example, Tesco previously viewed value as a product of price and quality, but now they clearly see it as the meeting point between price, quality and sustainability. So, sustainability or healthy eating credentials could add an element of cost to your products, but they may add a greater element of value that differentiates your proposition and that customers are willing to pay for.

4. Continuous Improvement: The recent crisis was a shock that encouraged most companies to find new efficiencies. But the clear message from our horizon scan participants was that finding efficiencies should be a continuous process that never stops. In this respect, a successful business will be characterised by continuous re-investment and both short and long-term thinking:

Short term investements might focus on continuous maintenance or driving throughput on existing production lines whilst maintaining quality. Whilst long-term investment should focus on making major advances, completely new approaches or new capabilities.

Regardless of the time horizon, continuous improvement needs to be fed by continuous ideas which is greatly enabled by cross-functional teams and a culture that is open to learning from industry peers.

What you decide to do however can vary greatly depending how your company is scaled right now and other variables like your geographical location or the prevailing labour costs versus the cost of technology applications. For example, in Western Europe labour availability is a real challenge so application of robotics is now a viable and necessary route, not just to drive efficiency but more to reduce exposure to limited availability. And different countries are experiencing very different levels of wage inflation so there will be more of a burning platform for them. For example, whilst Belgium is seeing +16% wage inflation off a base which is 2x higher than the Netherlands, North America is seeing a lower increase off a lower base so the impetus to automate will be significantly less.

PEOPLE

People emerged as the #3 greatest challenge for businesses in our online survey. The challenge applies equally to production staff and professional/management roles like sales, insights, marketing etc. There is a battle for talent not just within the grocery sector but in markets generally. And at the same time as companies are calling out their hunger for people, companies are quick to flag that people aren't as good as they used to be. Millennials get a lot of heat for having unstoppable ambition but lacking basic life and work capabilities. Is it a fair criticism to expect kids in their early twenties to have their lives together and have a perfect balance of technical and soft skills? Our horizon scan panel flagged the following considerations for future success.

1. Internationalisation: Large scale companies with multiple sites and an international footprint will take long term investment decisions based on long-term labour availability and cost forecasts. This might mean building production capacity in lower cost countries. Consequently, this may mean reducing investment in other countries in the long term. It's a path that has been walked by manufacturers in apparel, electronics and other manufacturing industries. But longer, more convoluted supply chains bring greater risks for food. There is less visibility and transparency and therefore more risk of unethical employment practices. There is also greater risk of food fraud and longer supply chains mean higher food miles and conflict with sustainability priorities. The more balanced solution might be for companies to focus on building flexibility by partnering with pre-existing producers in lower cost places.

2. Talent Competition: Getting good people is difficult but is certainly enabled by taking a more flexible position on location. And the drive to reduce labour costs may extend into the higher paid management roles too. Remote working has made it entirely feasible for employers to cast the net much wider, even employing key senior personnel that are located in completely different continents to the main production and customer base. This is already happening in the software industry so why not in grocery? Another key consideration is how companies nurture the next generation through under-graduate work experience placements, graduate programs and other ways. These programs help young talent to acquire the basic business skills they will need whilst providing an opportunity to move around the business and choose a particular career path. These kinds of programs give the employer a definite edge over their competitors. And they're not necessarily just for the larger companies. As with procurement, smaller companies can get together on a regional basis to create talent development programs that keep talented young people local to where they are rather than seeing them all move to the big city to access the opportunities.

3. Business Exposure: The challenge with remote working is that people are not necessarily factory based. And the most effective salespeople are those that truly understand the complete workings of their business. They are intimately knowledgeable about the company's unique capabilities, how this differentiates them for their competitors and perhaps even helps them command a higher price. This is infinitely harder for sales teams that are never on the production line or dispatch area but, with the right culture, companies can plan in regular training, site visits and cross-functional project teams that allow different specialist departments to learn from each other and collaborate together.

> *"Covid gave retailers a better understanding of their supply chains. So they now focus on reliable partners".*
> *(Supplier, Austria)*

CREATING GROWTH

The #4 challenge for grocery busineses looking out to 2023 was how they can continue to create growth. Our horizon scan panel identified one major characteristic of successful private label companies looking forward.

