

Formal and Informal Relational Contracts: The Grocer-Supplier Relationship in Canada



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What do we do? Document the evolution of the Canadian GCC; provide an analytical framework to understand the grocer-supplier relationship with a focus on the potential implications of an industry-wide code of conduct (CC) in conflict adjudication.
How do we do it? Scouting sources to document the evolution of the GCC and using a standard relational contracting model, we assess grocer's welfare outcomes under two scenarios: government-mandated CC, and voluntarily adopted CC.
What do we find? Using our model, we find grocers prefer a voluntarily-adopted CC over a government mandated CC. Because this parallels the observed behaviour of players in the industry, it lends credibility our model can continue to be used to study grocer-supplier relations in Canada.

A Brief History of the Grocery Code of Conduct (GCC)

- In July 2020, Walmart announced a unilateral 'infrastructure development fee' to their more than 3,000 suppliers to offset investments in expansion.
- Prominent industry organizations like FHCP and CFGI pushed back, calling for government intervention to alleviate tensions caused by this unilateral fee.
- The first draft of the GCC, the result of collaboration with various industry stakeholders, was presented to grocers in November 2023, with Metro and Empire agreeing to the terms immediately.
- The mounting reluctance from Loblaws, Costco, and Walmart was met with the threat of government legislation in February 2024.
- By July 2024, all five grocery chains in Canada have agreed to the terms of the GCC, which will go into effect in June 2025.

A Method For Studying the Grocer-Supplier Relationship

- The data that would be needed to analyze this relationship is difficult to source as it would require access to internal company data, generally not readily supplied by private companies
- Relational contract theory is an economic tool that facilitates the analysis of relationships between parties engaged in repeat trading, ideal for examining interactions between a grocer and a supplier

Industry Led CC: Voluntary Adoption

$$\max y - S - by + By + \frac{\delta}{1-\delta}V(c) \quad \text{s.t.} \leftarrow \text{Grocer's objective function}$$

The grocer's goal is to maximize their payoff (π^V), given:

$$\left. \begin{aligned} y - S - by + By + \frac{\delta}{1-\delta}V(c) &\geq \frac{\bar{\pi}}{1-\delta} \\ S + by - By - \frac{1}{2}y^2 + \frac{\delta}{1-\delta}U(c) &\geq \frac{\bar{u}}{1-\delta} \end{aligned} \right\} \begin{array}{l} \text{Participation} \\ \text{Constraints} \end{array}$$

This ensures it is worthwhile for a grocer and supplier to continue their interactions relative to their outside options.

$$S + by - By - \frac{1}{2}y^2 + \frac{\delta}{1-\delta}U(c) \geq S + by - \frac{1}{2}y^2 + \frac{\delta}{1-\delta}\bar{u} \quad \leftarrow \text{Self-Enforcement Constraint}$$

This ensures the supplier doesn't shirk their payment of the fee.

$$y \in \arg \max \left\{ S + by - By - \frac{1}{2}y^2 + \frac{\delta}{1-\delta}U(c) \right\} \quad \leftarrow \text{Incentive Compatibility Constraint}$$

Ensures the supplier can maximize their own payoff given the terms offered by the grocer.

Following the standard methods for solving a relational contract, the grocer welfare is $\pi^V = b - B - \frac{1}{2}b^2 + bB - \frac{1}{2}B^2 - \bar{u}$

Government Mandated CC: Strictly Enforced by a Third Party

$\max y - S - by$ s.t. In this scenario, the grocer's goal is to maximize their payoff (π^G), given:

$S + by - \frac{1}{2}y^2 \geq \bar{u}$ This participation constraint ensures the contract offered by the grocer provides greater payoffs than the supplier could obtain elsewhere

$$y \in \arg \max \left\{ S + by - \frac{1}{2}y^2 \right\} \quad \text{Incentive compatibility constraint}$$

This contract has no need for a self-enforcement constraint because it is being enforced by government regulation

The grocer welfare under strict enforcement is $\pi^G = -\bar{u}$

Results and Contribution

$$\begin{aligned} b - B - \frac{1}{2}b^2 + bB - \frac{1}{2}B^2 - \bar{u} &\geq -\bar{u} \\ \pi^V &\geq \pi^G \end{aligned}$$

A grocer's payoff is higher with an industry led, voluntarily adopted CC than with a government mandated CC. This finding reflects the observed interaction between grocers and suppliers in the industry, namely the impact of threatened government enforcement on the behaviour of grocers. The next steps for this model are to evaluate the impact an industry-led and government mandated CC has on supplier welfare. This study provides a methodological contribution for examining the interactions between parties in differing regulatory scenarios.