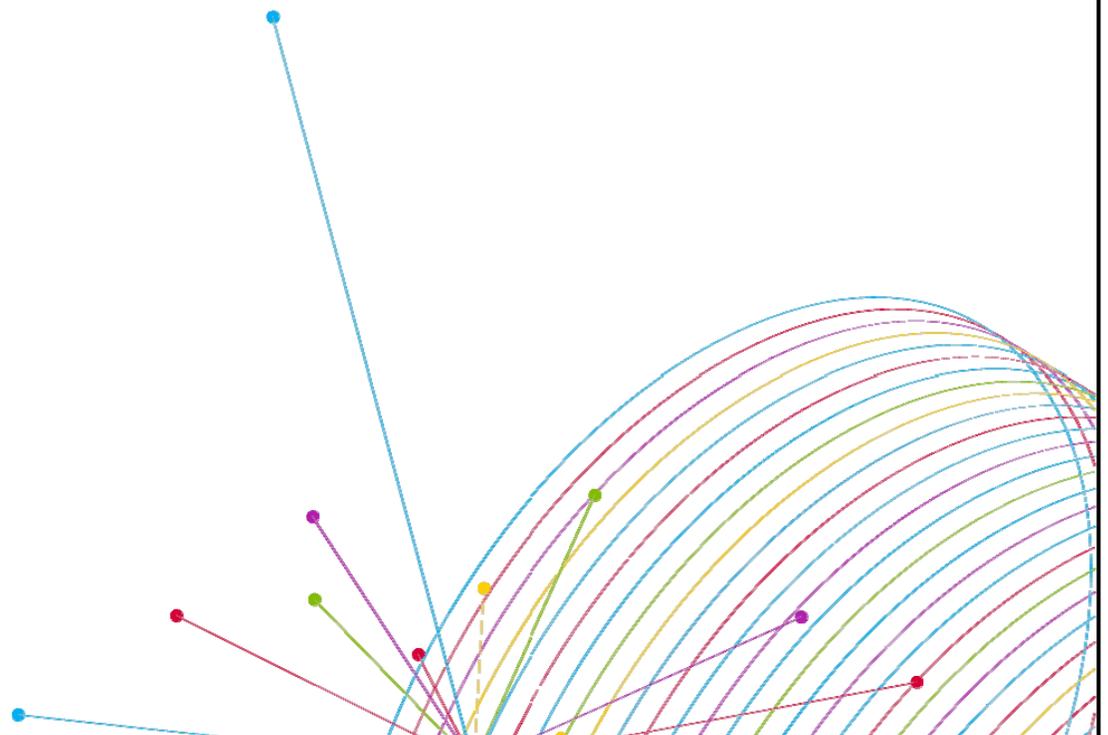




AN UNCOMMON SENSE
OF THE CONSUMER™

MONITORING RETAIL PRICES OF BABIES' CLOTHING AND SPORTING GOODS POST TARIFF ELIMINATION

SUBMITTED: JANUARY 9, 2015



INTRODUCTION AND BACKGROUND

Many consumer products consistently cost more in Canada compared to the same products sold in the United States. Even with a significant appreciation of the Canadian dollar over the past decade, these price discrepancies persist.

Concerned with this situation, in October 2011 the Minister of Finance asked the Standing Senate Committee on National Finance to complete a report identifying why these price differences exist. Along with a number of other possible factors, the Committee report suggested that import tariffs were playing a part.

Taking this into consideration, the Economic Action Plan 2013 eliminated \$79 million in annual tariffs on baby clothing and certain sports equipment including products such as ice skates, hockey equipment, ski and snowboards, golf clubs and other equipment to promote physical fitness and healthy living. In doing so, it was the expectation that wholesalers, distributors and retailers would pass these savings on to Canadian consumers in the form of lower prices at retail.

To help determine whether Canadians were in fact benefitting from this initiative, the Government contracted Nielsen Canada to monitor retail prices across items in these categories. The Retail Council of Canada and its members were also consulted and provided support throughout this process.

The purpose of this document is to present the data collected including an analysis of the pricing trends. In addition, this document outlines the scope and limitations of Nielsen Canada's work, an overview of the Preferential Tariff Treatment legislation and some insights into other retail factors that might have affected the pricing of these categories.

The information in this report has been synthesized into a set of salient observations for the Government's consideration as they seek to make future policy decisions.

RETAIL AUDIT – RESEARCH OBJECTIVES

To monitor retail pricing activity across Baby Clothes and Sporting Goods items, Nielsen Canada was contracted to audit a sample of stores for a period of about one year.

The objective of this in-store audit research was twofold:

1. Establish how pricing has changed over the duration of the audit timeframe in Canada
 - Have retail prices in the Baby Clothes and Sporting Goods categories come down for Canadian consumers?
2. Establish if the gap between Canadian and U.S. retail prices for the same categories changed over the duration of the audit timeframe
 - Has the price gap narrowed between Canadian and U.S. retail prices?

RETAIL AUDIT – LIMITS TO THE PROJECT SCOPE

It is important to note that while Nielsen’s mandate for this research was to observe pricing in the marketplace, we cannot isolate the impact of tariff elimination. Simply, we are reporting the pricing trend observed.

In reality, there are many other factors that may have affected prices in the marketplace. To provide further context into these factors, the Retail Council of Canada (RCC) was consulted and a summary of the insight they provided is found in the section “Other Retail Trends That May Affect Pricing”.

It is also relevant to note that while the tariff elimination took effect April 1, 2013, Nielsen’s Canadian price monitoring ran from the Fall 2013 to Fall 2014. Since retailers operate differently in how they approach inventory management and the implementation of pricing changes, a reduction in price could have happened prior to the start of Nielsen’s pricing audits and therefore a change in price may not be captured in this report.

In the case of the Baby Clothes items, efforts were made to monitor a consistent set of products that are broadly available in the marketplace. Auditors collected pricing for the same types of items month over month; but factors such as seasonality, change in product selection and out of stocks may have impacted the information collected.

Regarding Sporting Goods in particular, having a full year of data for most items was not possible due to the seasonality of sports and their availability at retail. As a result, the data collected for many of these items is limited and reduces the findings we are able to report on for this set of products.

U.S. pricing information was also collected with 2 audit sweeps executed in one city. Given this limited sample, a price trend analysis is not available for the U.S. market but has been used to provide a benchmark for price gap analysis with the baby clothing category.

This review is limited to only Regular Prices observed at retail in the market. Promotional pricing is not reflected in the results.

