UAE Food & Beverage Business Group

ACADEMIC AND GOVERNMENTAL VIEWS FROM ACROSS THE WORLD

- OUR SITUATION IS NOT UNIQUE, AND THERE ARE SOLUTIONS AVAILABLE

DOCUMENT INDEX

Introduction – What is the Market Access Issue?

The market access issue in UAE describes how F&B suppliers in UAE are finding it increasingly difficult to operate and survive in the market. The market access issue has three key components to it:

1. Increasing input costs
2. Big retailers creating a monopolistic environment
3. Unregulated imports stifling local "Made in UAE" businesses

It is a sad state of affairs that while the overall F&B grocery market has been growing in UAE, the manufacturers and suppliers of F&B products are increasingly running in losses and shutting shop or relying on exports to other markets and denied access to the UAE consumers. There has been a continuous decline in investment, innovation and interest in the sector and the industry is now at a point where this will get even more drastic.

Presently, the issue that the industry is facing is one that is being driven not just by local actors, but global ones as well.

In order for the industry to survive, balanced protectionist measures must be put into place to equip the industry to face the challenges that are now upon us.

Increasing Input Costs

Over the years, input costs for manufacturing have continued to rise. These fall under various overheads, including but not limited to:

However, earnings have not been commensurate as Price Control and Retailer Pressure prevent manufacturers from charging the true value of their goods in the market. For instance, the price of tomatoes has not changed in the past 20 years due to increased competition from cheap imports and product dumping.

These input costs are now spiralling out of control as the world is now entering into a global agricultural commodities super cycle (https://www.cargill.com/commodity-price-risk/corn-and-soybeans-the-start-of-a-new-supercycle-in-agriculture). This implies that cost of key agriculture products are now increasing to all-time highs, and are showing signs of a continuous increase into the foreseeable future.

A policy to counter these recent global and long term local trends will be needed to ensure local businesses are able to survive. Businesses are already strained because of input cost issues and the pandemic; but at the same time, it is motivated to achieve the objectives set out in **Operation 300bn**.

Big retailers creating a monopolistic environment

the UAE retail market is dominated by two major retailers who have a strong grip on all manufacturers and suppliers. They control a lion's share of the market and their position continues to strengthen with time, as they incorporate increasingly more unhealthy practices to control and subjugate manufacturers and suppliers.

Retailer	Market Share 2017	Market Share 2020
Carrefour	23%	28%
Lulu Emak Group	19%	22%
Spinneys	6%	9%
Union Coop	4%	8%
Sharjah Coop	5%	6%
Abu Dhabi Coop	4%	6%
Choithram	2%	6%
Al Safeer	5%	3%
Aswaaq	1%	2%
Al Maya	5%	2%
Others	26%	8%

Table: Market share of major retailers in UAE; Source: FBMG Research Cell, Industry Leaders

The consequences of this oligopoly held by the top 2 retailers severely impact the rest of the market:

Barrier to entry for new companies and new products	Brand value erosion owing to price fluctuations and promo abuse	Rampant market dumping of unregulated products (private labels and cheap imports)	Constant changes to contractual terms and conditions tailored to benefit the retailers only	Long payment cycles, reduced cash flow and unhealthy return policy (especially during the pandemic)

While these practices have been perpetuated by the top 2 retailers, these are being adopted by the mid to large sized retailers as well. The cascading of these unhealthy practices and the continuous increase of pressure has reached a point where manufacturers and suppliers have exhausted their earnings and patience.

