A deal between Carrefour and Tesco to team up on global purchasing will help them not only cut prices but also expand their own-label ranges, tightening a squeeze on major brand producers such as Nestle and Kraft Heinz.

The Carrefour-Tesco alliance will reset relationships with global suppliers like Unilever, Nestle and Procter & Gamble, at a time when they are already battling sluggish demand and start-up rivals.

In a further blow to major consumer goods firms, the pair will also jointly source own-brand products, sales of which are growing rapidly in Europe due to the expansion of discounters like Aldi and Lidl which mostly stock private-label goods.

"Buying alliances have a detrimental effect on the whole food supply chain," said Mella Frewen, director general of FoodDrinkEurope, an industry lobby group.

However, the alliance could also allow smaller suppliers that only supply one of the retailers to double their business:

"They could be into a massive opportunity for which they might very well drop their prices and compete," said David Sables, CEO of Sentinel Management Consultants, which coaches suppliers on how to negotiate with big supermarket groups.

Sales growth at Nestle, Procter & Gamble and Unilever has been driven almost entirely by shifting more goods this year, rather than price rises given a tough retail environment.

In the latest salvo from an activist investor seeking to shake up the sector, Third Point on Sunday recommended a series of steps to boost earnings at Nestle, whose brands include KitKat chocolates and Thomy sauces.

Faced with consumers shifting towards healthier food and independent brands, manufacturers like Nestle are
Faced with consumers shifting towards healthier food and independent brands, manufacturers like Nestle are responding by trying to sell more premium, higher-priced items.

But retailers are reluctant to put up prices as they face their own battle with discount groups and online players like internet giant Amazon.

Top brands have long taken a hard line in negotiations with retailers, assuming that stores are loathe to remove consumers' favourite products from their shelves.

That approach backfired for Nestle earlier this year when a buying group representing six European retailers flexed its muscles with the Swiss group, pulling some of its products for months during a pricing row that was only settled in May.

The Carrefour-Tesco alliance is just the latest purchasing agreement struck by major European retailers in recent years. German retailer Metro agreed a similar partnership with Auchan, Casino and Schiever of France last week.

The deals compound pressure on suppliers after Britain's second-ranked Sainsbury's agreed to buy Wal-Mart owned Asda, the number three player.

PRIVATE-LABEL SALES RISING FAST
Tesco CEO Dave Lewis, a former Unilever executive, said branded giants were being outflanked by start-ups and retailers when it comes to developing new products.

"For a lot of branded manufacturers ... agility is not always there and so they are getting out innovated by a lot of small players," Lewis said last week.

While about half of Tesco's sales already comes from private label goods, which tend to be more profitable for retailers than branded ones, the figure is only about a quarter at Carrefour. The French firm aims to raise that to a third by 2022, while it is expected to cut the branded goods it offers by 20 percent.

Retailers creating their own products is seen as a major challenge by a quarter of top executives at consumer goods firms, according to a recent survey by consultants KPMG.

Private-label goods grew to account for more than 31 percent of sales in the European Union in 2016, and are set to keep growing, according to Nielsen, eroding demand for big brands.

As Lewis has sought to rebuild trust in the British retailer since an accounting scandal in 2014, Tesco has operated in a more collaborative way with suppliers, in contrast to a confrontational approach at Carrefour, Sables said.

"Suppliers to Carrefour might think if any of Tesco's attitude in dealing with suppliers rubs off on Carrefour – that's a positive thing," he said, adding Tesco could recommend its private-label suppliers to Carrefour and vice versa.

The alliance could impact companies like Biscuit International, a leading producer of own-label sweet biscuits owned by private equity firm Qualium Investissement, according to Yves Marin, an associate at Bartle Business Consulting.

The deal could take time to take effect as private-label contracts run for one to two years and suppliers will have to cross check prices of products sold by Tesco and Carrefour, Marin added.

POWER SHIFT

In another sign of the shifting balance of power towards retailers, British supermarkets are taking longer to pay their suppliers, according to Duncan Swift, who runs the food advisory group at business consultancy Moore Stephens.

"The swelling ‘piggy-bank’ of supplier monies held by supermarkets exacerbates the risk of them making unwarranted deductions which causes suppliers financial distress," he said.
Swift said retailers had to be careful about how they implement purchasing alliances so they do not ring alarm bells with competition authorities, adding they do this by not sharing too much information.

Ian Wright, chief executive of Britain's Food and Drink Federation, said the Tesco-Carrefour deal would increase concerns about buyer power stoked by the Sainsbury-Asda merger and the risks they impose on suppliers, mostly smaller firms.

"It is imperative that these important changes to retailer-supplier market dynamics are properly examined by the competition authorities – in the round," he said.

Britain's Competition and Markets Authorities is already examining the merger of Sainsbury and Asda, which are expected to argue their deal is justified given the shake-up of the market due to the rise of the discounters and Amazon.

Discounters now account for 22 percent of sales of fast moving consumer goods in Europe, up from 17 percent a decade ago, according to data analytics firm Nielsen.

Analysts at Fitch Ratings do not expect the Tesco-Carrefour partnership to be subject to competition scrutiny as they have hardly any geographic overlap, although regulators could start paying more attention if more alliances emerge.

David McCarthy, HSBC head of consumer retail research, said buying alliances have not worked well in the past as retailers have failed to secure standardised prices. But he said Tesco and Carrefour now have a strong incentive to succeed.

"New ways of doing business are needed to deal with exogenous threats such as Amazon and discounter expansion," he said. "What is different this time is both the desire and need for the deal to work."