Retail Council of Canada Submission to the Competition Bureau's Market Study:

Competition in Canada's Grocery Sector

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PREFACE

On behalf of the Retail Council of Canada (RCC) and its members, I want to thank the Competition Bureau for this opportunity to provide a grocery industry perspective to your market study on Canada's grocery sector. These are highly important issues for Canadians and for public policy, hence RCC and its members understand the importance of contributing to this Study.

RCC is confident that the Competition Bureau will exercise its habitual objective and evidence-based approach to the issues at hand. That said, the study has been mischaracterized by others. For example, despite several very clear messages from the Competition Bureau that this is a market study not an investigation, the Bureau's work has already been misdescribed as being an investigation by several observers in media, academia, and politics.

The Bureau's market study is also taking place against a backdrop of valid public concern about rising food prices amidst a highly charged environment in media and politics. In much of the commentary, there have been attempts to causally link food price inflation to grocer profitability and in some instances to market concentration. This is so despite overwhelming informed and objective evidence that current food price inflation is being driven by global challenges including diseases, geopolitical and climate events. Grocers in Canada deeply care about offering the best value to Canadians particularly in this challenging environment and to paint grocers as profiteering in the face of evidence to the contrary is objectionable.

It is in this broader context that we make our submission to the Competition Bureau. RCC would be happy to provide detailed data underlying the charts in this submission and to otherwise provide whatever help we are able to assist with your study. It should also be noted that any data used in this submission is derived from publicly available sources.

Karl Littler
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OVERVIEW

Canadian grocers operate in a low-margin, competitive market where food inflation is driven by cost increases from suppliers

The Canadian grocery market is highly competitive as evidenced by, among other things: (i) the broad range of international, national, regional, and independent grocers, along with discounters and other formats of points of access to shopping distribution; (ii) diverse suppliers, farmers, and growers; (iii) an abundance of national and control brand products fuelled by innovation on the part of retailers and suppliers; (iv) a multitude of promotional and loyalty offerings; (v) innovative offerings in the food distribution channels; and (vi) the growing availability of meal kits, home meal replacements, and meal service subscriptions.

All of these factors demonstrate the low barriers to entry in the Canadian grocery sector as well as the dynamic and competitive nature of the sector. There is a plethora of choices for Canadians in terms of availability of products, price points, points of access, and promotions from which they can choose to meet their shopping needs. In this context, competitive dynamics in the grocery industry cannot be the source of food inflation, as the data presented in this submission illustrates; the grocery industry operates on thin, internationally-comparable margins in a competitive environment. The recent rise in grocery prices in Canada is due to food manufacturers raising their prices in response to a spike in their own input costs driven by three global crises: the COVID-19 pandemic, war, and climate events, along with labour scarcity in a number of regions.

1 Grocery retail in Canada is not concentrated, particularly when compared to other countries

Canada does not have a concentrated grocery sector despite criticisms to the contrary. Concentration has not increased in recent years, which have been characterized by the growth in market share of big box retailers and by new entrants such as Dollarama and Whole Foods, as well as enhanced food offerings at convenience stores and pharmacies. Regional markets feature a significant presence of mid-sized grocers, and independent grocers are continuing to grow and be profitable. Canada also has a well-established discount grocer segment, which 87% of Canadians use regularly for grocery shopping.

2 Grocery margins are low and have remained generally flat during this inflationary period

Canadian grocer margins are low and have remained flat during the inflationary period of the last 12 months, and are largely driven by profits from pharmacy, health, and beauty products, rather than food. Indeed, grocers as a whole work extremely hard to avoid passing on the full extent of price increases from manufacturers and processors to customers. These grocery margins – averaging around 3.5% – are lower than Canadian net farm income (2021) of 7.4%[1] and significantly lower than margins for food manufacturers and processors, especially the big

[1] Statistics Canada, Table 32-10-0052-01, Net farm Income

consumer packaged goods companies, where profits typically range from percentages in the low to mid-teens.

3 Grocers are not the source of food inflation

The cause of the recent rise in grocery prices is cost increases from suppliers, such as manufacturers and wholesalers. This is in turn due to higher costs for their own inputs such as grain, fertilizer, and fuel. This inflationary chain has been triggered by events including pandemic, war, and extreme weather disrupting production and supply chains. These events have severely impacted the supply of grain and produce in particular, leading to higher costs for products containing or dependent upon these ingredients and their derivatives.

SECTION 1: Grocery retail in Canada is not concentrated

Contrary to media reports, the Canadian grocery market is not concentrated, whether in comparison to grocery markets in peer countries or to other consumer-facing industries in Canada. Moreover, Canadian consumers, especially in urban and suburban settings, have diverse choices for grocery purchases from grocers of varied sizes and formats. Canada has three large grocers: Loblaw, Sobeys and Metro, plus big box retailers Costco and Walmart. Four of these are truly national in reach, whereas Metro is focused on Ontario and Quebec. There are other sizeable regional players of which Overwaitea is the most prominent, a number of independent grocers, including independent chains like Rabba, convenience stores, Dollarama, Giant Tiger, Whole Foods, etc., making any suggestion of a lack of competition within Canadian grocery sector misguided.

The entry into the Canadian grocery market of two large international retailers namely, Costco's entry into the market in 1985 and Walmart's creation of Supercentre stores (selling fresh groceries and general merchandise under one roof) in 2006, have significantly restructured the market, earning market shares of 11 % and 8% respectively, making them Canada's 3rd and 5th largest grocers by sales volume. This is based on 2020 data and the trendlines suggest that the market share percentages for Costco and Walmart may well have increased since then.

Though both first entered the market some time ago, the real point of significance is their growth over the ensuing period. Costco began with one store in 1985 and has expanded to 107 stores. Walmart has now grown to more than 344 Supercentre stores, significantly expanding its reach into most regions, and is now available to most Canadian consumers.

More recent entrants at either end of full-price and discount grocery include Whole Food Markets and the diversification of Dollarama into the grocery space.

Regional markets also have a significant presence of mid-sized grocers, especially in Western Canada, including Save-On-Foods, London Drugs, Federated Co-Operatives, and The North West

Company. Giant Tiger's 260 stores provide alternatives to the larger grocers in many smaller centres across Canada.

