

COMMERCE COMMISSION GROCERY WHOLESALE SUPPLY INQUIRY

SUBMISSION ON PRELIMINARY ISSUES PAPER

BY ERNIE NEWMAN

Thank you, Commission, for your very clear and thorough Preliminary Issues Paper (PIP) which does not mince words. This brief response comes from the perspective of one with a long history as a participant, and more latterly an active observer of this industry and others with competition issues. It comprises:

1 General Comments:

1.1 The Reactions of the Regulated Grocery Retailers (RGRs)

1.2 The Reactions of Suppliers

1.3 The Global Perspective

2 Responses to selected questions

1.1 The Reactions of the Regulated Grocery Retailers

It is clear from the PIP that the RGRs, Foodstuffs and Woolworths, have made a deliberate choice to thumb their noses at the Commission's request to establish an open wholesale regime designed to offset some of their extreme concentration of market power. The PIP makes this very clear, including in paragraphs 30, and 57-61. There is ample evidence to invoke Sections 65 and 82 of the Grocery Industry Competition Act.

That response is the RGRs' deliberate choice. They could have embraced the opportunity to work with the Commission to unravel some of the damage they have done to the market - as the Commission invited them on its home page with the words "We encourage all players in the industry to support the *intent* (emphasis added) of the new legislation."

Instead, the RGRs have offered only a token number of products while avoiding best sellers, private label products, and direct delivery. Their pricing obviously fails to pass on the major benefits they receive through RDP. They have cynically gone through the motions of complying with the Commission's requirements in the hope of buying time. Local businesses catering for the top-up and secondary shops still find it more viable to trek around PaknSave and pay consumer prices - that is a travesty.

The RGRs are employing classical economic game theory - looking several stages ahead to test what their adversary, the Commission, might do in reaction to their various moves. They are probably expecting the Commission to work laboriously through its range of

escalating tools, potentially taking several years to reach a meaningful end point while price-gouging continues. They will be hoping that within that time period some future government will tire of the lack of any meaningful downward pressure on consumer prices and will respond to their relentless lobbying by stopping the process. Meanwhile failed markets, excessive prices and social damage will continue for years.

That must not be allowed. The RGRs have clearly positioned themselves as hostile to the regime and the Commission must respond accordingly. The Commission needs to see through the invitation to an endless game of cat and mouse, and seize the initiative back.

For that reason, I recommend:

RECOMMENDATION 1: That the Commission and the Government make the bold but necessary decision to switch off the “escalators” and take the elevator straight to the top floor. That means enforced structural separation. This could be achieved either by splitting each RGR into totally separate wholesale and retail operations; or by splitting each banner group into totally separate independent businesses. Either way separation would have to be absolute.

This may appear a bold proposal. Yet there is ample evidence that it is the right one, including the failure of this first “escalating step” of the wholesale regime. That failure has not come about by accident - the RGRs have deliberately chosen to ignore the olive branch and maintain their position of excessive market power to the massive detriment of consumers. They must now accept the consequences.

1.2 The Reactions of Suppliers

A disturbing revelation from the PIP is that so many suppliers, including some providing staple everyday necessities of life, are resisting participation in the wholesale regime. On the face of this they are turning away new business. So their rejection begs the question – why?

Perhaps some are genuinely fearful of jeopardising the goodwill and ongoing custom of the RGRs if they participate. If so, suppliers should not be given the option of non-participation in the compulsory wholesale scheme – if they supply an RGR then the right of that RGR to on-sell via wholesale would be automatic?

Or perhaps the issue is resale price maintenance, benefitting the supplier as much as the RVR? I suggest exploring this should be a feature of the Commission’s work plan as the process develops.

RECOMMENDATION 2: That the Commission (a) drill down to understand the details and rationale of those suppliers who have opted out of the wholesale regime, (b) communicate forcefully to suppliers the legal consequences of resale price maintenance, (c) consider whether the Commerce Act has adequate provision to protect consumers against practices that may have the effect of driving out genuine discount operators, and (d) consider making it compulsory that every product a supplier provides to a RGR must be available for that RGR to include in the wholesale scheme.

1.3 The Global Perspective

It is clear from looking at the international market that the agglomeration of power in the hands of a small number of grocery wholesaler/retailers is a global trend. In earlier times grocery retailers were metaphorically like giant farmers markets – places where consumers went to buy merchandise from a wide range of suppliers, with the retailer taking a cut which was modest and generally uniform. Today the retailers have manoeuvred themselves so they effectively determine which “farmers” are allowed to grow the products, which products they will grow, and how they will be grown and marketed. They also stop anyone else from opening a farmers market in opposition to their own.

This market consolidation, vertical and horizontal, has engulfed the entire sector and removed real competition from a vast swathe of business, vertical and horizontal.