Be like the brands: Many private label companies are only recently coming to terms with the new reality that they need to act a little bit more like the brands. This is counter-intuitive considering that the private label brand owner in actually the retailer. But succesful suppliers will see that the retail buyers are increasingly more stretched, less experienced and more restricted by the direction coming from their global HQ thought leaders. This will create opportunities because whilst the buyers have never had more access to data, they've equally never had less time to understand the insights and a very short window to create substantial change before they moved off to a new category. This means that private label suppliers need to start investing in category insights, bringing proposals to their customers based on both shopper and holistic business needs, understanding shopper preferences and behaviour around price elasticity etc. Both shopper and buyer behaviour has changed during the turbulence of covid, the war and the inflation crisis. It is vitally important for private label manufacturers to understand this new world and have the skills to provide solutions.

SUSTAINABILITY

Prior to the covid pandemic, climate action was the number one topic for retailers and suppliers. Retailers were creating ambitious sustainability programs rooted directly to the UN Sustainable Development Goals (SDGs). This focus was blurred somewhat by the pandemic and the Russian invasion of Ukraine. Some retailers, especially those that lack global thought leadership switched focus to supply chain management and mitigating inflation. But pressure is coming again from retailers for the sector to reduce its overall carbon footprint. This drive comes right from the very top of the organisation where policies are being set for both the retailer own brands and the A-brands. Three themes emerged from our horizon scan panel:

1. Leadership: Successful suppliers, both branded and PL, will create their own momentum on sustainability. They will define their own strategies and prioritise action that delivers meaningful impact on the SDGs that are most relevant to them, rather than simply reacting to the retailer's priorities. And if you are unsure where to start, take a look at the UK and the Scandinavian countries who have taken a clear lead on carbon reduction.

2. Clarity: Successful manufacturers need to be clear on where maximum impact can be created. For example, where exactly the carbon impact comes from within their business. Knowing this allows them to focus their energies. For example manufacturers in the household detergents category are now clear that 70-80% of their carbon footprint originates in their formulations, so they are working with their suppliers to produce greener equivalents with less chemicals and less packaging thanks to more concentrated formulas.

3. Holistic View: Sustainable companies will need to look at the big picture and take an integrated approach that doesn't solely focus on one issue like Carbon Footprint. Water supply is a good example as it has a huge influence on crop viability. For instance, Europe currently takes only a small proportion of the worlds rice output but rice growing regions in Spain or Italy may become unviable in future due to climate change – and production may be displaced to somewhere like the Mekong Delta requiring new certification systems to be created. Another good example is cocoa which is grown by thousands of small farmers in developing countries making it almost impossible to guarantee ethical labour practices.

DIGITAL TRANSFORMATION

Many businesses talk about digital transformation but the reality is that, like most national health care systems, many large scale manufacturers are still using paper based systems for food safety systems, project management, NPD and demand planning. Companies will succeed in future by getting to grips with digital transformation.

We learned from the horizon scan panel that the opportunities for digital transformation in the grocery supply chain are worth proper investigation even for small and medium sized enterprises. This is due to the interconnected nature of food and drink supply chains where each of the stakeholders is constantly raising the bar. Shoppers assume that they will get exactly what they need, when they need it. They demand quality, provenance and sustainability at an acceptable price. Retailers demand security of supply from manufacturers that do not cut corners and work in partnership to pool insights on how to do things better. Manufacturers need suppliers and customers that enable them to manage their inbound and outbound supply chains with maximum efficiency and zero waste. They also need to automate as far as possible to reduce the risk of human error or bad actors, especially on issues of ethics, food safety and product integrity.

To satisfy these combined needs forward thinking FMCG companies are already looking to digital transformation because it aids increased efficiency, it tears down the invisible walls of a siloed organisation, allowing useful data to be shared across the company so that smart people in cross-functional teams can design better ways of working. It enables a step-change in forecasting accuracy which maximises on-shelf availability and decreases wastage by integrating the retailer's replenishment systems with the manufacturers production planning. It supports open communication between buyers and sellers, more integrated category deep-dives, slicker project management, reduced new product launch leadtimes. Digital transformation enables a new level of connection and collaboration to bring positive change but it also helps the stakeholders to identify and manage risks in areas like cold chain management, traceability, quality monitoring and data analysis.

"We use a sales-fed software system where we keep track of all existing clients and prospects. We register product volume, RSP's and specifications in one central database. Before it was spread all over the organisation in multiple spread sheets".
(Supplier, UK)

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