Discount grocery offers further diversity of choice and lower prices

Canada also has a well-established discount grocery segment, which 87% of Canadians use regularly for grocery shopping [Exhibit 1]. The importance of this discount segment cannot be overstated. Typically, prices are lower in discount stores than in those operated under the full-service banners.

There are adequate offerings across the range of food staples and specialty products in discount banner stores, which allow for a full shop. In this way, grocers provide consumers with lower-cost options on the same or comparable products, essentially establishing two price levels for each major grocer.

This of course complements the offering of private-label products at both full-service and discount store levels, which are also designed to provide shoppers with lower-cost options on a diverse range of products. These private label products have become widely available and compete both on price and quality with national brands.

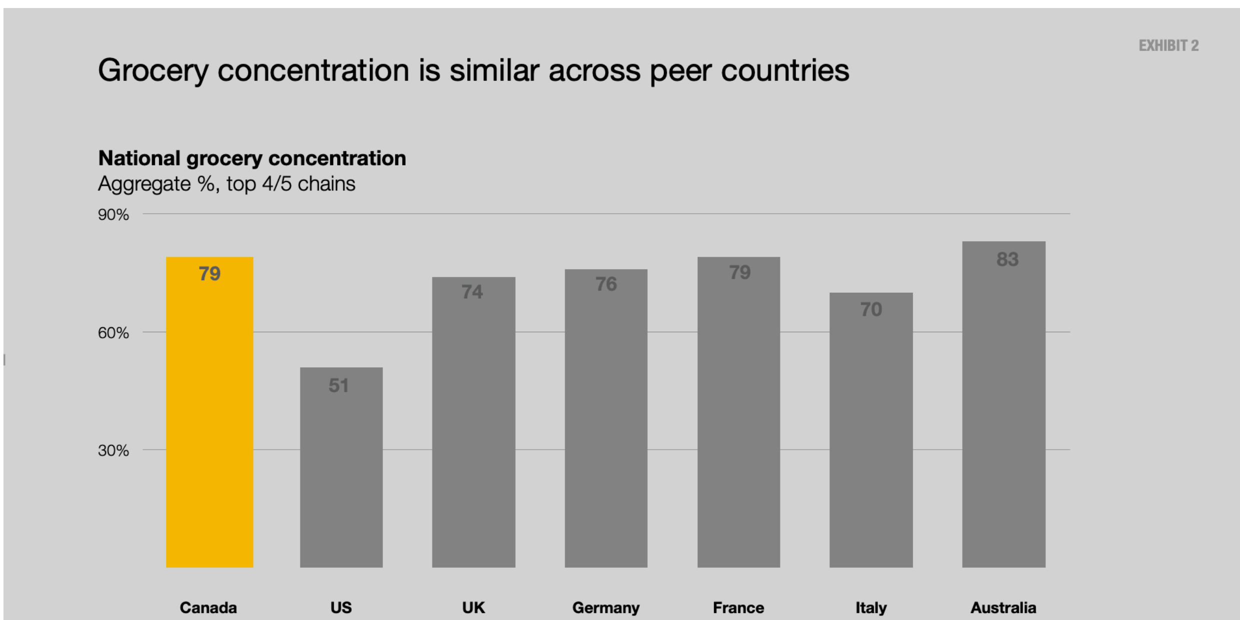
The robust nature of the Canadian discount grocery segment leads to further diversity in consumer choice.

Independent grocer presence in Canada

There is a large number of independent grocers in Canada, offering yet another option for Canadians to meet their shopping needs, as these independents generally provide more unique and targeted offerings to please shoppers who are looking for a differentiated experience. The Canadian Federation of Independent Grocers (CFIG) represents approximately 6900 independent grocery retailers across Canada (in some cases with cross-membership with Retail Council of Canada), which for a Canadian population base of 39 million averages out to one for every 5640 citizens.

Canadian grocery concentration reflects international norms in peer countries

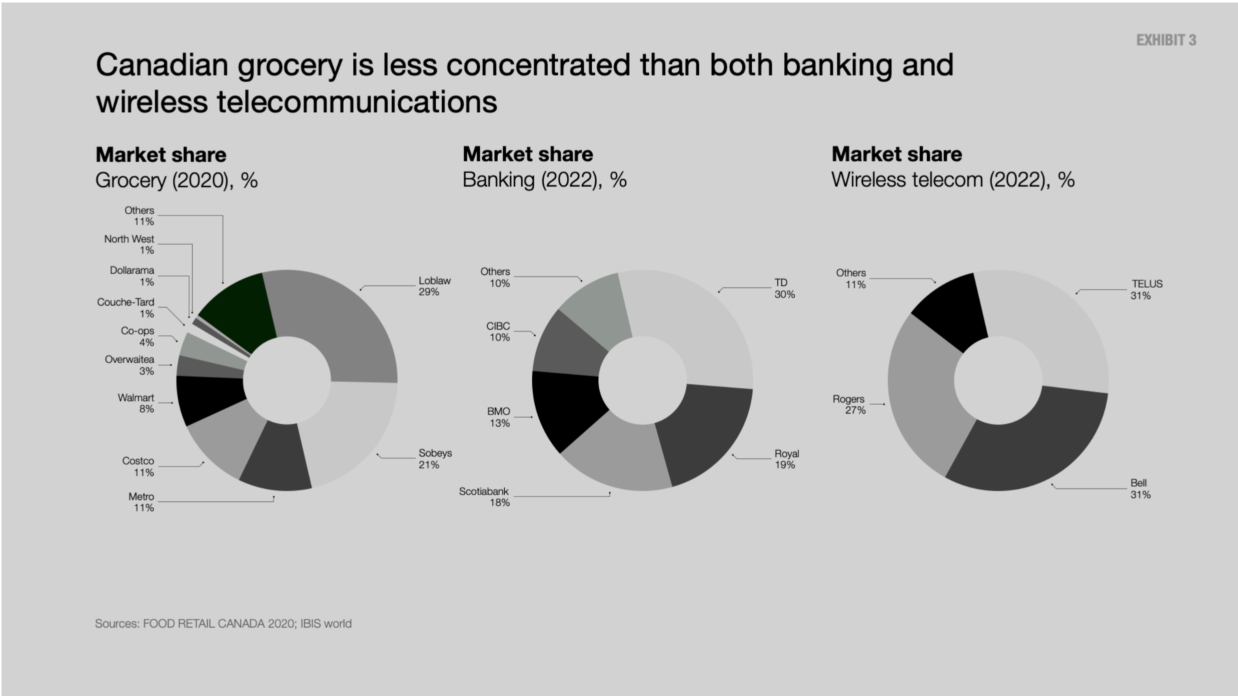
Exhibit 2 tells this story clearly. Canada's grocery market share for the top five players is comparable to the market share of the top five players in each of France, Germany, the United Kingdom and Italy and lower than that found with the top four players in Australia, with its similar population base and far-flung geography.