RETAIL AUDIT – DATA COLLECTION METHODOLOGY

To monitor the pricing trend, auditors manually collected prices for a select group of baby clothes and sporting goods items in a subset of stores in the Canadian and US marketplaces. Following are the audit parameters:

Period of Collection:

The audits were conducted from Fall 2013 to Fall 2014.

Frequency of Audits:

- In Canada, 12 waves of retail audits took place over the duration of the study
- In the United States, 2 waves of retail audits took place over the duration of the study
- US baby clothes collection – September 2013 and August 2014
- US sports product collection – January 2014 and June 2014

Products Observed:

As this was an on-going audit, the goal was to pick up the same type of item each store visit. Following is a topline overview of the products observed by category:

Baby Clothes Audits:

- Auditors were provided a list of approximately 60 baby clothes items (size 24 months and under) to collect pricing on for each store visited. The items monitored crossed a variety of clothing types including Jeans, Onesies/Bodysuits, Sleepwear, Layette Sets and Socks.
- A cross section of Store Brand and popular Brand name items were audited. Baby boy clothing was monitored where possible as there tends to be less variability in the offering of baby boys clothing versus baby girls clothing.

Sporting and Exercise Equipment Audits:

- Auditors collected pricing information across a variety of sporting and exercise equipment. Since some Sporting stores specialize in only certain types of equipment, also due to the seasonality of some sports, the range of products observed in each store varied over the course of the audit (on average 85 products could have been observed in a given store).
- The items monitored included Hockey Equipment (Skates, Pants, Shoulder Pads, Shin Guards, Helmets), In-Line Skates, Bicycle Helmets, Baseball Gloves, Tennis Rackets, Soccer Shin Guards, Golf Clubs and Exercise Equipment (i.e. weights, exercise balls).
- The vast majority of products audited were popular brand name items.

RETAIL AUDIT – DATA COLLECTION METHODOLOGY continued

Markets:

Baby Clothes Audit:

- 20 Canadian stores were visited crossing 12 major retailers in the Greater Toronto, Montreal and Vancouver areas
- 12 US stores were visited crossing 12 major retailers within the Greater Buffalo Area (US retailers were selected to, as best as possible, align with Canadian retailers in the sample)

Sporting Goods:

- 17 Canadian stores crossing 6 major retailers within the Greater Toronto, Montreal and Vancouver areas
- 7 US stores crossing 6 different sports retailers in the Greater Buffalo Area

Data Collected:

- Results in this analysis are based on Regular Prices observed at retail.

RETAIL AUDIT – DATA ANALYSIS METHODOLOGY

Data Validation:

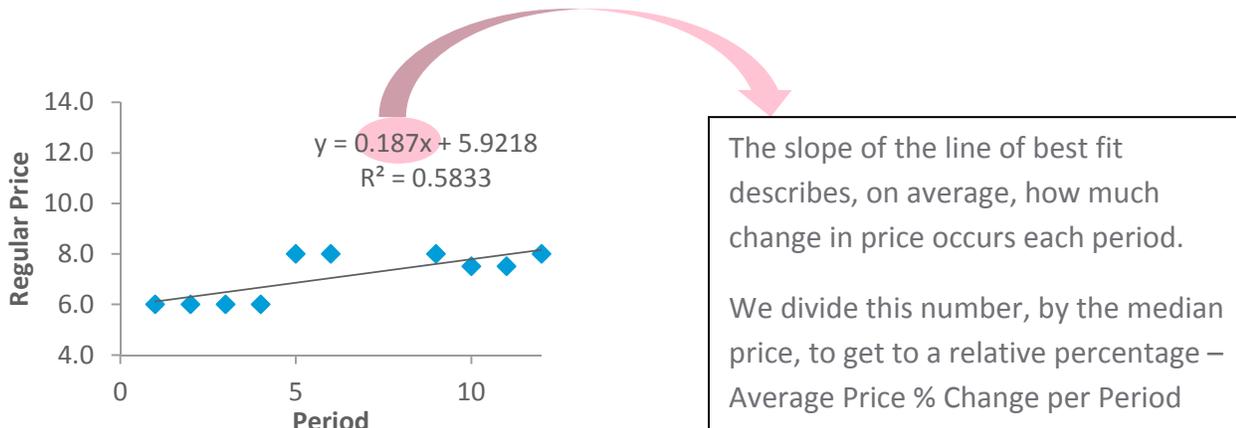
- For a record (i.e. a single product in a single store address) to be included in the trend analysis, the record must have:
 - In Baby Clothes, at least 2 regular prices in the first 6 months of the audit period and at least 2 regular prices in the following 6 months of the audit period.
 - In Sporting Goods, at least 4 regular prices observed over the course of the audit timeframe.

Note: Different rules were applied by category as many sporting goods are seasonal and availability of prices for many of these products is limited to only certain times of the year

- If a record met the above qualifications, the record was then assessed using a standard regression analysis. While some records in this qualifying group were found to not follow a linear trend (i.e. some fluctuation in pricing noted), the trend of this group overall was consistent with records that did follow a linear trend, and as such were included in the analysis.

Trend Analysis Calculation:

- A line of best fit is applied against all qualifying records. The slope of the line of best fit is divided by the median price of the record to determine the rate of change in price per period.
- Items are then bucketed into 3 groups: Increasing, Decreasing, Static, and the average rate of change for each group is calculated.
- In the below example, the record in question fits into the “Price Increasing” bucket.



RETAIL AUDIT – DATA ANALYSIS METHODOLOGY *continued*

Trend Analysis–Reporting:

The trend analysis is reported by looking at each individual store/product record and then allocating each record to one of three buckets:

1. Increasing Price Trend
2. Decreasing Price Trend
3. Static Price Trend

Final results are recorded as the percentage of records that are allocated to each instance (bucket) above.

An illustration of this methodology is below:



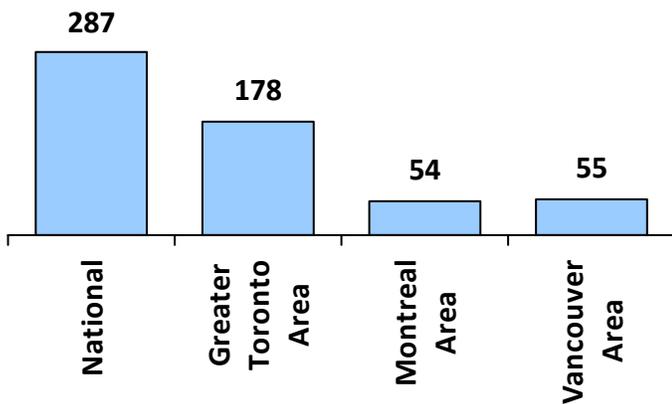
In this example, 3 retailers carry the same 3 products. The trend of each product is represented by the direction of the arrow.

