16 August 2024

Submission to the Commerce Commission on its Statement of Unresolved Issues re the proposed Foodstuffs North and South Island merger application.

The Grocery Action Group (**GAG**) was set up to bring down the prices of groceries for all New Zealanders. We strongly oppose the application from Foodstuffs to merge its North and South Island (**the Parties**) operations because it would result in higher, not lower prices, for consumers and would substantially lessen competition in an already uncompetitive market.

Our broken supermarket sector will not be fixed for the long-term benefit of consumers by stopping this merger, only a significant structural change to the sector will do that. However, preventing further consolidation of this uncompetitive sector will preserve at least the current limited choice, variety and quality of food available to consumers.

What should not be lost in consideration of the Parties' application, is the real impact on Kiwi households of paying some of the highest prices in the world for groceries. A recent study has found the very high prices for groceries in this country means it is "virtually impossible" for families on a benefit to feed children healthily.[1] The Parties, the regulators and the Government should be ashamed of that finding. The ability to make a change is in your hands.

GAG has been horrified by the stories it has heard from small- to medium-sized suppliers about their interactions with the duopoly. All speak of lowered margins for them as the profits for the Parties go up. All fear speaking publicly because of what the impact might be on their businesses - products being wiped from the shelves. Few support the merger.

[1] University of Auckland study published in the Journal of the Royal Society of New Zealand, 8 August, downloaded 16 August 2024, https://www.auckland.ac.nz/en/news/2024/08/08/Soaring_food_costs_take_toll_on_kids.html#:~:text=In%20the%20paper%2C%20the%20tool,and%2013.6%20percent%20in%202023.

Rejecting the merger applicaton will provide some assurance to suppliers that the wholesale market for groceries is not cut from the current three to two operators. It will prevent the further consolidation of duopoly power, provide some ability to negotiate with three wholesalers not just two, and the barriers for competitors to enter our supermarket sector, which would benefit consumers, will not become completely unassailable.

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1. Key recommendations

1.1 Refuse to clear this merger application because it is anti competitive and not in the interests of the long-term benefit of consumers.

1.2 Put consumers at the centre of the decision-making as per the purpose of s 1A of the Commerce Act 1986.

1.3 Give the regulator the tools it needs to force reasonable competition in the supermarket sector and fair treatment of suppliers, for the long-term benefit of consumers.

1.4 Act with urgency so that ordinary Kiwi families can afford to make healthy eating choices.

2. Long-term benefit of consumers

2.1 In its submission on the Statement of Issues (**SOI**), GAG noted the scant attention given to the impacts of this proposed merger on consumers. GAG contends consumers should remain at the heart of the Commerce Commission's (**the Commission**) considerations, given the purpose of the Commerce Act, 1986, section 1A (**the Act**) is to promote competition in markets "for the long-term benefit of consumers in New Zealand".

2.2 We note the Commission's invitation in the Statement Of Unresolved Issues (**SUI**) at [50] for submissions on the extent to which it needs to consider the downstream effects on retail consumers in assessing whether the proposed merger would be likely to substantially lessen competition in relevant upstream markets for the acquisition of groceries. We also refer to the Commission's May 2022 Mergers and Acquisitions Guidelines which explicitly set out a substantial lessening of competition is a lessening of competition that will adversely affect consumers in the market in a material way.[2]

2.3 The Commission's position seems to be that while the ultimate purpose of the Act is consumer welfare, the provisions relating to mergers (including s 66) focus on the impact of competition and not the impact on consumers as such. It would therefore be an inappropriate gloss on the statutory language to read in a restriction on the Commission's primary directive of preventing a lessening of competition in the market.

2.4 GAG agrees with the Commission, that the ultimate purpose of the Act is consumer welfare. That was made clear by the Court of Appeal in *Godfrey Hirst Ltd v Commerce Commission*[3] where in commenting on the business acquisition regime of the Act generally, it noted legislative history indicated that "the long-term benefit of consumers within New Zealand must be the primary consideration".[4] The Court of Appeal further explained the long-term benefit of consumers "informs the specific provisions governing approval of business acquisitions".[5]

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[2] Commerce Commission Mergers and Acquisitions Guidelines, May 2022, p5 at [7], downloaded 13 August 2024.
[3] *Godfrey Hirst NZ Ltd v Commerce Commission* [2017] 2 NZLR 729 (CA).
[4] At [22].
[5] At [21].