Sources: Supermarkets & Grocery Stores in Canada, 2022. IBISWorld; https://www.statista.com/statistics/778198/market-share-supermarkets-hypermarkets-chains-france/; https://www.freshplaza.com/europe/article/9281055/market-power-of-the-food-trade-is-truly-great/; https://www.statista.com/statistics/1285229/leading-supermarkets-italy/#:~:text=The%20top%20five%20supermarket%20chains,by%20Selex%20with%2022.22%20percent; https://www.exportgate.gr/en/explore-new-markets/country-profiles/united-kingdom/distributing; https://www.huntexportadvice.com/post/australia-market-overview-2021;

The competitive dynamic is better in Canadian grocery than in other Canadian industries

As Exhibit 3 demonstrates, the competitive dynamics in the grocery market in Canada is also better than that in several other consumer-facing industries. Banking and Telecommunications are notable examples. The "Big Five" banks have 89% of the Canadian banking market and the three largest telecommunications firms have 89% market share of wireless telecommunications. The top five players in grocery, by contrast, have a 79% market share.



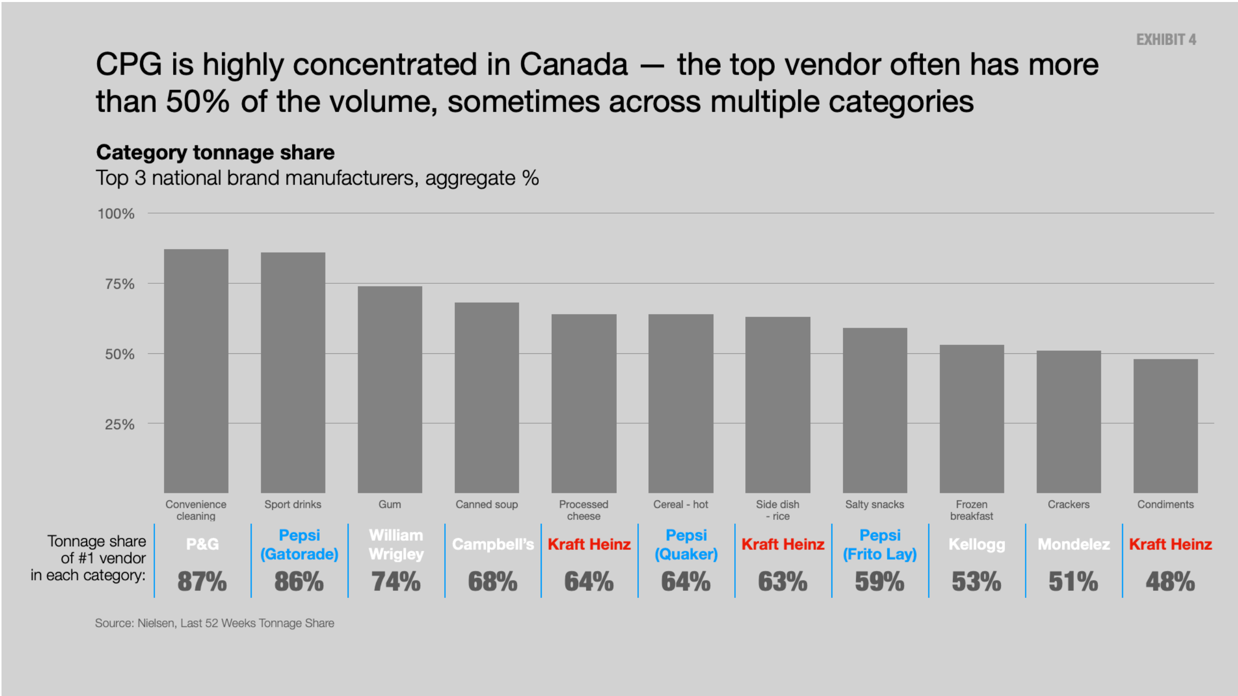
While these are not directly comparable markets, we believe that it is reasonable to assert that the vast majority of Canadians have far more diverse choices in grocery than in many other spending decisions and are apt to exercise those choices across a wider range of grocers.

Canadian grocery suppliers are concentrated in many product categories

The Canadian grocery industry is more competitive than that of the manufacturers of many of the goods sold in grocery stores, both food and non-food items. As Exhibit 4 demonstrates, there are multiple categories in which big individual packaged goods companies represent more than 50% of sales volume, in contrast to the grocery market in which no participant has greater than 30% market share.

Manufacturer complaints about grocer competitive dynamics are not based in fact and do not align with consumer interests

It will not be a revelation to the Competition Bureau that food manufacturers and processors have periodically levelled criticism about concentration in the Canadian grocery market. More recently, some representatives of the big packaged goods companies have attempted to latch on to inflation-related public policy processes in parliament to further their assertion that the grocery sector in Canada is too concentrated.



For the reasons given above, RCC and its members reject any assertion that the market is too concentrated, whether in regard to the competitive dynamics in the Canadian grocery sector, consumer interests or otherwise. It would also be a mistake to conflate the perspectives of manufacturers with the need to make any regulatory changes to the competitive dynamics in the sector or the interests of Canadian consumers. Not only are those interests not aligned they are typically divergent.

Given our submissions above, the Canadian grocery sector is functioning in a healthy and competitive manner with low barriers to entry [Exhibit 5]. The risk of introducing any regulatory changes to this dynamic may serve to undermine the competitive nature of the sector. Given that the competitive dynamics are not the cause of the high cost of food prices in Canada (or globally for that matter) it would be wholly misguided to then look at the competition dynamics as an area in need of change based on the views of one group of stakeholders in the industry. This dynamic would not serve the interest of the sector in particular or of Canadians in general.