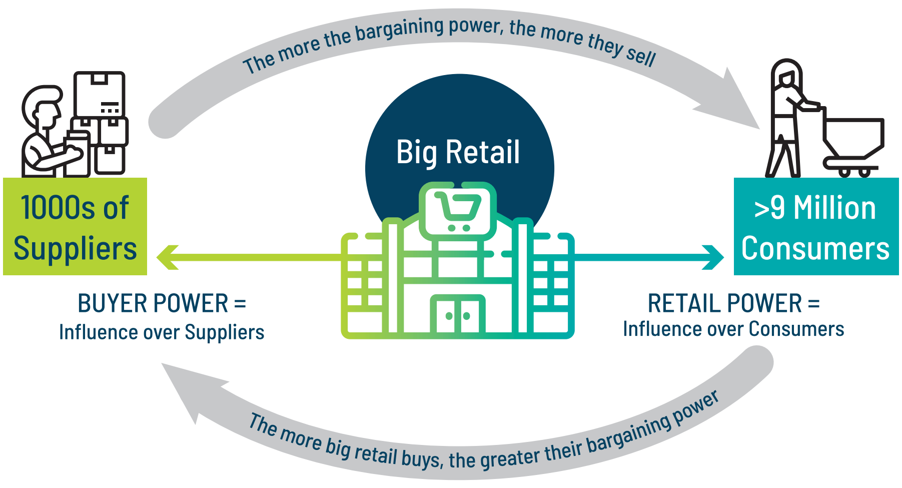
Unregulated imports stifling local “Made in UAE” businesses

Local businesses are being pushed out of their own market. A cursory look at the retail environment will reveal that UAE products are provided with minimal shelf space. Support to local produce is not being taken seriously and put into effect as even shelves dedicated for local produce have imported products occupying space.

Cheap imports, across food categories, are entering our market while circumventing regulatory requirements. Often times, these imports are non-compliant and unhealthy foods which is a disservice to our population. While UAE produce are subject to stringent standards that are costly and complex. Imported products are able to price their way into the market without such overheads.

One of the key messages delivered in Operation 300bn is to “Make it in the Emirates” – the industry is ready and geared to push forward, but require help and support from the policy makers.

Cascading impact of this situation



This is a global phenomenon across developed countries – where large retail chains control a very high share of the overall grocery markets. UAE is a market where >50% of the market is dominated by two retailers. And if we add the Coops into the mix, there are 5 retail chains that control >70% of the F&B market.

Figure: 5 retailers control the entire market; Source: Consumer International, FBMG Research Cell 3

It has been well documented that the consequence of this high concentration of grocery market share gives these retailers unprecedented bargaining power over the suppliers and consumers. When control is skewed towards one entity, the impact on the other key stakeholders, supplier & consumer, is as follows:

Retailer Abuse	Impact on Supplier
High listing fees to just allow representation on shelf	• Additional cost to supplier • Risk of stocking largely on supplier
Threat of delisting if suppliers refuse high retailer costs, a form of black-mail or retribution	• High business uncertainty • Inability to plan business • No bargaining power • Substantial loss of volume
Visibility support fees just to have fair share of shelf and in-store visibility	• Unnecessary business expense • No risk for retailer, business risk solely on supplier
Marketing support costs for marketing, store openings, renovations, retailer promos, packaging, etc.	• Additional costs without commensurate earnings • Risk of retailer initiatives borne by supplier
Rebates deduct a % of total sales of goods and are used by retailers to manage their own profitability	• Additional costs without commensurate earnings
Return policy is at the supplier's expense and includes perishable fresh foods as well	• Risk of retailer initiatives borne by supplier • Cost & risk of retailer's forecasting errors borne by supplier
Late payment cycles	• Impacts supplier cash flow • Additional financing costs • Uncertainty over income
Constant changes in agreements that are sometimes retrospectively affected to manage their own profitability, e.g., rebates	• Cost & risk of retailer's forecasting errors borne by supplier • Impacts supplier cash flow • Additional financing costs • Uncertainty over income
No price control as selling prices fluctuate dramatically, and sometimes below cost	• Distorts brand value and consumer perception of product • Impacts supplier cash flow • Uncertainty over income • Can result in competing retailers demanding lower prices
Promoting private labels by pushing out smaller brands, copy cat packaging, price wars	• Loss of volume, profitability and visibility • Loss of IP rights • Disincentivising innovation

