MONOPOLY WATCH NZ
market structure matters

Submission from Monopoly Watch NZ comments on the Commerce Commission's Market study into the retail grocery sector Draft Report 29 July 2021

Monopoly Watch is a New Zealand public policy group which studies and comments on competition issues in capital intensive utility and commodity industries in NZ.

Monopoly Watch draws upon wide and varied experience from game theory economists and captains of industry to millennials, centennials or adjacent, workers, middle management, Māori, the LGTBQ community, consumers and suppliers.

For more than decades New Zealand has had one of the weakest competition legal frameworks in the OECD.

It is the goal of Monopoly Watch to provide evidence-based third party commentary and policy solutions to market structures that don't work for the public interest in New Zealand.

Summary Points

The evidence points to a competition problem which can only be solved by a structural split of the existing business.

The Commerce Commission's final report must recommend the government break up the supermarkets and force each operator to divest 100 supermarkets and force the construction of 2 new distribution centres.

Foodstuffs was correct in its legal submissions from 2001 to 2005 that the merger of Foodtown and Countdown would substantially lessen competition and create downstream problems in the sector. Foodstuffs' concern in 2001 that a two-player market in NZ supermarkets would lead to a value chain which would evolve into a lazy duopoly was correct. The competition problem created in 2005 must now be fixed by dismantling and forcing divestment of a scalable chains of stores from both organisations.

The Commission must respect the work of its analysts, researchers and managers who delivered a well researched 517-page draft report and recommend to the government that it splits both Woolworths NZ's operation into two parts (by unwinding the 2005 merger), and splits Foodstuffs North Island and South Island.

The draft report exposed the ridiculous profitability of the supermarket organisations. While the incumbents may question, moan, whinge and complain about the WACC rates used in the calculations, the prices paid by Foodstuff franchisees for new supermarket businesses can be seen as third party verification of superior profitability. Publicity about individual franchisees entering the rich list provokes more research on the international benchmarks for this industry structure.

This is not a time for Government to get squashed by incumbent duopolies or lobbyist pressures and blame everything on the RMA or agree to some pyrrhic competition noise like an industry conduct code. This is the time for bi partisan agreement the current market structure is not working for:

1) Consumers
2) Suppliers
3) Employees
4) NZ 's public interest as premium food exporter.

NZ is the only country In the OECD with no lobbyist legislation, so this report has been a bonanza for lobbyists and lawyers.

Our submission will cover off how a breakup should take place, and remove the fantasy promoted by the incumbents that consumers will benefit by pyrrhic solutions like industry codes or new entrants.

Why break up of existing supermarket network by forced sales – why not just reduce barriers to entry for new operators, or rely on innovation to create competition?

Without a like-for-like sustainable challenger, consumers in NZ will suffer. A voluntary code of conduct would deliver no price, service or utility benefit to customers.

Food kits, Uber Eats, restaurants, new internet virtual stores are all noise when set against a $20bn supply chain duopoly. This dominance can be maintained whatever the technology platform. Established distribution centres and buying dominance, combined with an RMA-endorsed real estate footprint for retail sites means it's impossible to build a challenger business case. There may be room for niche operators, as have emerged, but nothing that will challenge on price.

What should the rules for new divestments be? Should it be a block sale, or individual separation

Owners of supermarkets and franchises are professional investors. They would know or have been advised they were buying into a globally unique market duopoly structure which was determined by a bizarre legal process in 2001-2005. The should be aware of the risk of competition regulation to level the playing field for challengers. This assumed awareness should give regulators room to move.

The Commission should conduct more regional HHI analysis of regional monopolies and high regional HHI operations, The Commission should hire its own independent consulting economist to model what stores should be divested from both store networks.

The new channel should be given a thee-year sharing right to existing distribution centres, on a like-for-like price basis, before it is obliged to build and operate its own with its own supplier agreements. During this period the New Zealand econony should see significant consumer and supplier benefits.

If there are four operators, they will behave like an oligopoly?

The challenger and incumbent networks will be able to build new stores and the Commission's third party economists will consult on a game theory basis to deliver a market structure that has ongoing competitive tension and PASS THROUGH, so consumers get the benefits of cost out .