We would summarize the above data as:

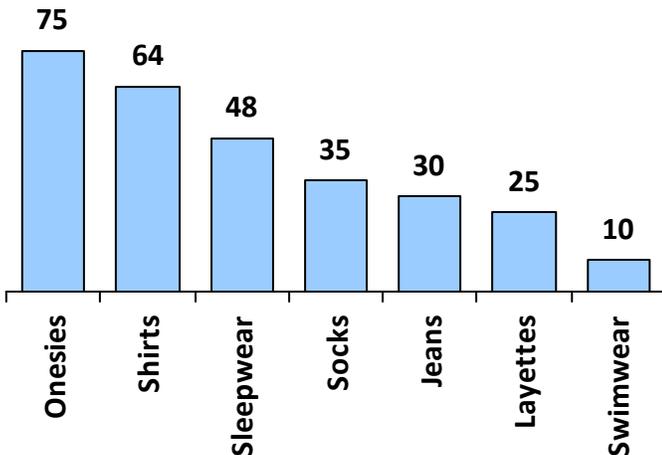
- Total Records = 9 store/product combinations
- 56% of items decreased in price (5 of 9 records), 33% of items showed no price change (3 of 9 records), and 11% of items increased in price (1 of 9 records)

RETAIL AUDIT – BABY CLOTHES – CANADIAN PRICE TREND RESULTS

of Records that met Analytic Criteria By Region:



of Records that met Analytic Criteria By Segment:



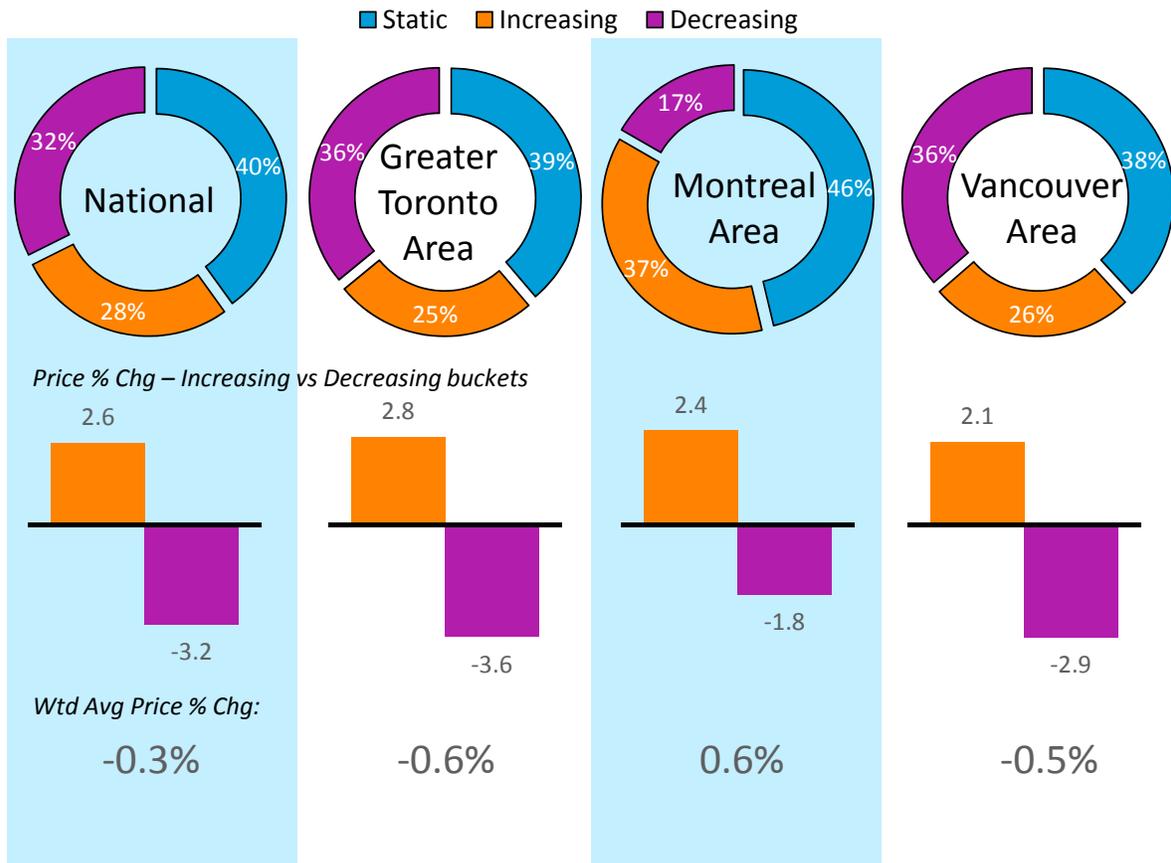
- Auditors were able to collect at least 1 regular price point on 584 records (a record is a product/store combination)
- 287 records met our analytic criteria of having at least 2 regular prices in the first 6 months and at least 2 regular prices in the following 6 months
- Data analysis conducted at a National and Regional (Greater Toronto (GTA), Montreal Area and Vancouver Area) levels; as well as at a segment (Jeans, Layettes, Onesies, etc.) level
- Sleeping Bag was combined with Sleepwear for reporting purposes

RETAIL AUDIT – BABY CLOTHES – CANADIAN PRICE TREND RESULTS continued

National and Regional Results:

- Nationally, the majority (40%) of baby clothes items monitored had no change in price over the course of the audit. 32% of baby clothes items monitored had a decreasing price trend and 28% had an increasing price trend. As a result, National trend of baby clothes prices is flat or slightly down overall
- The Greater Toronto and Vancouver areas are driving the negative pricing pressure with more items declining in price than items increasing in price
- The Montreal area is seeing opposite trend with more items increasing in price than items decreasing in price

% of Items Static/Increasing/Decreasing by Region



RETAIL AUDIT – BABY CLOTHES – CANADIAN PRICE TREND RESULTS continued

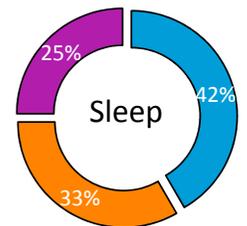
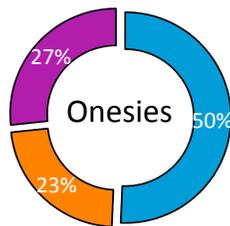
Segment Results:

Segment Analysis

- Overall most segments following National category trend
- Onesies, largest piece of the market, very stable, most products unchanged in price
- Shirts, Socks, driving prices down
- Sleep only segment showing price increase

% of Items Static/Increasing/Decreasing by Region

■ Static ■ Increasing ■ Decreasing



Price % Chg – Increasing vs Decreasing buckets

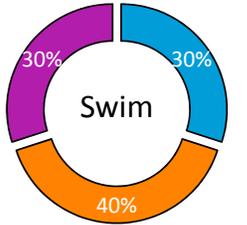
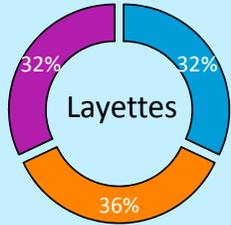
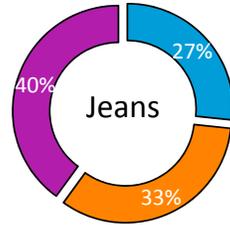
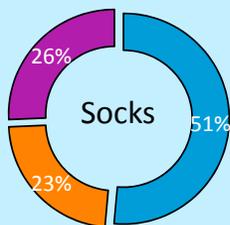


Wtd Avg Price % Chg:

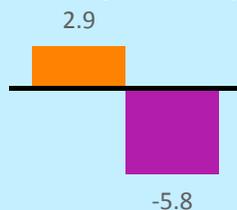
-0.2%

-0.8%

0.4%



Price % Chg – Increasing vs Decreasing buckets



Wtd Avg Price % Chg:

-0.8%

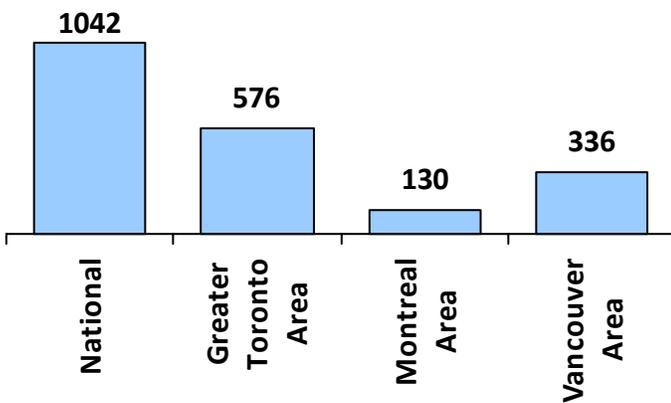
0.0%

-0.6%

-0.3%

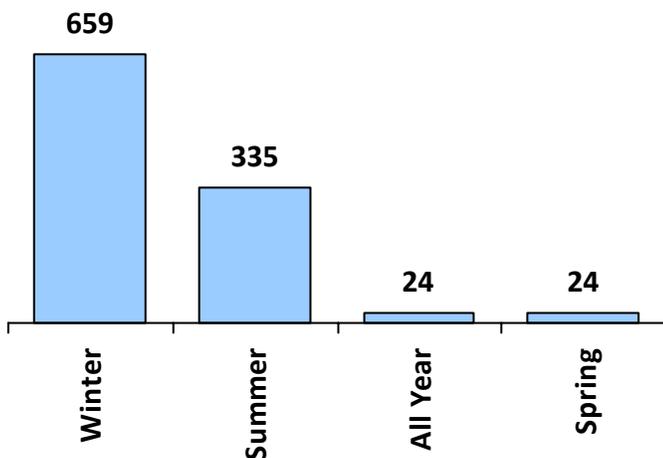
RETAIL AUDIT – SPORTING GOODS – CANADIAN PRICE TREND RESULTS

of Records that met Analytic Criteria By Region:



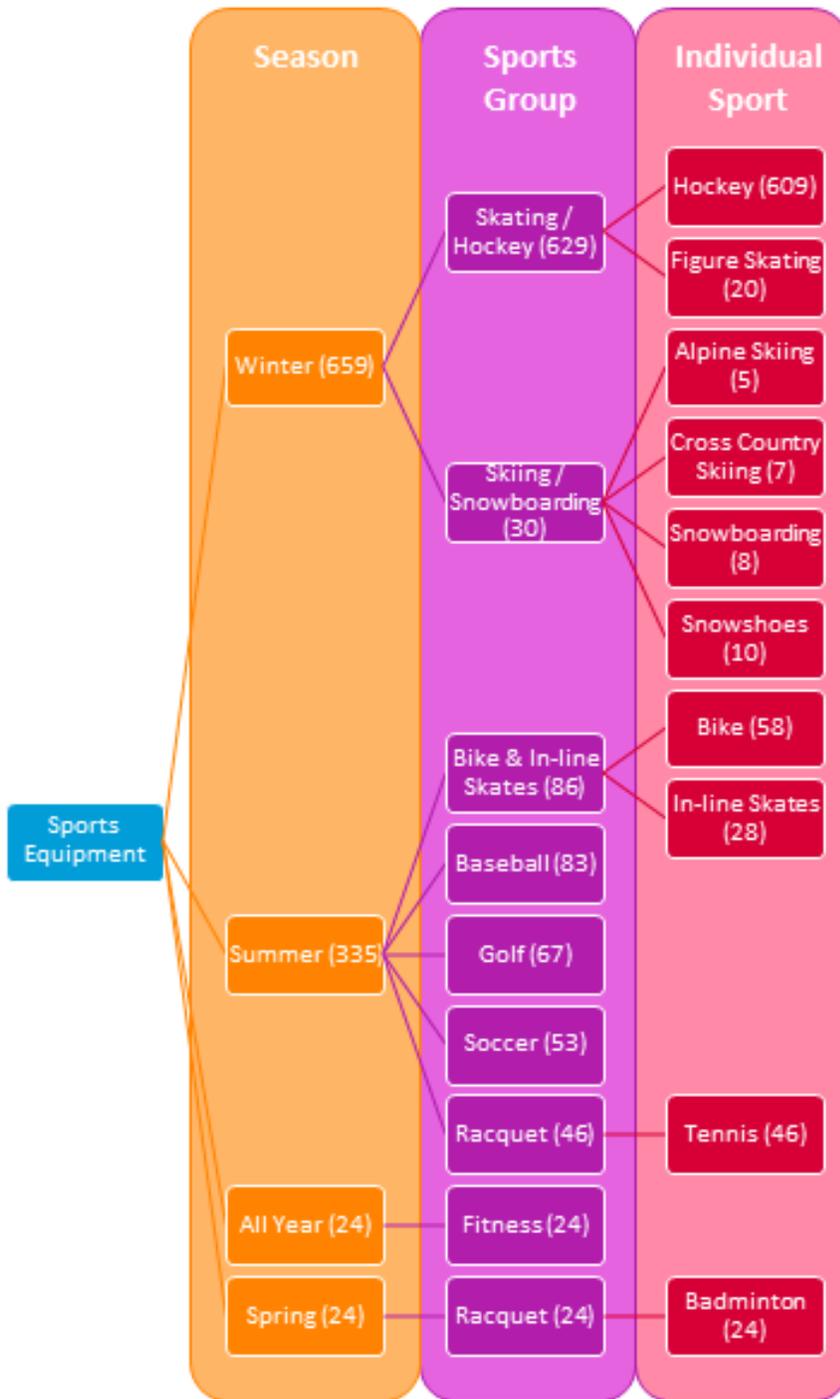
- Auditors were able to collect at least 1 regular price point on 1317 records
- 1042 records met our analytic criteria of having at least 4 regular prices across the 12 periods of audit (methodology is different from Baby Clothes due to the seasonal availability of many sporting goods items)
- Data analysis conducted at a National and Regional (Greater Toronto, Montreal and Vancouver Areas) level; as well as at a Season and Sport Group level where sample permits