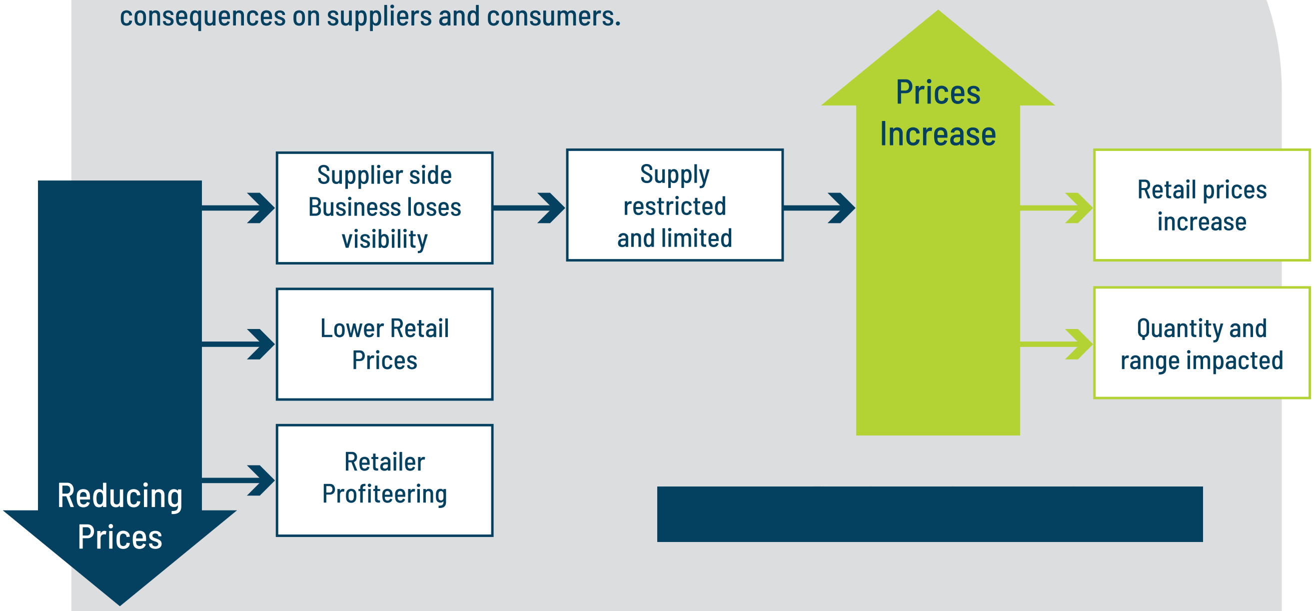
[1] "The relationship between supermarkets and suppliers: What are the implications on consumers?", Consumer International, sponsored by the European Union

To summarise, the impact of big retail on suppliers is as follows:

1. Complete risk of retailer's business, initiatives and forecasting errors borne by supplier
2. Loss of volume, profitability and visibility
3. Additional costs without commensurate earnings
4. Non-visibility of financial and business planning
5. High business uncertainty
6. Impacted cash flow
7. Potential to impact price and quality
8. Loss of IP rights
9. Disincentivising innovation
10. Distortion of brand value and consumer perception of product
11. No bargaining power

Impact on Supplier	Consequences for Consumer
Unable to get fair prices	• Will impact supply • Can impact quality owing to strain on business to reduce costs
Additional business costs	• Long term this will lead to an increase in prices and inflation as suppliers reach a breaking point • Short term will lead to higher prices at smaller retailers – reduced choice for consumer, business risk for small retail
Retailer risk borne by supplier	• Reduced focus on innovation and cost cutting will lead to reduced product range and lower quality • Reduced funds for investments and promotions
Threat of delisting	• De facto choice will become private labels • Reduced consumer choice and poorer quality products
Loss of IP rights	• With copy cat products available, consumer confusion is high • Product range in long term will be severely curtailed
No real price control	• Cost benefits are not passed on to the consumer • Benefits used to manage retailer profitability alone

The purpose of highlighting this is to deliver the understanding that we are presently in a vicious cycle that will have far reaching and potentially irreversible consequences on suppliers and consumers.



