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Commerce Commission
PO Box 2351
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Dear Sir/Madam

Submission on the Market Study into the Grocery Sector: Draft Report

BusinessNZ is pleased to have the opportunity to provide a submission to the Commerce Commission (ComCom) on its draft report entitled 'Market Study into the Grocery Sector', published on 29 July 2021.

1. Introduction

The purpose of the study is to consider whether competition is working well for grocery consumers. Its purpose is to identify and assess factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand, and to make any recommendations that the ComCom considers may improve competition. Providing this submission gives us the opportunity to outline some initial thoughts and comments we would like the ComCom to consider before the final report is presented to the Government.

To that end, rather than getting into the technical detail of the grocery market (preferring to leave this to others who are more directly involved in it), as we have done in all our recent submissions on the issue of market studies, we use this submission to stand above the specifics and raise some meta-issues we would like the ComCom to consider.

We would also point out that the membership of BusinessNZ involves a wide and diverse range of businesses, including those participating in, or affected by, the grocery sector. We expect a number of these members to provide their own thoughts and insights concerning the draft report, especially with regards to the detailed technical aspect of how the sector has been examined by the ComCom, as well as the practical consequences of the potential changes going forward. Therefore, it is crucial that the ComCom listens to any feedback from the current players in the sector so that final recommendations are built on a full understanding of the market, high quality analysis and well thought through recommendations that minimise the likelihood of unintended consequences.

2. Timeframes for proper investigation

The market study for the grocery sector was announced in November of 2020, with the final report due by 23 November 2021. In comparison, the retail fuel market study was officially announced on 18 December 2018, with the final report handed to the Government on 5 December 2019. Therefore, both studies have provided a time frame of around one year to gather information, talk to major players, provide draft findings, seek feedback from submitters and produce a final report for the Government to take into consideration. However, BusinessNZ is concerned that we are not strictly comparing apples with apples around the timeframes proposed.

We note that the briefing for the incoming Minister of Commerce and Consumer Affairs by MBIE on the 4th of November 2020 stated that, "*...the Commerce Commission has resourcing to undertake one study at a time. Our preliminary view is that a supermarkets study will take approximately 16 months, concluding in May 2022, with the building supplies study to commence in June 2022.*" Despite this recommendation, the incoming Minister David Clark announced a study time of just under 12 months instead.

Also, while the grocery market study was new investigative territory for the ComCom, the retail fuel market study already had initial analysis in place by way of a report in 2017 on the findings and recommendations of the Fuel Market Financial Performance Study by MBIE, which was undertaken by the previous Government. Furthermore, one of the three options in the 2017 report - Option 2 – recommended, "*...pursuing further analysis through a Commerce Commission-led market study, which may lead to regulatory intervention.*" This meant a largely natural progression from the work in 2017 to the ComCom market study in 2019. Although the work undertaken in the 2017 report was by MBIE, it no doubt provided the ComCom with a sizeable base of information from which to begin their market study, obviously helped by interdepartmental cooperation.

The additional time requested for the grocery sector market study points towards an acknowledgement by MBIE that it is a sector that requires more time to fully understand. Not all sectors are equal in terms of day-to-day operations and their

associated complexities. Some markets have a relatively simple structure that any lay person can understand reasonably quickly, while others have a far more complex structure, which means any recommendations require a high level of comprehension so as to ensure any recommendations minimise the risk of unintended consequences.

Therefore, given both the initial required estimates of time and the more complex structure of the retail grocery sector, we are concerned that the ComCom has not been given adequate time and resources to properly undertake the market study and provide robust and high-quality analysis for their draft report. Therefore, BusinessNZ would not be adverse to the idea of extending the time taken to provide the final report to the Government. This would mean the implications of the ComCom's recommendations are better understood, particularly those recommendations seeking significant upheaval to the current structure of the sector.

Recommendation: That the timeframe between the draft report and the final report is extended so that the implications of all recommendations are better understood.