Grocers face increasingly frequent efforts by manufacturers to raise their costs. These increases, if accepted, can inevitably lead to higher prices for consumers. Some of these supplier cost increases are understandable of course, given the inflationary pressures on agricultural products, labour, and fuel among other items. Others are more opaque as far as their justification, while still others are rejected outright or pared back in negotiations between suppliers and grocers.

It should be unsurprising that suppliers find it more difficult to push frequent cost increases through with grocers of scale. Grocers of scale benefit Canadians in a multitude of ways including (i) offering private label products that provide a real side-by-side comparison in terms of price and quality to national brands; (ii) offering a broad range of innovative, seasonal, local and diverse products – both national brand and control brand – at a competitive price primarily because of their scale and their access to the international supply chain; (iii) offering loyalty and promotional programs that provide real concrete value to Canadians. Smaller and independent grocers offer different but equally important benefits to Canadians ranging from giving Canadians access to unique products to offering personalized customer experience. The bottom line is that there is benefit to having all sizes and formats of grocers in the Canadian grocery sector and any attempt by suppliers to undermine the benefits of large grocers in Canada would be detrimental to Canadians.

There are also ongoing criticisms on the part of suppliers about certain contractual practices, which are more properly a focus of government-initiated but industry-led discussions around a Code of Conduct for the industry. In this regard, it is important to note that the Competition Bureau has previously provided its view that these kinds of disputes are outside of the mandate of the Competition Bureau and better handled through alternative channels.

Our point in making this set of observations is that it is essential for grocers to challenge supplier cost increases. Grocer push-back against any unnecessary cost increases is the primary bulwark protecting consumers from even higher grocery price inflation. In this context, the tension between suppliers and grocers in negotiating cost increases is necessary in order to ensure that customers are protected against unjustified and unreasonable price increases.

SECTION 2: Grocery margins are low and have remained generally flat during this inflationary period

Canadian grocery retail margins are low and have remained flat during the inflationary period of the last 12 months, and are largely driven by profits from pharmacy, health, and beauty products, rather than food. Indeed, grocers as a whole work extremely hard to avoid passing on the full extent of price increases from manufacturers and processors to customers. These grocery margins – averaging around 3.5% – are lower than Canadian net farm income (2021) of 7.4% and significantly lower than margins for food manufacturers and processors, especially the big consumer packaged goods companies, where profits typically range from percentages in the low to mid-teens.

Latest Full-Year	**Sales ($m)**	**Adjusted Net Earnings ($m)**	**%**
Sobeys	$ 30,162.4	$ 745.8	2.47%
Loblaw	$ 53,170.0	$ 1,911.0	3.59%
Metro	$ 18,888.9	$ 922.1	4.88%

Weighted	$ 102,221.3	$ 3,578.9	3.50%

Latest Quarter	Sales ($m)	Adjusted Net Earnings ($m)	%
Sobeys	$ 7,937.6	$ 187.5	2.36%
Loblaw	$ 17,388.0	$ 663.0	3.81%
Metro	$ 4,432.6	$ 219.4	4.95%
Weighted	$ 29,758.2	$ 1,069.9	3.60%

N.B., it is not possible for RCC to derive adjusted net earnings in the grocery retail space for the mixed merchandisers or for privately-owned grocers.

Moreover, grocery profits are increasingly driven not by food but by items in health, beauty, and pharmacy. Grocers report food profits as flat and some have stated that they are not passing on the full extent of price increases from the manufacturers and processors on to their customers..

As has been noted by several commentators, most grocers do not report their sales or profitability in food alone but on a consolidated basis. That should hardly be surprising. Simply put, these grocers report *on what they sell*. The range of products is diverse, as any shopper will know from a visit to the grocery store, whether that be household paper, cleaning products, health and beauty, pharmacy, housewares, or pet supplies, among many other categories.

And that's only within a grocery setting. Most large Canadian grocers have other lines of business, notably pharmacy, but also including extensive interests in convenience stores, gas bars, garden centres, and so on.

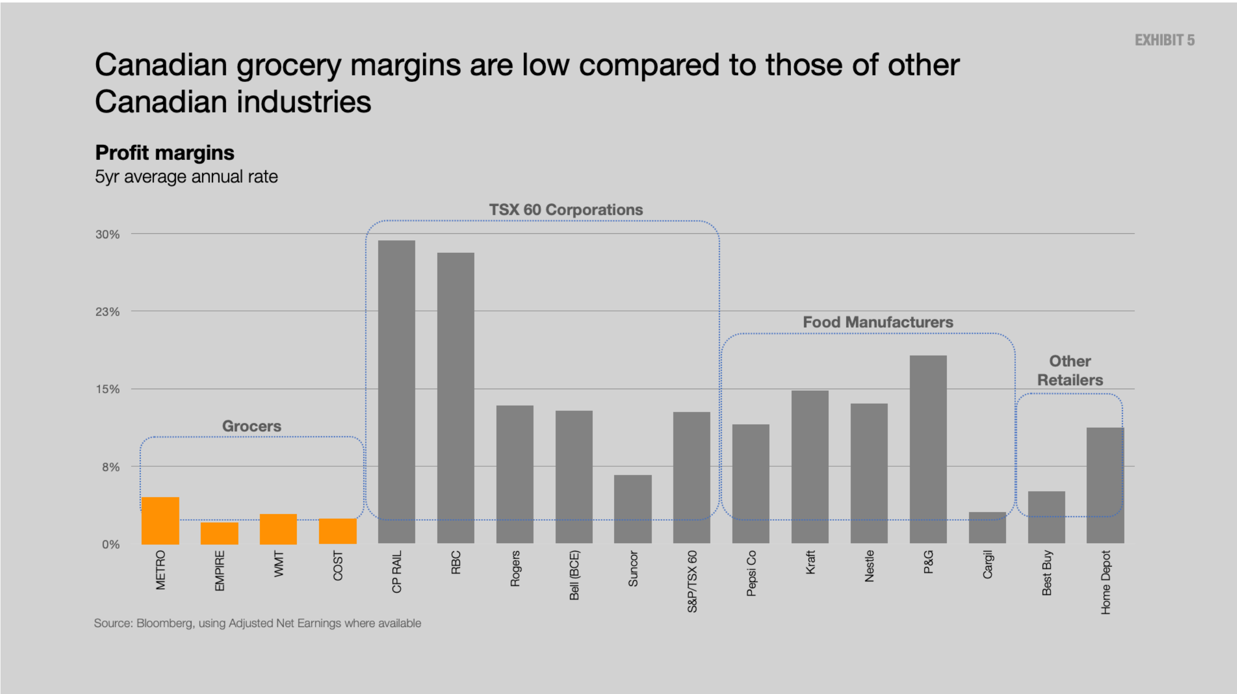
For other grocery-selling formats, including mixed merchandisers like Walmart, Giant Tiger, and Dollarama or for warehouse clubs like Costco, the general merchandise to food ratio is even higher.