of Records that met Analytic Criteria By Sport Season:



RETAIL AUDIT –SPORTING GOODS – CANADIAN PRICE TREND RESULTS continued

of Records that met Analytic criteria By Sports Group and Individual Sport:

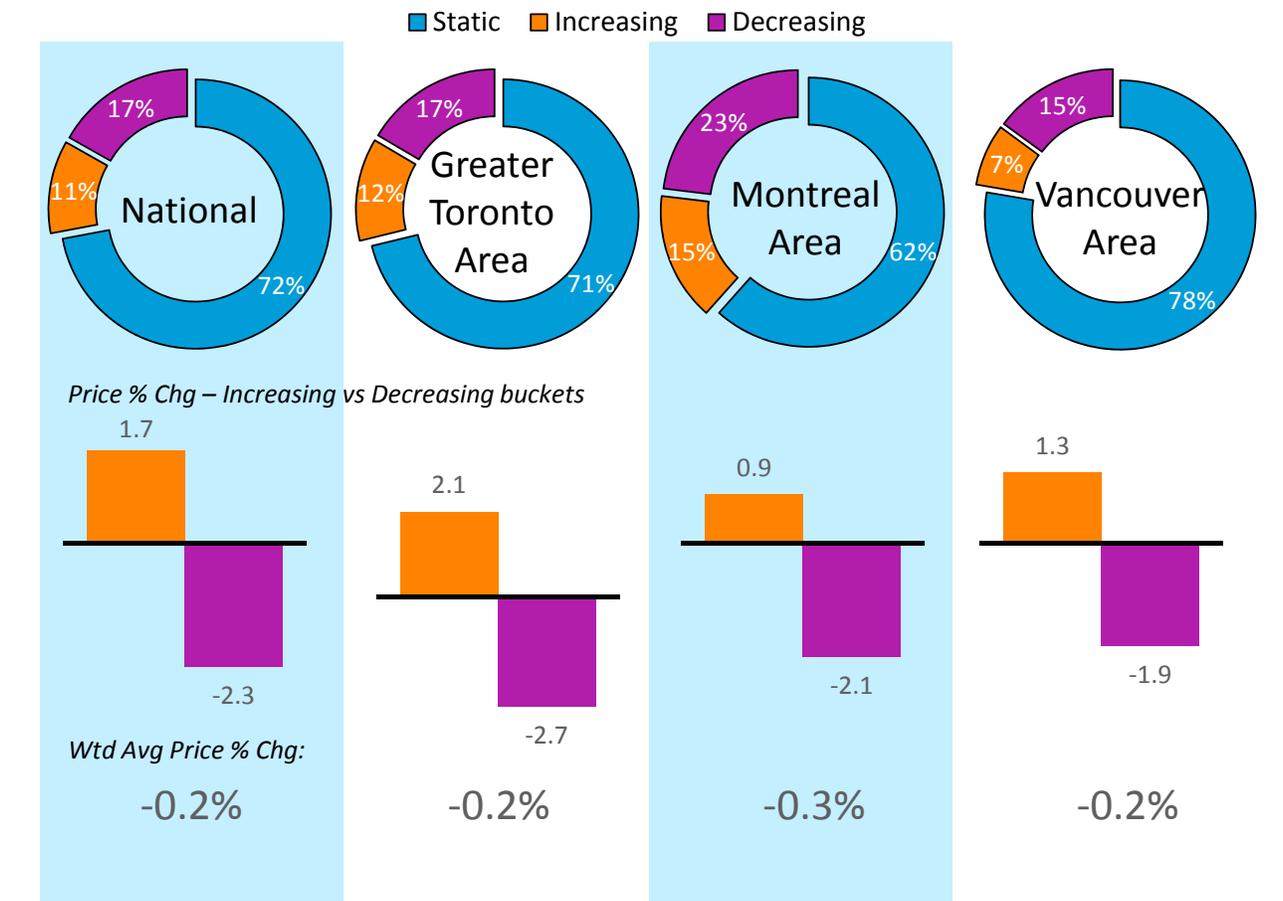


RETAIL AUDIT – SPORTING GOODS – CANADIAN PRICE TREND RESULTS continued

National and Regional Results:

- Nationally, the majority (72%) of sporting goods items monitored had no change in price over the course of the audit. 17% of sporting goods items monitored had a decreasing price trend and 11% had an increasing price trend. As a result, National trend of sporting goods prices is flat or slightly down overall
- All regions contributed to the negative pricing pressure with more items declining in price than items growing in price