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- Local manufacturers & suppliers will be pushed out of business
- Private labels will dominate the market
- Distorted price perception and quality of products will abuse consumer choice
- Increased dependence on imports and global supply vagaries
- Food security will not be achievable

Making a case for Price Increase

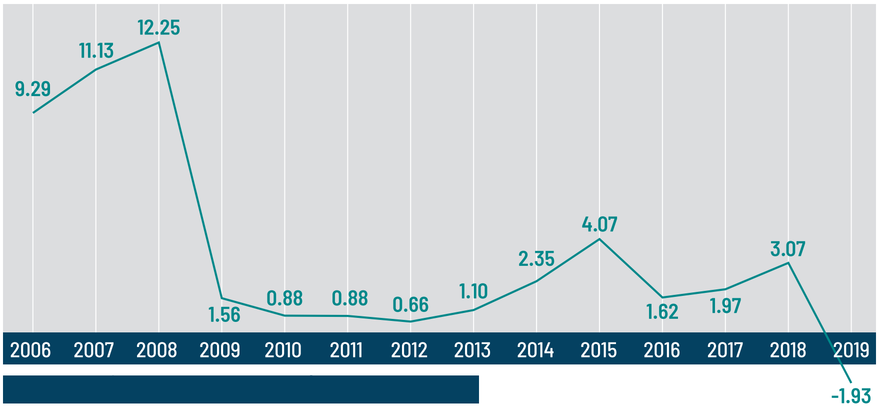
Point 1

Inflation is now under control

As detailed in this paper, price control mechanics were put into place in UAE in the aftermath of the Global Financial Crisis of 2008-09. This was done to curb inflation and protect consumers from uncontrolled price increases.

With inflation well under control, the need for price control now seems negated and a relaxation of rules would be welcomed by the industry without pushback from the population.

UAE Inflation (%)



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In fact, the last price increase that occurred in the industry was 10 years back in 2011.

Point 2

Price control further skews the retailer-manufacturer power struggle

The key concerns with the current mechanism of price control are that the on-ground reality is that there is no benefit of the existing price control mechanisms. The onus of maintaining price control applies to manufacturers – while retailers use this price control to impose higher costs on manufacturers and manage their margins.

As a result, Retailers decide prices (up or down) as per their business requirements while Manufacturers find it difficult to manage their businesses and are suffering losses. This is over and above the retailer costs that have been spiralling out of control, even during the height of the pandemic when the business environment was the most sensitive.

While the splits of the below cost heads vary from retailer to retailer, the on-ground reality is as follows:

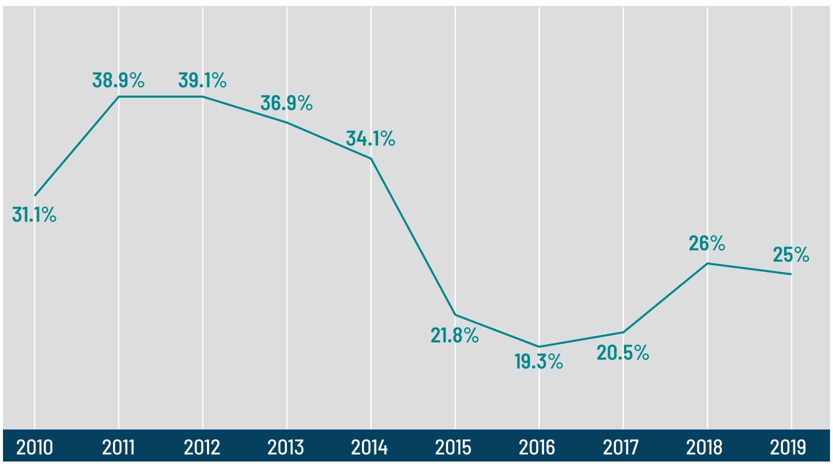
Back Margin Heads	Average for Major Brands	Actual reality for Local Companies
Rebates	5-6%	12%
Visibility Support	4-5%	10%
Promo Budget	10-15%	25%
Marketing Support	2-4%	7%
Logistics Support	2-5%	5%
Scan Data	1-3%	3%
Total	**24-38%**	**62%**

Moreover, the industry is experiencing an increase in retailer costs of about 8% YoY. This concentrates the earnings and benefits at the retailer end as neither the consumer, nor the manufacturers benefit from the current situation.