2.5 GAG considers the Commission *should* consider the effects on consumers when determining an application under s 66. As to this:

a. The Commission's starting point must be s 1A of the Act, which makes it clear that promoting competition for the long-term benefit of consumers is *the* purpose of the Act. It not one of several purposes, or even the primary purpose – it is the sole purpose. The Act is concerned with protecting consumers and therefore the Commission should ensure that any competition-related decision it makes under the Act – including s 66 – is for the long-term benefit of consumers – which ever test is applied.

b. Section 1A also makes it clear that "competition in markets" must be for the long-term benefit of consumers. That is, consumers are central to or an inherent part of the idea of competition in markets. When deciding whether an application under s 66 will substantially lessen competition in a market, the Commission must consider the impact of any competitive changes on consumers.

2.6 This analysis is consistent with the Court of Appeal's comments in *Godrey Hirst* cited above. It is also consistent with *Foodstuffs (Auckland) Ltd v Commerce Commission,*[6] where the Court of Appeal considered the legislative history of s 1A and noted changes to the text – in particular the addition of the words "for the long-term benefit of consumers within New Zealand" – clarified that "competition" is not an end in itself but a means to promote the long-term benefit of consumers and New Zealanders as a whole".[7]

2.7 GAG therefore submits that these authorities *require* the Commission to take into account the impact on consumers when considering an application under s 66 of the Act. The Commission cannot divorce the impact on consumers from considerations regarding competition in a market. As the Court of Appeal recognised in *Godfrey Hirst,* the long-term benefit of consumers must be the Commission's primary consideration in any assessment.

2.8 GAG contends consumers will be materially adversely affected if the merger proceeds because it would effectively:

[6] *Foodstuffs (Auckland) Ltd v Commerce Commission* [2002] 1 NZLR 353 (CA).

[7] At [1].

a. decrease competition in an already uncompetitive market by consolidating power in the largest supermarket operator

b. heighten the barriers for any new market entrant, denying consumers choice, variety, quality and fair/competitive pricing

c. increase prices to consumers because there would be no competitor to hold the duopoly back. New Zealand consumers already pay some of the highest prices for food in the world

d. drive some suppliers out of the market because of their reduced margins, meaning less choice and innovation from which consumers could benefit

3. Upstream and downstream market competition

3.1 The Parties contend the Commission would be compelled to approve the merger if the impact on retail prices was neutral or negative however that impact arose.[8] GAG strongly disagrees with this. It supports the Commission view that it needs to consider both the upstream and downstream effects of substantially lessening competiton as a result of this application. GAG contends the upstream impact on suppliers does inevitably negatively affect the downstream impact on consumers – the lack of choice, innovation, quality and price being some of those impacts. The impacts of a lack of proper competition in the upstream already flows through to consumers and suppliers. The Commission's own market study has found that. (see below) To allow further consolidation by the largest duopoly player can only be detrimental downstream to the long-term benefit of consumers.

3.2 As an example, a supplier told GAG supermarkets' gross profits were the highest since he had started dealing with them. One product he sold into the duopoly was at the lowest price he had been selling it for 10 years. But this had not been reflected in prices to consumers because supermarket margins were bigger than ever.

[8] Commerce Commission Statement of Unresolved Issues, An alternative approach, p15 at [54], downloaded 15 August 2024.

3.3 Another supplier noted Pak'nSave had gone from being "all about passing on savings on to consumers, to how much they could make". He said previously if there had been more than12% gross profit on sales of dry goods the head office would frown on it, because Pak'nSave was to be about savings for consumers. But, he said, that ethos was gone. The supplier noted one of his products was now being sold at 53% gross profit. One Pak'nSave owner, he said, was told by Foodstuffs head office his net profit of $6.5-7 million was not good enough.