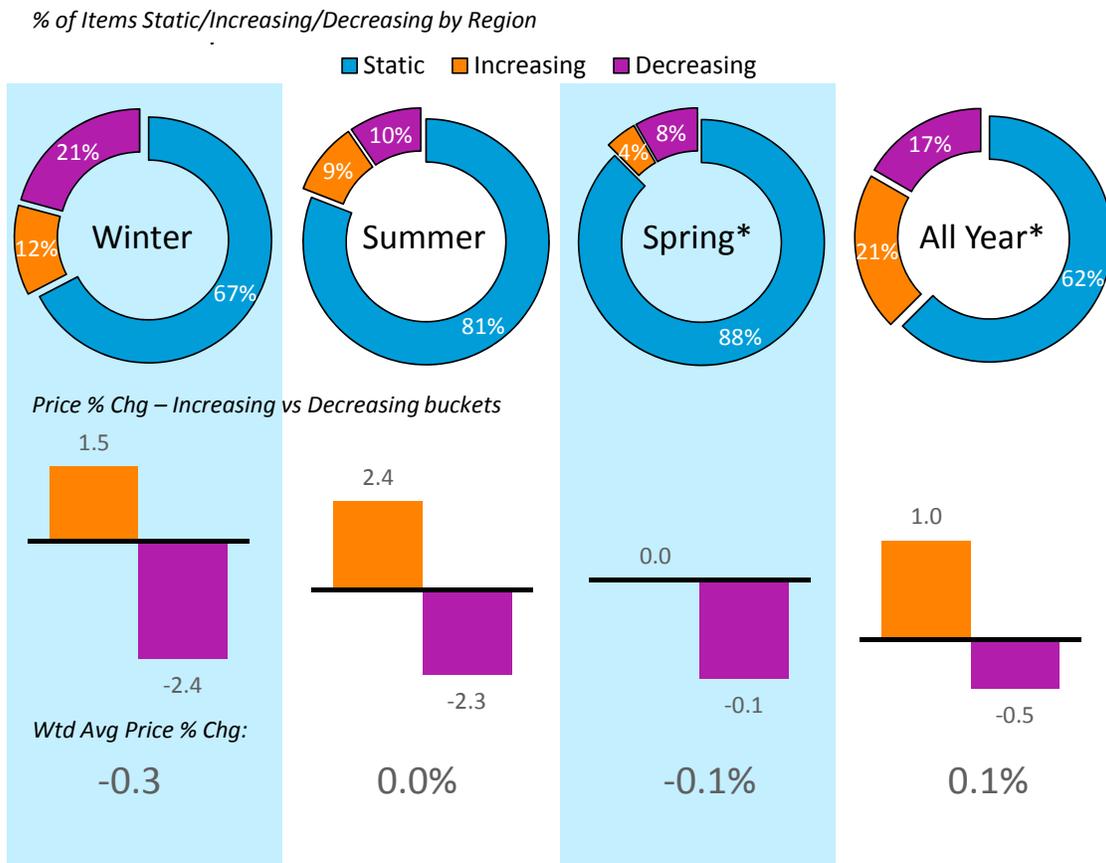
% of Items Static/Increasing/Decreasing by Region



RETAIL AUDIT – SPORTING GOODS – CANADIAN PRICE TREND RESULTS *continued*

Sports Season Results:

- Given the seasonal nature and availability of certain sporting goods, products audited were classified based on the season in which they are played.
- Winter Items, the largest piece of the sample, had a smaller percentage of items with Static pricing and a greater percentage of products that had a decreasing price trend.
- With the exception of All Year Items, all season's had a higher percentage of items decreasing in price versus increasing in price.



RETAIL AUDIT – SPORTING GOODS – CANADIAN PRICE TREND RESULTS continued

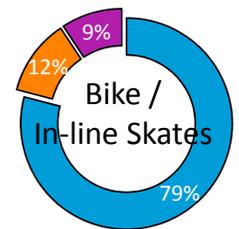
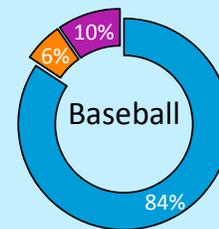
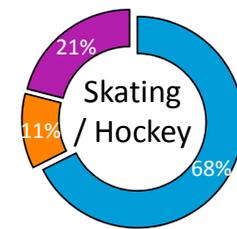
Sports Group Results:

Sports Group Analysis

- Across all Sport Groupings, the majority of records had unchanged prices.
- Racquet, Soccer, Baseball, Bike/In-Line Skates had highest percentage of stable pricing
- Misc. (Skiing/Snowboarding + Fitness Equip) and Skate/Hockey had the greatest percentage of items decreasing in price

% of Items Static/Increasing/Decreasing

■ Static ■ Increasing ■ Decreasing



Price % Chg – Increasing vs Decreasing buckets

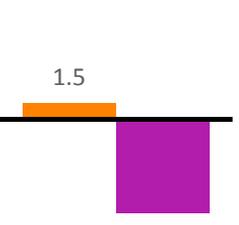
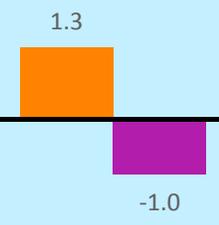
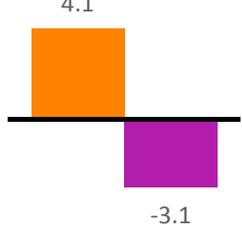
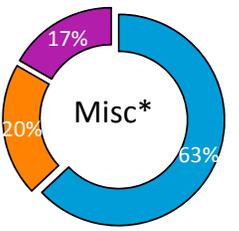
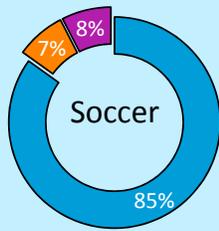
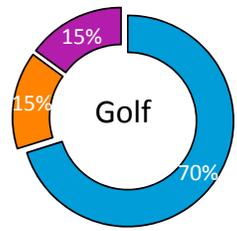
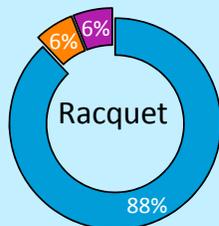


Wtd Avg Price % Chg:

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-0.1%



Wtd Avg Price % Chg:

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0.0%

0.0%

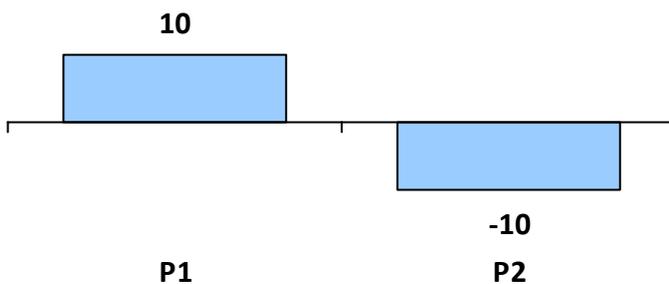
-1.1%

RETAIL AUDIT – BABY CLOTHES – CANADA VERSUS THE UNITED STATES PRICE DIFFERENCE

US vs Canada - Average Baby Clothes Prices
(US Prices converted to CAD based on the Exchange Rate at time of audit)