All of these lines of business could be reported separately of course, but there is no reason why they must – or why they would have been to date – whether for financial reporting purposes, tax compliance, or in keeping with generally accepted accounting principles.

Grocery margins in Canada are lower than those of other Canadian retailers and industries

Media and political commentary on grocery industry profits rarely if ever place grocers within the context of profitability in other sectors in Canada or in relation to food manufacturers. Simply put, grocer earnings of around 3.5% on average are among the lowest among Canadian industries and are eclipsed by those of most of the food manufacturers, especially the big global CPG companies, whose earnings are several multiples higher [Exhibit 5].

One need only compare the 5-year average of earnings for Procter and Gamble (18.2%), Kraft Heinz (14.8%), Nestle (13.6%) and PepsiCo (11.6%) to those of Canadian grocers (ranging from 2.1% to 4.5%) to get a clear picture of who is making big profits in the food chain.



SECTION 3: Grocers are not the source of food inflation

The reason that prices have risen on grocery shelves is a straightforward one: suppliers – the manufacturers, processors, and wholesalers of food – have been increasing costs of products they supply to retailers repeatedly and almost across the board. That is overwhelmingly the biggest driver of higher prices on the shelf.

Why are suppliers' prices rising so rapidly? Because suppliers' own costs have soared, driven by unprecedented price increases from farmers, growers, and importers. These, in turn, have been caused by massive cost increases for fertilizer, fuel, and feed, amongst other inputs.

What we have experienced is a unique confluence of events: a pandemic, war, extreme weather, supply chain disruptions, and labour shortages, all building on high fuel, freight, fertilizer, and commodity prices, which have remained at or near record levels since late 2021. As noted elsewhere in this submission, the price of fuel has a high direct and indirect impact on almost all components of the grocery value chain (fertilizers, agriculture equipment, transportation, etc.), affecting food prices in turn.

Russia's invasion of Ukraine crashed grain and fertilizer exports from these leading producers and drove up the price of those commodities. And grain is critical – not only for staples such as bread, pasta, cereals, and cooking oils, but also as feed for most animals raised for meat or for producing eggs and dairy. Grain is also the base for the majority of products in the core aisles of grocery stores.

In the same timeframe, scorching weather and drought have hammered fruit and vegetable producing regions in the North American West on which Canada most relies, especially in California. This has driven up the cost not only of fresh produce, but also canned, frozen, and preserved vegetables and fruits, as well as sauces, juices, and anything in which these are ingredients.

As Statistics Canada noted recently, *"These weather conditions have contributed to increased year-over-year prices for fresh vegetables (+11.0%) and fresh fruit (+8.9%) in October 2022. Reduced crop yields put upward price pressure on raw agricultural products, resulting in higher prices for finished food products."*[2]

The Competition Bureau will be well-familiar with the decisions of the Canadian Dairy Commission (CDC) in relation to milk, raising the price by a total of 11% for 2022 and a more modest 2.2% for 2023. The CDC has been quite explicit in its justification for these price increases, attributing them to *"increases [faced by producers] in feed costs, fertilizer costs, fuel costs, and interest rates."*[3]

Canadian food price inflation is comparable to or lower than that of peer countries including the USA

Aside from touching on the global causes of food price inflation, it is also important to look at the relative impact on Canada. This is not in any way to minimize the challenges faced by Canadian consumers in the current inflationary environment. We know that it is challenging for consumers to manage food price inflation touching on double-digit levels. That's why grocers have been focusing on food staples in promotions, have promoted discount shopping options and in-house brands, and offered record loyalty benefits. It is a major reason why grocer margins have remained flat on food in at least the last 12 months and why some grocers have reported not passing on the full measure of supplier cost increases.

It is nevertheless important to note that Canada is not alone in facing these inflationary challenges. On the contrary, high inflation is affecting countries globally and not just in the food