4. Previous merger

4.1 Foodstuffs merged its upper North Island and lower North Island operations in 2013. The promise was that efficiencies gained would be passed on to consumers through lower prices.

4.2 Suppliers spoken to by GAG said they had hoped there would be efficiencies through streamlining and simplification but this had not eventuated. One said they were promised the merger would bring cost savings for suppliers and better prices for consumers. But neither had occurred. What did happen was an increase in costs to co-operative members, the co-operative taking a higher margin and head office costs increasing substantially. The supplier said category managers had increased from between five to 10 under the old regime to more than 170 today. Both suppliers and consumers were worse off.

4.3 Another supplier said there had been no efficiencies gained from the merger. Prior to the upper and lower North Islands combining, his company had negotiated separately with the two entities. The upper North Island took more, but he got a better price for less in the lower North Island. His relationships were much closer. The merger meant a loss of somproducts. It had turned into a "monopoly" situation with an inability to negotiate, and where regional considerations and choice were no longer considered. Another supplier noted inefficiencies and more cost had grown with suppliers often having to send their product through Foodstuffs' distribution centres where previously they had been able to supply directly to the supermarket.

5. Foodstuffs North and South Island operations

5.1 The Commission's SUI notes the differences in suppliers' negotiating powers with regard to the North and South Island Foodstuffs cooperatives.[9] GAG's own discussions with suppliers supports this. Suppliers either located in the South Island or supplying to the South Island say they have a more proactive relationship with individual stores than they have with North Island stores, where the power is more centralised. That means some suppliers in the South Island do not, for their own reasons, supply the North Island. They can try out new products with individual stores before spreading the net wider. That more individual approach also gives store operators more autonomy to make decisions about what gets stocked on their shelves.

5.2 If the merger was cleared, all that would be lost in the move to centralise. That's bad for competition and ultimately New Zealand consumers because some suppliers may leave the market altogether or ignore the local market and just export.

6. Competition and the likelihood of the merged entity impacting entry/expansion in retail grocery markets

6.1 The Commerce Commission supermarket study, completed in 2022, found a concentrated market, high prices and unfair competition. Its key findings include that the intensity of competition between the major grocery retailers is muted, and it said the profitability of the major grocery retailers was high and did not reflect workable competition.[10] It noted if competition were more effective, the major grocery retailers would face stronger pressures to deliver the right prices, quality and range to satisfy a diverse range of consumer preferences. [11]

6.2 The OECD in its recent report on competition issues facing this country noted the reforms to the grocery industry (largely through the Grocery Industry Competition Act and its underlying Grocery Supply Code) may not be sufficient.[12] It said, while complex, stronger measures such as a breakup of the duopoly through a forced sell-up of brands or a separation of the wholesale and retail branches of these companies, as well as the

[9] Commerce Commission, Statement of Unresolved Issues, July 16, p46 at [149], downloaded 15 August 2024.
[10] Commerce Commission Market Study summary, downloaded 15 August 2024, chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://comcom.govt.nz/__data/assets/pdf_file/0025/278404/Market-study-into-the-retail-grocery-sector-Summary-of-findings-8-March-2022.pdf
[11] As above.
[12] Revamping competition in New Zealand, OECD, Working Paper no 1817 at 15, downloaded 15 August 2024, chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://www.oecd.org/content/dam/oecd/en/publications/reports/2024/08/revamping-competition-in-new-zealand_c0022411/8bbbad04-en.pdf

upstream growers and manufacturers they own, could be warranted. It recommended further work on a cost-benefit analysis of divestiture.[13]

6.3 It is inconceivable, against this backdrop, that allowing the most powerful of the duopoly operators in New Zealand to combine its North and South Island retail and wholesale operations will be good for suppliers or work in the best long-term interests of consumers.

6.4 The only recent national competitor to the duopoly, online grocer Supie, collapsed in 2023, after a withdrawal of financial support. CEO Sarah Balle (a member of the GAG board) says the proposed merger will result in Foodstuffs having significant procurement power. The new merged purchasing power, simply due to its size and market share, could achieve terms and pricing that could not be offered to a new entrant or competition that has significantly less market share.