US vs Canada - Average Baby Clothes Prices % Price Difference



- In addition to the Canadian audit, 2 audit sweeps took place in Buffalo, New York in the Fall 2013 (P1) and August 2014 (P2) to collect prices on like items in like stores
- Prices collected in the US were converted to CAD equivalent using the average daily noon exchange rate for the weeks the audits were conducted.
 - The Average Weekly Noon Exchange rate went from 1.0299 in September 2013 to 1.095 in August 2014 (CAD fell 6% during this time)
- For each period at the item level, prices were averaged across retailers in each market to establish an average Canadian and US price by item.
- Items that had Canadian and US prices in both periods were included in the analysis.
 - This resulted in a sample of 24 products across 12 retailers in the US and 10 Canadian retailers
- Based on this limited sample, it was found that prices in the US market (in CAD) grew, while Canadian prices were largely static during comparable audit periods.
 - Almost 1/3rd of US price growth is the result of CAD declines
- As a result the CAD price difference between US and Canadian retailers shrunk considerably.
- Note: while US pricing was collected for Sporting Goods items, limited records were available where we had pricing for both P1 and P2 of the US audits. Due to lack of sample, completing a price gap analysis for this category was not recommended

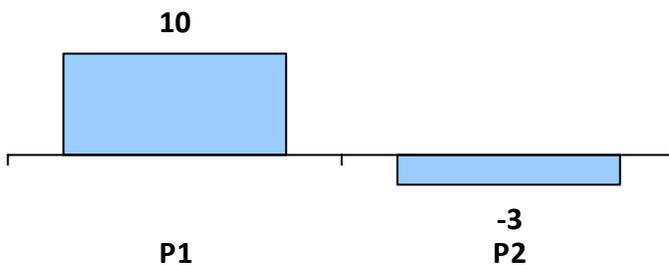
RETAIL AUDIT – BABY CLOTHES – CANADA VERSUS THE UNITED STATES PRICE DIFFERENCE continued

**US vs Canada - Average Baby Clothes Prices
(US Prices converted to CAD using Constant
Exchange Rate in P1 & P2)**



- Given that the changing Exchange Rate had impact on the price declines observed, a second analysis was completed where by the Exchange Rate was held constant across both P1 and P2 (September 2013 Exchange rates of 1.0299 were applied to US prices in both periods)
- With the exception of holding the Exchange Rate constant between P1 and P2, the same analytic methodology was applied.
- Based on this limited sample, it was again found that prices in the US market (in CAD) grew, although not at the same rate as the previous analysis, while Canadian prices were largely static during comparable audit periods.
- As a result, the CAD price difference between US and Canadian retailers shrunk, although to a lesser extent versus the previous analysis.

**US vs Canada - Average Baby Clothes
Prices % Price Difference**



CONSIDERATIONS WITH RESPECT TO THE COUNTRY OF ORIGIN

Preferential Tariff Treatments and Impact of the Tariff Elimination

The *Customs Tariff* is the Canadian legislation that establishes the rates of duty applying on goods imported into Canada. Different tariff treatments exist under this *Act* and, as a result, different tariff rates may apply to an individual product depending on the country of origin.

The Most-Favoured-Nation (MFN) rate is the tariff rate applicable on imported goods in the absence of a preferential tariff treatment.¹ Tariff preferences may be provided through unilateral preferential treatment for developing countries or least developed countries:

- The General Preferential Tariff (GPT) offers imports from developing countries preferential tariff treatment for over 80% of tariff items, at either duty-free or a preferential rate (approximately 2/3 MFN); and
- The Least Developed Country Tariff (LDCT) offers duty-free access to all products, excluding certain agricultural goods, from the world's poorest countries.

Tariff preferences may also be provided through reciprocal preferential tariff treatment accorded under free trade agreements (FTAs). Overall, the *Customs Tariff* contains 21 different possible tariff treatments which may be applicable.

While the tariff elimination initiative removed all tariffs on baby clothing and certain sports equipment, some of the products targeted were already imported duty-free or at a reduced rate under the GPT or the LDCT treatments prior to April 1, 2013.

For similar products, the applicable tariff rates can vary. For example, water-skis imported into Canada prior to April 1, 2013 may have been subject to one of the following rates of customs duty:

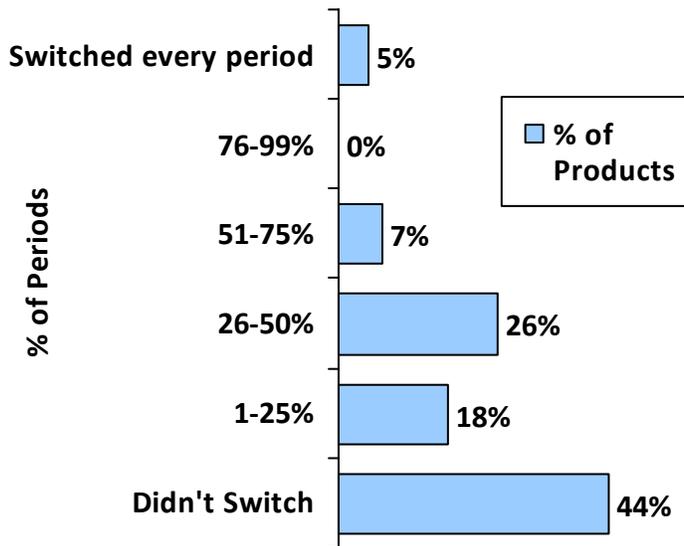
- Duty-free if imported under an FTA (e.g., made in the U.S.);
- 5% if imported under the GPT (e.g., made in Sri Lanka); or
- 7.5% MFN rate if no tariff preference was applicable (e.g., made in France).

As another example, baby clothing made in an LDCT country (e.g., Bangladesh) could already be imported duty-free prior to April 1, 2013. In this case, the tariff elimination initiative did not have any effect on the importation costs and, therefore, should not have any impact on the retail prices. In contrast, baby clothing imported from countries not benefiting from duty-free rates under the LDCT or an FTA is impacted by the *Economic Action Plan 2013* tariff elimination.

¹ In select cases where a country is not a signatory to international law governing the treatment of international trade (e.g., North Korea), a General Tariff rate of 35% applies to imports that originate in that country.