3. All recommendations matter

Although this may sound obvious, it is still important for the ComCom to fully understand the point that all recommendations matter. BusinessNZ believes that any recommendations made, particularly within the context of a full and deep market study investigation, should not be taken lightly. The full costs and benefits of any recommendation can be significant, along with the likelihood of any unintended consequences.

The draft recommendations made by the ComCom represent a wide range of potential options. Viewing these from a *regulatory pyramid* perspective (recommending light-handed regulation where appropriate and extending to more heavy-handed options where required), a number of the options outlined are 'light-handed,' where market participants and the Government could come to agreements around change, while other options propose a serious regulatory shift that would have significant implications for existing players in the market, with potential flow-on adverse effects on consumers and on other sectors.

BusinessNZ does not deny there might be potential issues with the grocery market sector that need to be addressed. Therefore, we would support justifiable measures based on sound evidence to correct specific concerns. Any process that begins by making the case for change, followed by an attempt to assess in a logical fashion how far to move up the regulatory pyramid, usually means the business community will be prepared to have an in-depth discussion about proposals for change. The best outcomes are those where both the public and private sector reach an understanding of what changes need to be made, and what long-run benefit the changes will bring for consumers and the wider economy.

Recognition of the potential for significant upheaval in the sector, including any chilling effects on competition, should mean a very high threshold for regulatory intervention, especially when the intervention is looking to displace market practice. From BusinessNZ's perspective, the process by which a business entity decides to conduct itself in the market should attract as little regulatory intervention as possible. Any attempt to create regulatory roadblocks should be crystal clear about the justification for such a move. Overall, an extreme response that is disproportionate to perceived problems will inevitably produce a sub-optimal and likely controversial outcome.

In terms of its findings, the ComCom has, *"...developed a spectrum of options for recommendations to improve competition based on our preliminary findings. These are the options for which we consider further investigation may be warranted. We acknowledge the importance of assessing whether the benefits exceed the costs or any recommended changes to the status quo."* To that end, the Comcom has split the recommendations of the draft report into five main areas:

- Increasing wholesale access to a wide range of groceries at competitive prices
- Free up sites for retail supermarkets
- Directly stimulate retail competition
- Supplier Code of Conduct
- Pricing and promotional practices
- Increased transparency for loyalty programme terms and conditions

As stated above, looking at the suite of recommendations from a regulatory pyramid approach, it is evident that the recommendations cover various levels.

At the 'light-handed' end, discussions around a code of conduct, greater transparency for loyalty schemes, and consistent pricing options are generally areas where the main players would likely be open to further discussions with the Government to the betterment of consumers.

In terms of other areas for discussion that may lead to regulatory change, the ComCom have noted that *while land banking, restrictive covenants and exclusivity covenants in leases in relation to sites which would otherwise be suitable for grocery store development create similar reductions in site availability, our view is that restrictive covenants and exclusivity covenants in leases are currently more likely to be more of a concern.* While this may be an area where the current players and the Government work together to examine how practices involving such covenants could be reviewed, the ComCom also needs to be mindful that restrictive and exclusivity covenants are an issue that typically goes beyond just the retail grocery sector. Also, careful consideration needs to be given to covenants in subdivisions and leases as they can often encourage wider investment. Therefore, any changes in this space may have flow on effects elsewhere in the economy. Also, the very nature of differing covenant situations, such as a separate plot of land compared with one associated with say a

shopping mall, may likely require more nuanced changes that again need to be well thought through.

In relation to the above point, what role the impending replacement for the RMA may have around future planning regulations and resource consents remains to be seen given the current consultation process being undertaken in this space. However, as we have pointed out in our submission to the Environment Select Committee, it is possible the end result will simply amount to replacing one form of complexity and uncertainty with another, for little substantive net gain. Any future planning may be a moot point if the bar for environmental protection is set at the expense of economic well-being.