6.5 She noted it would also lessen competition as suppliers became nervous about supplying new entrants at competitive prices or supplying competition at all. Supie experienced this regularly as a new entrant, which meant it had to spend considerable time with suppliers educating them about anticompetitive behavior – a symptom she said of suppliers' concern about supplying any competitor to the duopoly. But without access to supply new entrants can't succeed as consumers demand a full range of groceries to switch to new supermarkets.

6.5 Ms Balle said a cleared merger would provide Foodstuffs with a larger war chest to fend off new entrants in cities and smaller communities. Potential investors see monopoly/duopoly markets as inherently risky. Supie received this feedback constantly during capital raising, she said. A consolidation would further entrench this notion. The war chest consisted of the ability to drop prices temporarily to a level new entrants could not sustain, buying all effective advertising such that new entrants could not buy any online advertising on popular sites and buying up all relevant search terms, raising wages and salaries to uncompetitive levels.

6.6 New Zealand's only other currently viable national competitor, The Warehouse is in a state of flux as to what happens next. But critically, even with its heft, it faced supply issues last year when Sanitarium refused to supply it with Weetbix, until the company went public, and consumer pressure forced Sanitarium to recant. That pressure to stop supply

[13] As above.

undoubtedly came from the incumbent duopoly, another illustration of the sorts of activity that can only worsen if clearance is given to this merger.

6.7 While the Grocery Supply Code went some way to assisting access to wholesale, large suppliers don't necessarily go through the wholesale regime, they supply direct and/or opt out of agreements which then allows them to refuse to supply. This had happened to Supie.

6.8 Complete lack of access to home brands was also anticompetitive Ms Balle said. None of that product goes through either Woolworths' or Foodstuffs' wholesalers.

7. Grocery Industry Competition Act 2023 and the Grocery Supply Code

7.1 GAG notes the Commission's admission in the SUI that the Act and related regulations, presumably including the Supply Code, are not intended to, and would not, mitigate the structural loss of competition in relevant upstream and retail grocery markets that would result from the proposed merger.[14]

7.2 GAG believes the Act and regulations have gone someway to levelling the playing field but strongly contends they represent a missed opportunity. Without more power, such as those that would allow for, say forced divestment, the legislation and code can do nothing but fiddle with an already uncompetitive market. As one supplier told us: "the code doesn't address the actual issue, which is the private meetings between supermarkets and suppliers where the real action goes down. Everyone is too scared to bring it up and talk about it."

7.3 GAG urges both the Commission, MBIE and the Government to give more power to regulators, and to complete the work on the cost-benefit analysis of structurally forcing break-ups in this market. There are local competitors who would relish an opportunity to move into grocery, if entry to the industry was made more equitable.

8 Conclusion

8.1 The merger will not be to the long-term benefit of consumers. In fact, the opposite will occur. We are already in a situation where many Kiwis cannot afford to feed their kids a healthy diet. The application must be rejected.

[14] Commerce Commission Statement of Unresolved Issues, p7 at [12], downloaded 15 August 2024.

8.2 If allowed, it would further reduce an uncompetitive market, already noted by the Commission in its Market Study 2022 and the OECD, and consolidate the power of the biggest player in the duopoly.

8.3 Suppliers will have one less outlet for their products and their already muted negotiating power will be reduced further. Innovation will be stifled and prices for consumers will continue to rise.

8.4 The possibility of new competitors will be further reduced as the duopoly power becomes unassailable.

8.5 GAG urges the Commission, MBIE and the Government to give the regulator more power and to complete the cost-benefit analysis into forced divestment.

9. Who we are

9.1 The Grocery Action Group was formed to bring down the prices of groceries for all Kiwis. Our vision is to influence government, the regulators and other parties to deliver a competitive and consumer-focused grocery sector in New Zealand. Our board is made up of consumer, industry, supplier and Māori interests experts. For more info visit www.gag.nz

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