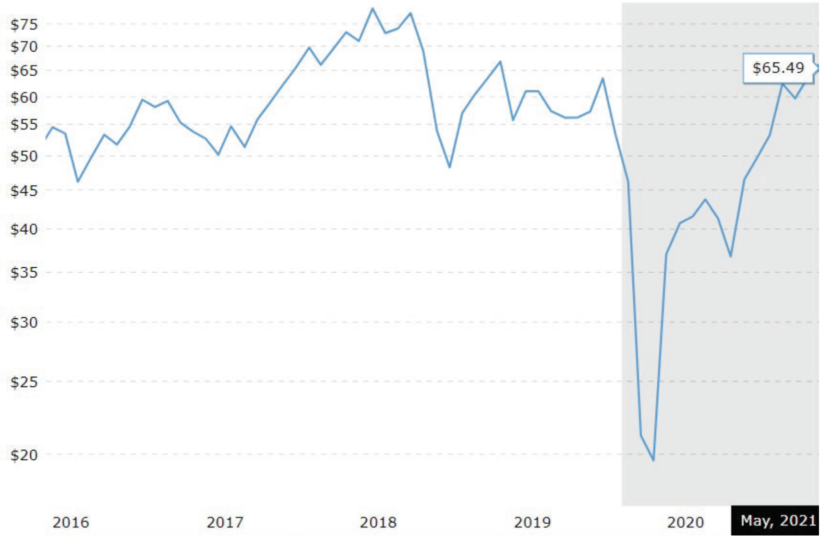
Point 3

As commodity super cycle emerges, it is also having a positive uplift on global oil prices.

Despite diversification, hydrocarbons remain a mainstay of UAE's economy.



As stated earlier, the world is observing an increase in prices of all commodities. This has also seen a recovery in global oil prices, from the lows observed in April 2020 (at the height of the pandemic). Oil prices are now nearer to 2018 levels and this would have a positive impact on UAE's economy owing to ~25% contribution of hydrocarbons to the GDP.



This makes it an opportune time for other key components of the economy, namely F&B, to undergo much needed price corrections without disrupting consumer needs and behaviour.

Further reading: Information from other GCC countries managing Market Access

The concern that manufacturers and suppliers of F&B products in UAE have are that the dominance of a few retailers has severely restricted market access and caused a great difficulty in conducting business in the country.

As mentioned in the Market Access Issue Position Paper, there are key learnings to be had from similar situations that occur in different countries across the world. We need not look too far, as some practices implemented by our neighbours in the GCC are market positive measures that help rebalance the equation between supplier and seller.

Some of these are:

- **Oman** has placed a cap/ limit on how much rebate a retailer can charge
- **Qatar** has restricted retailer rebate costs to only 5% for local manufacturers
- **Saudi Arabia** has no price control mechanism in place, allowing manufacturers to adjust prices as other cost heads fluctuate (such as, raw material, retailer costs, government fees, etc.)

Similar or more practices must be put in place to ensure that UAE remains the most attractive investment destination in the Gulf region. Without such government led interventions, the objectives of Operation 300bn would also become increasingly challenging to achieve.

Further Reading: Similar situation across the World – Opportunity for UAE to be a Global Policy Leader

The "retailer abuse management playbook" is not unique to UAE. There has been evidence of a dominant retailer environment across the developed world and the negative consequences of this situation.