Raising Capital for a 3rd , 4th or 5th operator

"There is competition in NZ to buy a supermarket, because there is no competition when operating one ***"(quote from millennial Crumb Coffee Customer June 2021)***

When the barriers to entry are removed, and the Government has established clear rules through new legislation, capital markets will open to this asset class, and it will be easy to finance.

The Commisison should note that four working days after the 10 October, 2006 publication of its Mobile Telecommunication Market Review, $250m of capital was raised to build NZ's third mobile operator. Such is the power of detailed analysis by government regulators

Capital is available for supermarket investment through the existing duoploy structure because returns are so attractive. As the ComCom report explains, it isn't available to new operators because of barriers to entry . Remove these barriers and capital will flow.

Any interim solution which protects the incumbent duopoly's dominance would discourage inveators who are ready to build new distribution centres and choreograph new franchise operating systems

New Zealand food innovators also need vigorous competition in the domestic market to test their product, packaging and marketing.

The Commission needs to be complimented for the way it backed out goodwill from the Countdown balance sheet when working out the WACC returns. This is a major signal to investors the Commission is alert to balance sheet bullshit from incumbent monopolists and does not believe there is a property right to a monopoly rent .

Noteworthy comments and issues of the 517 Page Commerce Commission report on Supermarket operation in NZ

Issue	Comment	Impact
Backing out goodwill of WACC calculations	This adds real credentials to the Tobins Q calculation of the	Stimulates 3rd party investors to consider entering
Initial location HHI analysis	This illustrates a series of geographic monopolies	Smoking gun for assistance in breaking up the industry
Discussion of impact of wholesaling on market structure, pricing, barrier to entry	This helps understand who else is suffering (ie small convenience stores)	This helps the commission understand what they need to regulate and facilitate access for a transition period
Payment of rebates	This is NZ hairy gorilla issue	International executives would be handcuffed if similar behaviours took place in other OECD countries
Economic benefit impact of break up and more competition	This is missing	ComCom or MBIE must do this, consumers will reap a $10b dividend over a decade
Data protection & capture & loyalty	This is sensible and illustrates that without competition (massive amounts of prescriptive regulation is required) **Similar to number portability, data should be shared at the customers requests (Ie NewCO can service you better**) data ownership should stay with customers like phone numbers do	Parts of This should be handled in a different enquiry. But the Management of Data in a split up is really important, - it should be shared with a like for like challenger
"Specials".	Notworthy that competitive markets don't have as many specials	Alarm bell that confusion is being used,
Lack of banner competition on price	Smoking gun issue	Well canvassed and should point Commission to a more ambitious competition solution
Exclusiveness of stores in restrictive property covenants	Its noteworthy that this has been banned by the competition regulator in South Africa	These need to be unwound and banned
Own Brand IP theft	Its not worthy that the NZ CEO of Countdown; s old organisation was prosecuted for this in South Africa	Its essential that brands, and USPs , packaging and labelling are invested in . Food security is under threat by too much own brand penetration
Lack of Innovation	This is quite difficult to review and compare, the Commission must be complemented for review of it ,	% on line, range , NZ suppliers and own brand
Lack of demand for wholesale due to vertical integration by major grocery retailers		This means that when a structural separation takes place , special emphasis should be made for a glidepath transition out of existing distribution

Summary

There is no shortage of capital for supermarket infrastructure in New Zealand, but the market is closed because monopoly rents collected by existing cartel has been invested in increasing the barriers to entry.

This study may represent the biggest signal to New Zealand business since the structural reforms of the 1980s facilitated this generous market structure. The new powers the Commerce Commission has been given to study market failure and recommend remedies is inspiring for consumers and business people who can challenge incumbent monopolists. Building materials, banks, energy companies and retirement village operators are also in line for overdue reviews.

The market structure needs to change to create like-for-like challengers, similar to the innovation and wealth unleashed by the break ups of Standard Oil and AT&T 1n 1911 and 1982 respectively. Pretend market competitors and self-regulatory prescriptions need to be avoided, as do massively detailed regulatory frameworks. Competition is best created by structural separation where markets are allowed to work.

The monopoly club needs to be fractured. This reform is not wealth envy. It's about reforming an abberation and aligning New Zealand with international best practice market structure .

