

President and CEO Matti Halmesmäki's answers to questions at Kesko's Q1/2013 media and analyst briefing 25 April 2013

Tommi Tolkki, STT Lehtikuva: A question concerning the proposed amendment of the Competition Act: Kesko has estimated that if the bill is passed, food prices would go up by some 10%. Could you give a concrete example of the impacts of the amendment; how would it affect food prices and your operations?

Matti Halmesmäki: No one can say how it would affect, but it is clear that it would have significant impacts. The Act is unclear and unfair to the K-Group and K-retailers, because K-retailers make decisions concerning their selections. K-retailers' direct purchases from local suppliers have increased substantially within a year, amounting to nearly €700 million. The K-retailer always decides the quantities he/she purchases. Although the common chain selection accounts for around half of the total selection, K-retailers can modify the mix in their stores. The Act is lobbied by the food manufacturing industry and partly by primary production in order to strengthen the price level. Food manufacturers have two objectives: they want to access store selections and see the trading sector as the gatekeeper. They think that the new law would give them easier access to store selections based on their equality requirement. And the other objective is higher prices on their products. This follows that the prices of Finnish food would rise. In any case, all kinds of analyses and accounts would be required of the trading sector, as the law would be used as a threat arguing that the trading sector has misused its position. Many decisions concerning product selections and campaigns are made on a daily basis and it is not possible to have them all documented. As it is, many kinds of official accounts are already made as required. In Finland, the same terms and conditions are applied to Finnish and foreign suppliers. However, they are not applicable to purchases made under international purchasing cooperation. In other words, the position of international suppliers would improve and imports would increase. This is not a threat, but a logical fact. The K-Group and Kesko are always committed to Finnish origin. In fact, a campaign for Finnish products is currently running in K-citymarkets. The trading sector offers products which customers want to buy. For example, meat prices have recently risen, and the financial figures for especially pig farms are very sad. But the situation is not corrected by making the two trading sector operators pay more for pork. Instead, it is put right through higher imports by the existing or emerging operators. That's how the market economy operates. It is very old fashioned to think that regulation would be the solution. If the Finnish production conditions do not enable competitiveness, support is needed from the EU or national government. Strong primary production and food manufacturing industry in Finland are benefits. But using regulation to make two trading sector operators pay will not succeed. Another major issue are private labels, whose quality is often even higher compared to branded products, are 15-20% cheaper. The food manufacturing industry wants to control and reduce them and make their operation more difficult to give higher margins. The new law is very ambiguous and its impacts have not been evaluated. If such an evaluation was made, and it would undeniably reveal difficulties and problems for which solutions would be sought, the

amendment of the law would be easier to accept. But not this mantra of the two blocks, which is a political manifesto not based on facts.

TT: Professor Jyrki Niemi wrote in Helsingin Sanomat that the amendment should not affect price levels if the competitive tools now used by the trading sector are not based on a blatant misuse of market power. How do you comment?

MH: Different opinions have been expressed about the issue. I'm disappointed that we haven't been able to explain the K-Group structure clearly enough for a professor, let alone ordinary citizens, or the Commerce Committee MPs to understand it. The proposed law amendment has been prepared on one-sided knowledge and such an amendment is not needed. The EU regulation and the existing laws already enable the elimination of any defects. If the bill is passed, nothing will happen overnight. I expect the Finnish Competition Authority to have some programme, which it will impose and take to the Market Court. The proposed amendment includes another ambiguity for us: the Competition Authority wants the law amendment to affect the retail level, but how would the K-Group be treated in that respect because we don't have own retailing? We cannot control K-retailers more than what is provided in the chain agreements, they are independent entrepreneurs. For example, a K-retailer can have a cooperation agreement with the local bakery, what is Kesko's responsibility for the operations of a single retailer. Kesko is not engaged in own retailing. Instead, we use chain agreements in which Kesko's possibilities to adjust the selection and control prices have been increased in some respects. It is important that retailers maintain their entrepreneurial freedom.

Elina Kervinen, Helsingin Sanomat: A question concerning Musta Pörssi retailers: when their chain agreements were terminated, what percentage of the retailers quit? And could you tell us about the new agreements?

MH: To my knowledge, new agreements have not been signed, but the process is underway. If my memory doesn't fail me, at the beginning of the process, there were 30 retailers, and around a dozen have expressed their willingness to become Musta Pörssi partners in the new business model. The others have quit, joined other chains or began operating outside chains. The sector is clearly suffering from a profitability problem, which makes leaving the business understandable.

Tiina Taipale, Maaseudun Tulevaisuus: About the building and home improvement trade and the agricultural trade: the sales and profit of the building and home improvement trade fell, whereas the sales of the agricultural trade increased. What does it tell us and what is Kesko's view on agricultural trade as a whole now that the competitive situation is changing quite radically?

MH: Farmers are patriotic people and many of them are our customers, i.e. customers of a Finnish agricultural trade operator, which explains part of our growth. Grain prices have risen and grain brokerage has increased, whereas profitability in the agricultural trade has

not improved in line with the growth. For us, however, the agricultural trade is a profitable line of business.

Heino Yli-Sipola, Kaleva, Turun Seudun Sanomat ja Väli-Suomen Media: About the amendment of the Competition Act: a few weeks ago, the Central Union of Agricultural Producers and Forest Owners (MTK) required an independent auditor to be introduced to control the competitive situation in the grocery trade. What is your opinion on it?

MH: The K-Group has always been in favour of free competition and less bureaucracy. Agriculture, for example, has paid dearly for having been a highly regulated sector for such a long time. The need for change had piled up and finally led to dramatic developments. The world is full of problems, but very few of them can be solved by increasing regulation. A good example is emissions trading in which the only consequence was an increase in energy prices plus a huge bureaucratic system. Especially the growing number of political generations who have done practically no other work except politics in their lives cannot see other solutions than further regulation. Regulations on alcohol and tobacco, for example, have increased parallel imports and single-purchase quantities.

Elina Kervinen, Helsingin Sanomat: A specification concerning the cashback service: Will it be available everywhere all at once, or will it be tested somewhere first?

MH: The aim is to include it in the K-food store chain concept and thereby made available at all K-food stores. It would also be easier for customers in terms of marketing. The objective is that all of the nearly 900 K-food retailers sign the agreement on the service by this summer.

Topi Kanniainen, Taloussanommat: About the new discount label you mentioned in the interview of Helsingin Sanomat: How ready are your plans?

MH: Pirkka and Euroshopper are our private labels, but Pirkka is not actually a discount label in that according to surveys, it is a highly appreciated quality brand among customers. In many product groups, it is considered to be better than a corresponding A product or brand. Euroshopper was originally targeted against the arrival of Lidl. Our new private label would be a high-quality brand, a brother or sister to Pirkka. Finnish food is pure and tasty, but high-quality foods are produced in other countries too. Our new product range will presumably be more affordable than Finnish products and other branded products. So in that sense, it can be called discount label, but without any compromise on quality typically attached to discount labels. In K-food stores, customers especially appreciate service counters, which are among the K-food retailers focus areas. Customers also value service, product quality and selections. Proof of which are the purchase amounts for the weekend and public holidays. The planned new private label is intended to increase the selection while maintaining a competitive price level.

TK: But why would you introduce a private label so similar with Pirkka?



MH: Pirkka has a profile of its own as a range concentrating on Finnish products. It accounts for nearly 20% of K-food stores' sales, which is not much on an international scale, but because it is such a top brand among customers, we don't want to take the risk of change pressures on Pirkka. A parallel brand would serve that purpose. Thank you!