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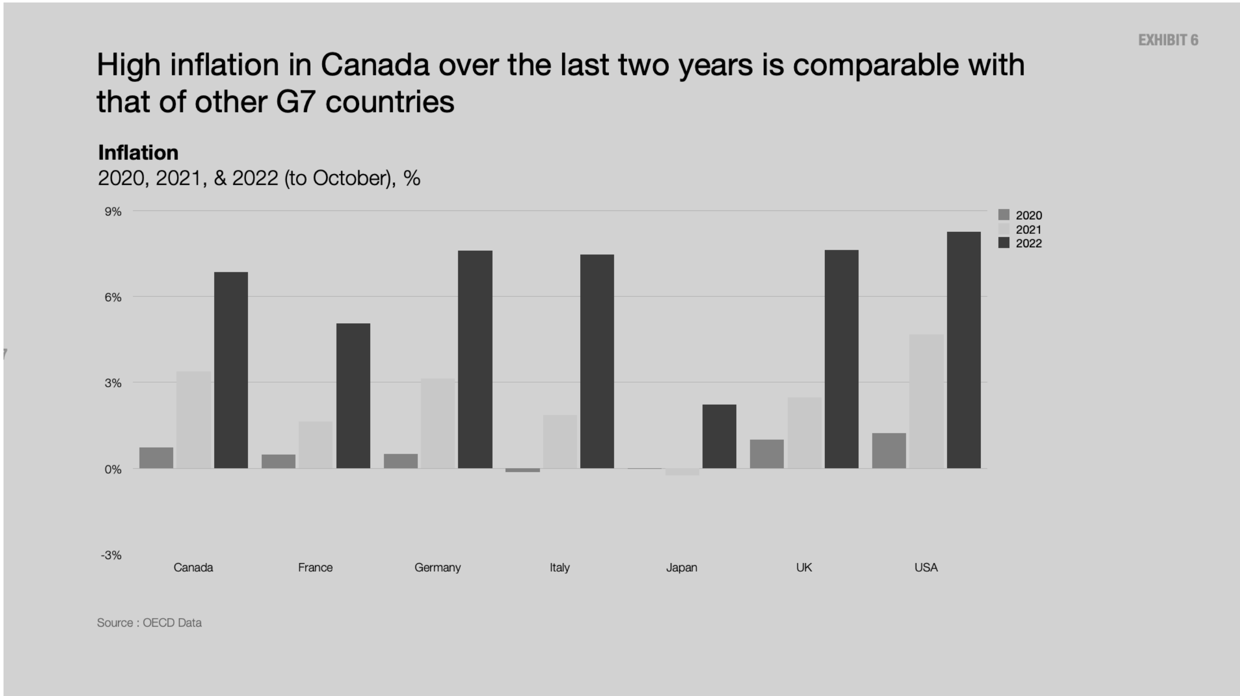
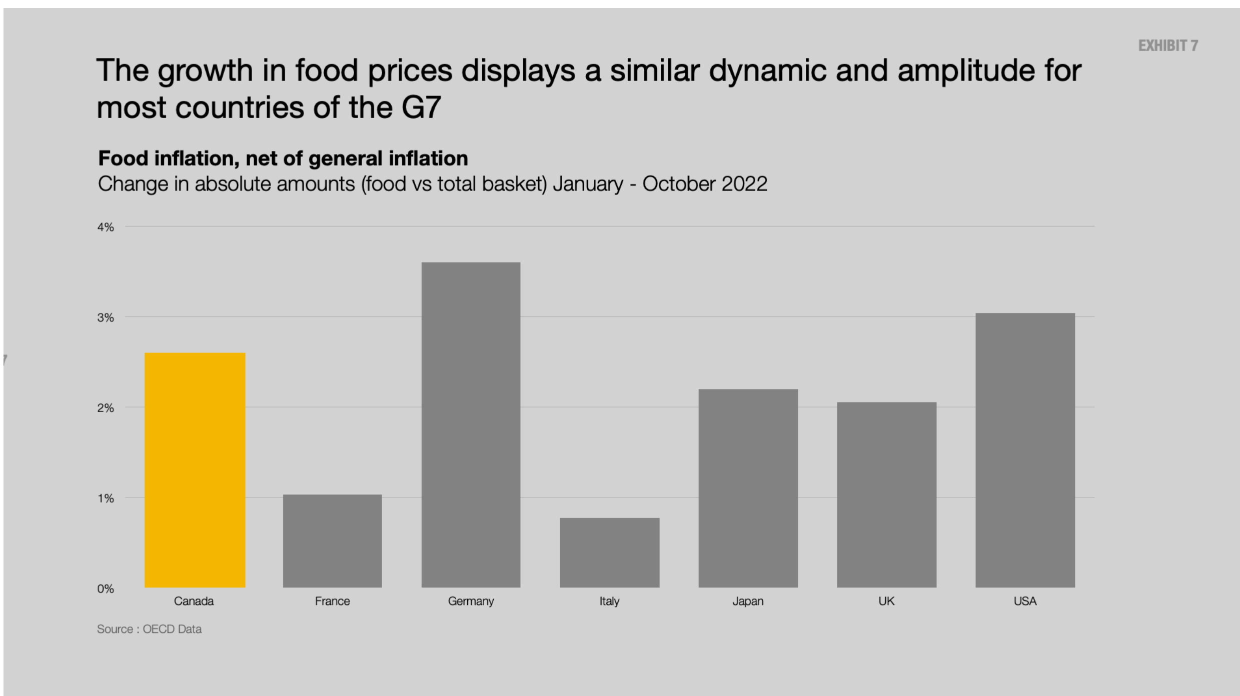
[2] Source: Statistic Canada, Behind the Numbers: What's Causing Growth in Food Prices, November 16, 2022