Meanwhile retail prices which once were cost-plus are now set by a mass of marketing professionals aiming to confuse and trick customers as to what a fair price looks like. Increasingly they are aided by a mushrooming arsenal of data about individual consumer behaviour – loyalty cards, facial recognition, number plate recognition, algorithms, payment card data, scan data, artificial intelligence, and more. Individually each tool is powerful, but collectively they provide an overwhelming advantage to RGRs in setting pricing and marketing strategies. While there are arguably some benefits to consumers, there are far more disadvantages arising from all that change for which consumers pay the price.

So while it can be argued that some of the issues we see are global trends, that is not a reason for the Commission to hold back on implementing urgent solutions fitting New Zealand’s needs.

RECOMMENDATION 3: The Commission’s over-arching goal should be to create an environment that enables the entry of one or more genuine budget operators. Operators who will offers prices that are genuinely low and genuinely every day, at

reasonable margins, with minimal or zero confusion from RDP. Structural separation is the only practical route to achieve that. There is no point in delaying – the task will not get easier with time.

2 Responses to Selected Questions

Question 1 - Who do you think the wholesale regime should service? For example, what types of customers and what market share?

While the regime should accommodate as close to 100% of the retail sector as possible and should err on the side of inclusivity, it may be too much of a stretch to include every corner dairy individually. Certainly it should be structured to meet the needs of smaller players such as Night and Day and The Warehouse. Perhaps individually-owned stores could be attracted with a framework that allows them still to physically stock up at PaknSave, but be charged the lesser of either the standard wholesale price on that day, or the PaknSave retail shelf price?

Question 5 - Please describe your experience and awareness of the types and value of RDPs. How does this affect you as a wholesale customer (eg, retail pricing) or supplier? For example, what types of RDP between suppliers and wholesale customers have you used, and what impact did this have on margins? Please provide evidence if available.

At an earlier stage of my career I worked in a distribution sector where retrospective volume-based rebates were commonplace. What I learned is the insidious ways these can be manipulated. For example, it was common practice for the CEO of the supplier business to personally visit their counterpart in the customer business to present the quarterly or biannual rebate cheque. On the face of it, the rationale was to allow the customer CEO to control how the rebate appeared in their books so as to shield the real cost from more junior sales and marketing staff and thus prevent their “trading the rebate away” in the market.

There was clearly a trade-off between the level of rebates and the headline price.

Retrospective rebates can be justified in various ways but their impact on a market can be very murky. I urge the Commission to look under the covers of rebate arrangements to fully understand why they are deployed, looking especially for ways in which they may be used to obfuscate and confuse the intent of the Commission’s wholesale arrangements.

There may be a case to put some constraints around the nature of RDPs in the sector. In normal circumstances that would be a serious invasion of commercial freedoms, but these

circumstances are not normal – we are dealing with a broken market and it may be a necessary step.

Further, there is an area of murky ambiguity in the difference between the nominal wholesale cost and the net cost. The Commission has identified this as around 15%, but others believe it to be nearer 20%. The Commission should drill down to understand the nature of this difference and come up with a pricing formula the industry can adopt to ensure smaller players can purchase competitively and in the confidence that they are not being unreasonably disadvantaged. Bright sunlight on pricing structures to replace murkiness would remove a serious disadvantage to small retailers.

Question 15 – What is your opinion on the findings of this progress assessment? Is there anything we have not mentioned in this paper that you consider is relevant? Please explain.

As noted above the regime has been shown to incentivise the RGRs to treat the Commission with contempt and carry on regardless. This has to stop. Following are three tools the Commission should seek or invoke to give itself real teeth in its work:

A Extension of the whistle-blowing scheme: Suppliers should be able to not only whistle-blow with confidence, but know there will be consequences for any serious offence they reveal. There should be extremely robust protections for suppliers who whistle-blow, along with industry-specific penalties where a case of anticompetitive conduct by a RGR is proven – for example a fine of ten times the estimated commercial gain from the conduct.

B The Commission should introduce detailed random audits, supplier by supplier, to expose gouging, standover tactics, threats, or other unethical practices by either supplier or RGR.

C Serious breaches of significant scale should be punishable by personal prosecution of RGR or supplier management.

Question 20 - Please describe your views on the additional regulatory options.

As explained above it is clear the RGRs will continue to play for time if the Commission continues up the escalator of options; therefore a decisive one-off move to structural separation is the only viable option.

The wholesale regime has been met with a derisory response from the RGRs; it is implausible that any amount of tinkering such as a wholesale code will change that.

Operational separation, through the Telecom precedent, has been proven an ineffective remedy and open to gaming.

Specified access terms had a measure of success in telecommunications markets where there was a limited number of “line item” products. However, it is unlikely these could be implemented practically in the grocery industry with tens of thousands of items in play.

I remain happy to discuss any aspect of the above with the Commission.

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