New investors have trouble taking New Zealand Governments seriously about competition issues when after business apartheid is perpetuated by the failure to change section 36 and section 27 of the Commerce Act despite 20 years of discussion.

Section 36 effectively means big business can abuse its power to inflict pain on small business through rebates , pocket pricing, and bundling. Many of the behaviours tolerated in New Zealand would have senior executives handcuffed in other countries. Consumers and small business in New Zealand wonder why they get such a raw deal .

Checklist of facts supporting new market structure in Supermarkets

	Fact	Comment	Conclusion
	Foodstuffs' complaints in 2001 to the ComCom about the Foodtown & Countdown merger moving from a 3 to 2 market structure	Foodstuffs CEO in the early 2000s was vigorously anti the 3 to 2 merger of the day – he could see these problems occurring even in his own organisation	A controversial, and globally unprecedented decision accompanied by the OECD's weakest competition law has seen this problem now explode
	Excessive profitability of the supermarkets earning approximately 5 x their WACC	This is a smoking gun, the 3rd party verification is the sale of supermarket franchises	The economic benefits to the consumers to have the monopoly rents paid back to them by lower prices , improved service , more innovation and time efficiency proves the case for break up
	The sale prices achieved of supermarkets by franchise owners	**https://www.nzherald.co.nz/business/giant-nz-supermarket-sold-ex-shelf-stacker-and-now-top-businessman-buys-multi-million-dollar-store/XOFU2IFOR5WLKEQYJITQDFPZ2M/**	
	OCED benchmarks	Sensible charts needs to be published in the final report , illustrating where NZ sits with its peer group of countries on many metrics	Too often the public are informed on these issues by Breakfast radio and TV popularists, who have little or no time to research issues , without simple charts and graphs , the fabulous ComCom work is wasted in the public arena by negative breakfast TV spin (noteworthy that incumbents spend over $100m on advertising in these channels)

Checklist of issues to resolve in the final report on what a recommendation to the Minister might look like

	Item	Comment	Next step
	Economic benefits report	Initial MWNZ suggests that the NZ inc is better off by $12.5bn over a decade from increased competition in supermarkets and over 2000 net new jobs would be created	3rd party cost benefit report must review what benefits to NZ will be generated by a new market structure
	Detailed HHI review to decide what retail distributions points need to be divested, (Similar precedent to divestments of the original merger)	Forcing supermarket divestments is a big intervention into a free market economy, there is plenty of precedent for it , however it needs to be fair and based on HHI facts	3rd party game theory economists need to support the decisions on what stores to divest
	International benchmarking study with OECD countries with populations under 10m	NZ suffers from small country syndrome, often because of poor benchmarking by lobbyists , better empirical data needs to be produced on "similar size economies "	NZ is 2 std deviations away from its peer group in market structure settings, this needs to be graphically depicted to ensure NZ politicians can understand it
	3rd party tenders to participate	Inevitable shareholder damage will be done to owners of supermarkets (a bit like Telecom Share price in 2008) , supermarket owners knew the risks (they are published in the Woolworths SEC and ASX filings, - but it is still important for a fair transfer off assets	A wealth transfer must not occur, but there must be no property right to a monopoly rent
	Māori participation	Māori, particularly regional iwi groups should be considered as investors in stores	*Māori language matters , Māori Inclusiveness matters* *Māori business ownership matters also*

Next steps for Commerce Commission

1) Recommend break up and sale of 200 supermarkets to two new entities;
2) Conduct a study using a game theory economist to work out what stores should be sold on a HHI (Herfindahl-Hirschman Index) ratio basis in 5km- 10km radius;
3) Ensure new network operators build their own core distribution centres, which compete on a wholesale as well as retail level.

Thank you for considering the position of Monopoly Watch NZ

This report is dedicated to the workers, who keep the machine working. They deserve to have a competitive wages and a dignified choice of employer.

Monopoly Watch NZ

Thank you to Mrs XYZ who has worked at Countdown Highland Park in Howick for 22 yrs and answered a question brutally honestly to the grumpy grey-haired guy covered in paint driving a Flat deck Hilux

When asked why is the 2 countdown supermarkets withing 50 meters of each other using the same car park?

"That's because Countdown don't want competition. It used to be Foodtown, the managers don't want a Pak n Save next door, but we quite liked it back in the day, the competition kept us on our toes."