[3] Source: Canadian Dairy Commission, https://www.cdc-ccl.ca/en/node/943

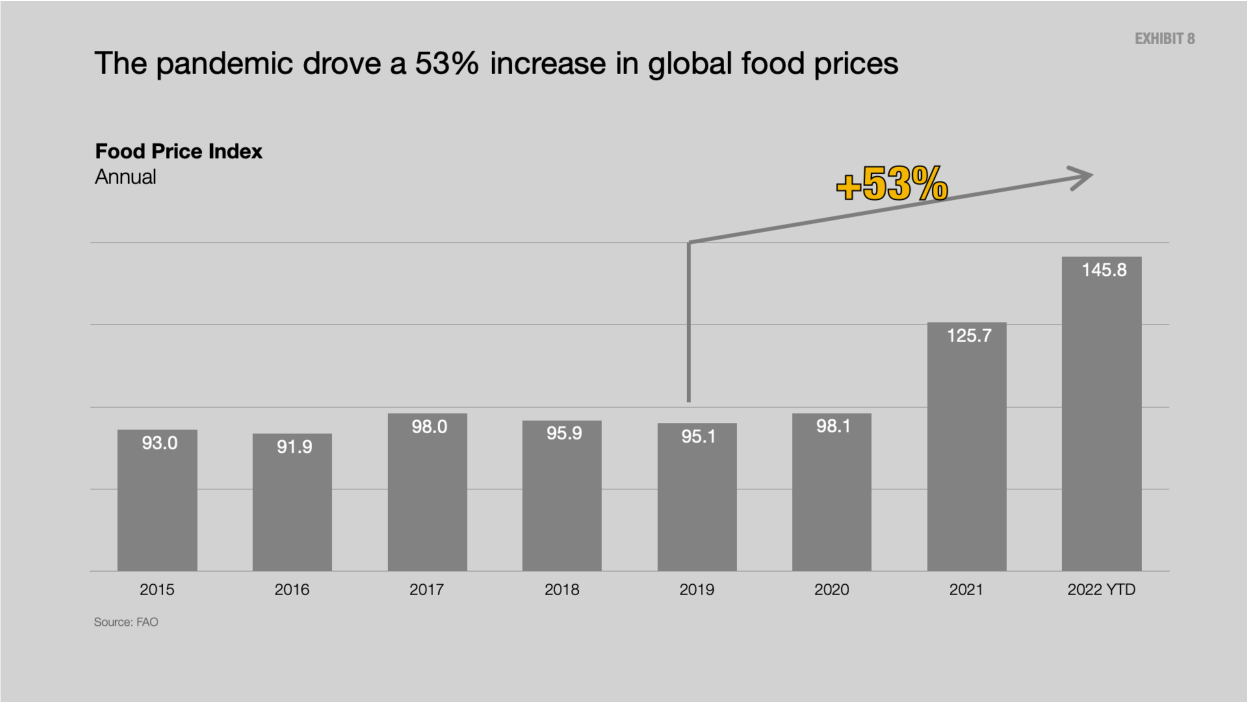


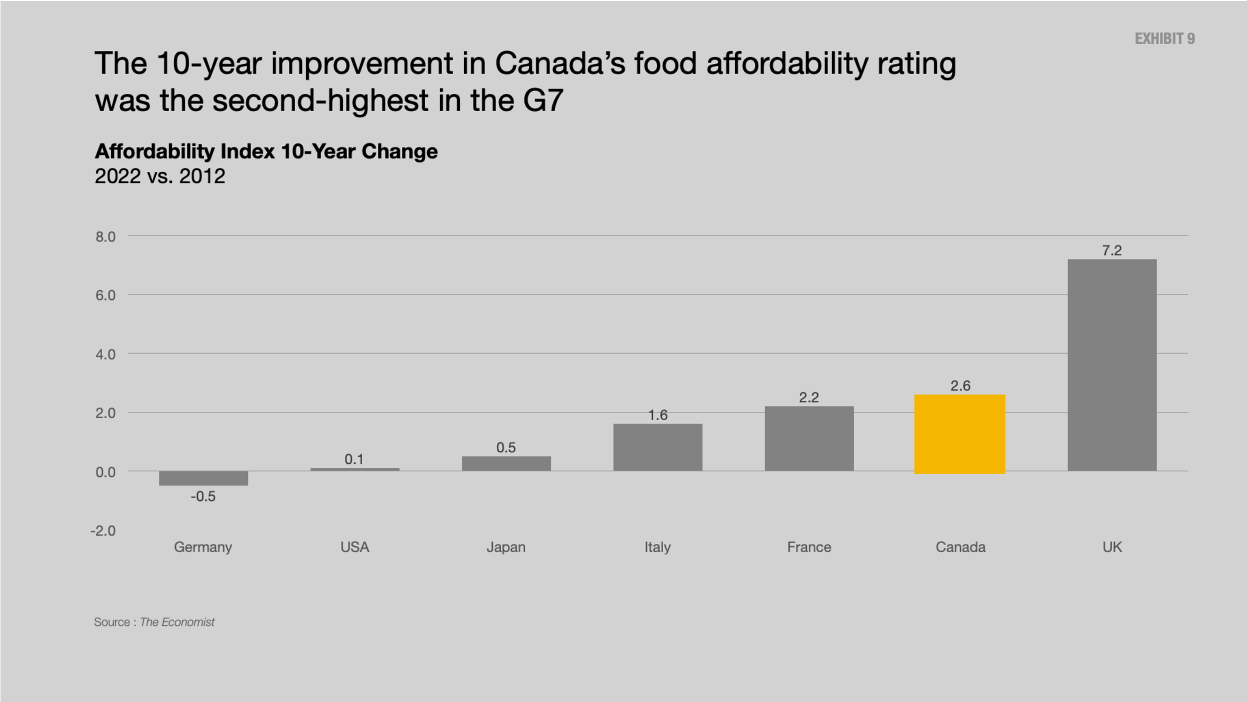


sector but in all sectors of the economy. Even in this challenging environment, Canada's rate of inflation is lower than that in several peer countries, including the USA. This is a testament to Canada's dynamic and competitive grocery sector that has been able to manage better than most other countries in this regard.

To begin with, we looked at the *overall* rate of inflation and find that Canada has experienced comparable but somewhat lower rates over the past two years and year-to-date [Exhibit 6]. RCC looked at food price inflation net of overall inflation and again finds that Canada's experience is not dissimilar from that of its peers and is again lower than that in several peer countries including the USA [Exhibit 7].

In essence, the run-up in food price-inflation is a problem with global causes and with comparable impact in Canada and peer countries, strongly suggesting that Canadian food prices are rising independently of domestic decisions or the competitive dynamic in the Canadian grocery sector which we have explained is very healthy and continues to intensify in competition.