RETAIL AUDIT – BABY CLOTHES – COUNTRY OF ORIGIN

Frequency of Country Switching



- Analysis conducted by Nielsen suggests that switching source countries for a given product can be relatively common.
- For items with at least two periods of data, a count of the number of unique country of origins was determined. This count was divided by the total number of periods with data. The result is shown in Frequency of Country Switching; the relative frequency of how often country of origin switched.
 - 44% of products did not switch origin, 5% had a different origin every period, and 26% of items switched country of origin 26-50% of the periods it was available.

A SUMMARY OF CONSULTATIONS WITH RETAILERS

It is recognized that there are many factors that impact pricing, and by extension, the prices examined over the course of this audit period. To better understand these influences, the Retail Council of Canada (RCC) and its members were consulted to bring further context to this report. A number of considerations were brought forward by these retailers which provided useful context with respect to analyzing retail prices over a one year period. Following is a summary of those insights.

Input Costs Affecting Product Pricing:

The price that consumers pay when purchasing goods is the culmination of a multitude of inter-related factors. While tariffs have an important impact on the ultimate price of merchandise, the retailers consulted outlined the wide range of other inputs that also affect costs, and ultimately, retail prices. Several examples of factors that impact the price of goods were cited, including:

1. Materials/components
2. Packaging
3. Labour
4. Manufacturing process - variable
5. Manufacturing process - fixed allocation
6. R+D, product development costs
7. Selling, General and Administrative expense
8. Freight
9. Duty (if applicable)
10. Margin
11. Marketing
12. Brand allocation
13. Moulds and tooling amortization
14. Warranty
15. Exchange rate (if appropriate)

A SUMMARY OF CONSULTATIONS WITH RETAILERS continued

Isolating the effect of any one factor can be challenging. Where input costs remained unchanged from a previous season, retailers suggested that tariff elimination will have had a downward impact on prices. Where input costs fluctuated, as several did during the evaluation period, it can be difficult to isolate the cause and effect of a single input factor. The exchange rate, for example, is one factor that varied significantly during the pre - and post - tariff elimination time period. To illustrate:

Between March 2013 and October 2014, the value of the Canadian dollar decreased from near par (.9759) to .8919 cents (using the monthly average exchange rates published by the Bank of Canada), a decrease of 9% over this period.

As such, similar products purchased at different times during this period would have different costs.

In this scenario, the decrease in the exchange rate would have decreased the retailers' buying power, thereby increasing the cost to purchase an item which would have resulted in a higher retail price.

Retailers illustrated currency as an example of a factor that would have driven prices up while tariff elimination simultaneously lowered costs. Without the tariff elimination, retailers indicated that retail prices would have been much higher.

Business Processes Affecting Product Pricing:

In addition to the various input costs detailed above, retailers also indicated that the following business models and practices influence product pricing:

- **Pricing Strategies.** Retailers indicated that there are a range of pricing strategies used in the retail industry. In some cases retailers employ a centralized national pricing strategy and as a result there is little or no variation in product prices between stores. In other cases retailers will establish a "recommended selling price" but each store has the discretion to set the selling price based on competitive factors, such as proximity to a U.S. border.
- **Procurement/Purchasing Strategies.** A variety of different product purchasing strategies, which are referred to as procurement practices, are used by the Canadian retailers that were consulted. These range from central procurement models (where all relationships with wholesalers/suppliers are managed through a centralized team and then product is distributed to individual stores), to the development of centralized price agreements (where individual stores order directly from the distributor or wholesalers, at a centrally agreed upon price). These differing models will impact both the type of product that is offered in individual stores, as well as pricing strategies.

A SUMMARY OF CONSULTATIONS WITH RETAILERS continued

- **Exclusive Distributor Agreements.** In some cases distributors or suppliers have an exclusive right to distribute particular products to Canadian retailers. Retailers noted that in some cases, where exclusive agreements were in place, lower costs due to tariff elimination were reflected in distributor prices to retailers and as such retailers were able to lower their retail prices accordingly. However in other cases, distributors had not lowered their prices and, because of the exclusivity rights, the retailers were unable to lower product prices if they wanted to carry that product.
- **Seasonal vs Non Seasonal Products.** Retailers indicated that unique pricing strategies are in place for seasonal products such as hockey skates, baseball equipment or snowsuits. These prices are set for a particular season and will only vary if the product goes on sale near the end of that selling period. Conversely, products that are offered on a year-round basis will have a consistent selling price that is determined at the time the product is made available for sale.
- **Provincial Government Regulations.** Retailers noted that specific government regulations, unique to particular provinces (e.g. recycling fees), will result in small variations in product prices.
- **Inventory Management.** Inventory strategies will also affect the timing of price reductions at the store level. Retailers noted that in some cases very little inventory is available where in other situations 6 to 18 months' worth of inventory could be on hand. Generally, retailers suggested that the reductions in tariff elimination were incorporated into prices once inventory from the pre-tariff elimination time period had been sold. Naturally this will vary from one retailer to another based on size, buying capacity, and warehouse facilities.

Tariff Elimination versus Study Timeframe:

The tariff elimination was announced in Budget 2013, released on March 21, 2013, and became effective on April 1, 2013. The price monitoring study was initiated in September 2014.

Retailers noted that, as a result of the various procurement and distribution models described above, changes in prices resulting from tariff elimination may have been reflected in product prices as early as the Spring of 2013 – prior to the initiation of price monitoring. In others cases changes in product prices would have been reflected over a longer timeframe.

A SUMMARY OF CONSULTATIONS WITH RETAILERS continued

Other Factors for Consideration:

Each retailer takes a different sourcing path to obtain goods that are sold in Canadian stores. During the pre- and post-tariff elimination period, there were several factors related to sourcing and buying practices that would have impacted retail prices. Examples include:

- In the case of baby clothing, some retailers began to carry new product lines during the post-tariff elimination period which replaced the majority of their previous stock. For this reason, there is very little comparable product from the year previous, thereby making exact price comparisons impossible.
- Retail products, particularly in fashion, are innovated each year. One season is not exactly comparable to the next because products are re-invented each year. This practice of innovation makes directly comparing products difficult from one year to the next.

Summary:

This summary has provided an overview of the multiple factors that retailers must consider when determining product pricing. Notwithstanding the complex nature of pricing and the various factors that can drive prices up or down, all retailers consulted underscored the competitive nature of the industry and the importance of offering the best price to consumers. Wherever savings are realized at the retail level – whether from tariff elimination or some other cost saving mechanism – retailers indicated that market forces dictate that consumers will benefit.