1. Under EU competition law, buyer power is not objectionable . However, abuse of buyer power is unlawful. The imbalance of bargaining power that exists between the big retailers and suppliers fosters abuse, and this has dire consequences for suppliers and consumers both

   As illustrated in this document, there is clear evidence of abuse of such power occurring in UAE as well

2. The UK Competition Commission cited that retailers are causing increased uncertainty for suppliers. There were 26 such practices that were described, mostly involving the transfer of retrospective (and therefore unexpected) costs and excessive risks to the suppliers. This undermines the suppliers ability to plan, invest and innovate – ultimately being a detriment to consumer choice

   This is evidenced in this report, wherein business development costs and promotional activities are allocated to suppliers without prior notice and sharply impacts their ability to earn and sustain their businesses. Arbitrarily attributing retailer side costs to the suppliers only serves the purpose of buffeting the retailers' balance sheet

3. The Spanish National Competition Commission concluded that the bargaining power of retailers may have a negative impact on competition, consumers and suppliers

   This is currently the case in UAE as well

4. The UK Competition Commission report also cited that deep discounting has an adverse impact on consumers. They recognised that the practice could mislead consumers into thinking that prices of all products sold by a retailer are lower than is really the case. However, the reality is that cost of deep discounting is recovered through the pricing of other items and by imposing the burden of discounting on the supplier

   This is the same situation in UAE as cited in this document. Price control is not an on-ground reality and consumer prices are heavily distorted creating incorrect price notions

5. Australia based consumer watchdogs CHOICE and Which? , in their investigations concluded that current price cut campaigns by leading supermarkets are "false sales" because these special offer prices had not changed for more than a year. Similarly, an analysis by the Danish Competition and Consumer Authority , found that special offers were not good for consumers since regular prices were set relatively high to finance the promotion and to make the price reduction seem greater

   These tactics are also being employed in UAE as evidenced in this report

6. Leading consumer watchdog in Australia, CHOICE , has extensively documented that the removal of branded goods from supermarket shelves and their replacement by retailers' own brands is driven by commercial interests and not consumer choice

   This has also been evidenced in UAE, where private labels are growing and increasingly pushing suppliers' brands to a diminished presence

7. The Norwegian Inquiry Commission "The powerful and powerless in the food supply chain" found that the pricing of private labels is financed by suppliers through costs and marketing funds. As a result, suppliers consider that innovation is undermined, and the survival of independent brands are threatened by imitation and the unreasonable use of under-cutting prices

   This has also been evidenced in UAE as private labels continue to enjoy pride of shelf and are growing at a rate much higher than the rest of the market.

[3] EU law does not define dominance in quantitative terms. It is not possible to equate it with, say, a certain percentage market share
[4] UK Competition Commission (The Supply of Groceries in the UK market investigation, 2008) p170
[5] Report on the relations between manufacturers and retailers in the food sector, Comision Nacional de la Competencia, 2011
[6] CHOICE, Supermarket Special When is a sale not a sale? May 2012
[7] Clear, consistent food pricing: Why unit pricing must be improved, Which? November 2011
[8] The Danish Competition and Consumer Authority, 2011 referred to in ECN Brief 05/2011
[9] CHOICE website: http://www.choice.com.au/reviews-and-tests/food-and-health/food-and-drink/supermarkets/supermarket-privatelabels-and-homebrand-products.aspx
[10] The powerful and the powerless in the food supply chain, April 2011

Governments across the world have not been able to effectively address this owing to the strong lobbying power held by retailers and their strong grip across the supply chain. Few governments have been able to address this control and the reality remains that there is a climate of fear that supermarkets instil in suppliers.

In our endeavour to resolve this issue while being cognizant of the overall economy comprising all stakeholders, i.e., suppliers, retailers, consumers and regulators; we have reviewed these learnings from across different markets to arrive at a list of recommendations in order to be harbingers of positive change. With due consideration, these recommendations may be implemented to ensure a level playing field in UAE and a brighter more robust economy in a post COVID world.