At the more 'heavy-handed' end of the scale, there are a few key recommendations that represent a fundamental shift in how the sector would operate. Regarding the options around increasing wholesale access, the ComCom has stated that, *"A possible last resort option is to vertically separate the two major grocery retailers by requiring the major grocery retailers to structurally separate their wholesale business from their retail business by moving the businesses into entirely separate companies. A separate wholesale or retail business could also be sold to an independent third party."*

Furthermore, in terms of directly stimulating retail competition, the ComCom states that, *"...one option is the facilitation or sponsorship of retail entry following a competitive tender process. This could be short or longer term support, investment as a joint venture partner and/or with a view to exit when competition is established. The second option is requiring the major grocery retailers to sell some of their stores to create a third viable major grocery retailer."*

Also, the ComCom states that, *"...the costs and risks of these options would be significant and anticipate that these measures are only likely to be appropriate if the costs, risks and expected benefits had been considered, and other options, particularly in relation to the wholesale market, were not feasible, had proved ineffective, or did not appear likely to improve competition within the desired timeframe."*

From our perspective, discussion around the potential for vertical separation or compulsory selling off some stores to create a third viable major grocery retailer represents a significant, and to be frank, radical regulatory overreach by the Government. Again, if we put these within the context of a regulatory pyramid setting, we would view such actions as close to the 'heavy-handed' end of the pyramid, notwithstanding the ultimate step of complete nationalisation of the entire retail grocery market.

What strikes us about the more heavy-handed recommendations is that they are a considerable step up in terms of regulatory intervention from anything that was outlined in the retail petrol market studies. We would obviously expect each market study to be treated independently given each will examine a different sector with its

own opportunities and challenges. However, we believe the ComCom should also be able to progressively refine and improve the process around how a market study is conducted, in order to improve the overall process. This includes key areas such as the collection of data from market players, analysis of that data, and recommendations that are comparable to findings.

We acknowledge the caveats the ComCom has placed on the very heavy-handed recommendations in the Report. We agree that any steps towards significant regulatory intervention requires considerably more analysis. However, BusinessNZ would be deeply concerned if such options were given priority by either the ComCom in their final report, or by the Government in their formal response to it.

Furthermore, even with significant caveats, the simple act of including such strident recommendations does not mean they will not be given greater weighting when the Government considers its response. Unfortunately, we have seen that it has been increasingly common practice in recent years for the Government not to acknowledge the proper steps that need to be taken when looking at severe regulatory options to remedy a perceived problem. For example, the complete banning of oil and gas exploration in 2018 took the respective sector (and most of New Zealand) by surprise. In another area, the impending introduction of fair pay agreements represents a massive industrial and commercial disruption to the country. These were not supported by MBIE in official documents, and also breach New Zealand's international labour obligations. From our perspective, neither decision by the Government considered other options that would have been nowhere near as severe but would have still provided a pathway towards addressing key concerns.

As mentioned above, each recommendation put forward by the ComCom matters, not only for the sector in question, but also for what may be expected for future market studies. Recommendations that have not been given full consideration based on sound evidence will no doubt create a chilling effect for not only the sector in question, but also those who might be next be in line for a market study.

This raises the question of escalation of regulatory measures: if the decision is made by the Government to introduce more heavy-handed regulatory options which then fail, can we accordingly expect even more stringent measures to be introduced? Would this mean greater steps towards the removal of property rights, measures around ceiling prices for food or other decisions that would stifle the free-market economy that New Zealanders generally accept? Overall, the ComCom needs to be very mindful of the broader adverse implications of including such extreme recommendations, particularly if it opens doors to other severe policy measures.

Recommendation: That the implications of more heavy-handed recommendations are better understood by the Commerce Commission before they are included in the final report to the Government.

In summary

Overall, we urge the Commerce Commission to continue to engage deeply and often with market participants to ensure that the issues we have raised in this submission are appropriately managed. We advocate for an exemplary process that can be shown to bring improved processes for future Market Studies, and we look forward to engaging with the Commerce Commission as this study unfolds.

Yours sincerely

A handwritten signature in black ink, appearing to read 'KH', with a horizontal line underneath.

Kirk Hope
Chief Executive
BusinessNZ