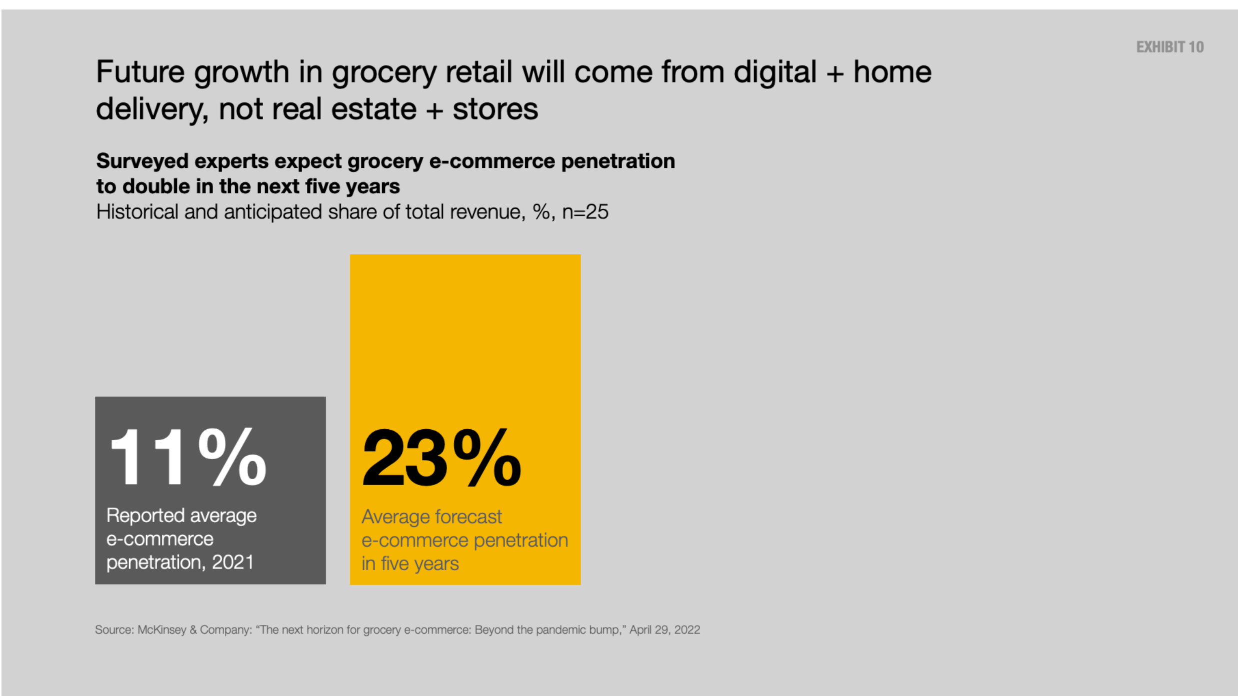


Appendix: **Barriers to entry**

The Competition Bureau has also asked for observations on barriers to entry to the Canadian grocery market. RCC would not purport to be in any way expert on this topic but does have a number of observations to make.

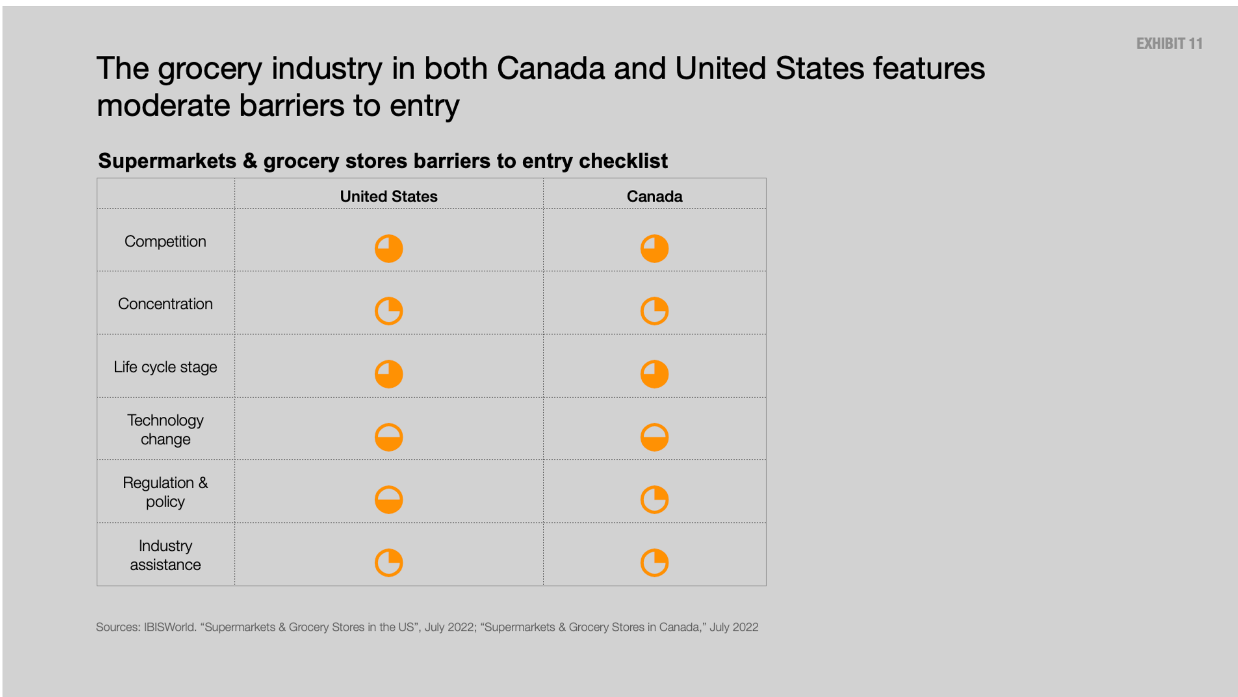
The first of these is the point made above that the grocery market has been very significantly changed by the entry of Costco and Walmart into the market, rising to be the 3rd and 5th largest food sellers nationally and with, collectively, a one-fifth share and growing. Though the dates of their entry may now harken back to 1985 and 2006, respectively, the issue of note is their rapid growth in stores and market share *through* the intervening period, which suggests that there are no real inhibiting barriers in Canada. Other entrants like Whole Foods and the expansion into food of Dollarama also suggest that Canada's grocery market has not been seen as closed to new entrants.

RCC would also like to make the point that future growth in sales may well be tied more closely to e-commerce and home delivery than to traditional brick-and-mortar stores. McKinsey and Company has estimated that the e-commerce share of the grocery business will double over the next five years [Exhibit 10]. For the most part that will occur independently of store settings and hence of existing real estate configuration. This e-commerce expansion will involve existing grocery players of course, who already operate substantial bricks-and-mortar store networks but is apt to include new or newer players as well.



In this regard, Amazon and other retailers with an e-commerce focus may well become major players in the Canadian grocery mix. Amazon is already here of course, both through its ownership of physical stores at Whole Foods Market and its online offerings in a multitude of packaged foods. Given Amazon's sophistication, expertise with Canadian consumers and skills at home delivery, we would expect Amazon and perhaps other e-commerce players to incrementally diversify their online offerings into other grocery categories.

Speaking more generally, RCC is not aware of there being any barriers to entry posed by existing grocery players as far as relationships with vendors or otherwise. While it is not our area of expertise, we note that IBISWorld's mid-2022 analysis [Exhibit 11] of both the US and Canadian markets finds highly comparable conditions in competition, concentration, life-cycle stage, technology change and individual assistance, with the only real variation being in the regulatory and policy space, itself beyond the control of existing grocery players.



RCC is ready to offer whatever support we are able to the Competition Bureau over the course of this market study and looks forward to participating in its stakeholder outreach phase in early 2023.