

**SUBMISSION TO THE COMMERCE COMMISSION’S  
“STATEMENT OF PRELIMINARY ISSUES” ON THE  
FOODSTUFFS NORTH ISLAND/SOUTH ISLAND APPLICATION**

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**1 Key Recommendations**

- A** Alongside the substantive proposal the Commission should investigate the legitimacy or otherwise of Foodstuffs North Island and Foodstuffs South Island non-competition with one another. On the face of it this has very serious anticompetitive effects and the fact of the companies having similar names in no way lessens the gravity of it.
- B** The proposal, in any event, should be declined. With the extraordinary level of market power concentration in such a strategic industry it would be highly unwise to allow further consolidation. The signal to the market and especially market aspirants would be that the regulator is incapable of protecting them. It would strengthen the barrier to potential new entrants.

- C A variation to the above could be to decline the application in its present form but invite the parties to come back with a plan to separate their wholesale and retail functions, and their banner groups, into truly competitive entities and then reapply for the FSNI/FSSI merger.**

**This Submission deals with these recommendations in more detail below.**

## **2 My View of the Market**

Consumers often know intuitively when the structure of an industry is broken. That is clearly the case with grocery distribution in New Zealand. It has resulted in an abundance of fake competition, an absence of real competition, ruthless range reduction, and large increases in margins over time. Consumers see tacit collusion, shrinkflation, 'greedflation', attempts to shut down adverse media commentary, and the deployment of well-funded public relations resources promoting what are in effect distractions from the real issues. As with the famous, though unintended acknowledgement by Telecom's CEO during the 2000s that "we use confusion as a marketing tool", grocery consumers see manipulation of prices designed to reduce consumer awareness of what a "fair" price might be - recently aided by the emergence of artificial intelligence.

Consumers see the notion of "Special" pricing manipulated to defeat provisions constraining the advertising of a "normal" price. They see the distribution sector moving aggressively to house branding thereby constricting the business of independent grocery manufacturing and absorbing the role and manufacturers' profits into the distributors' business. Over time there has been horizontal integration into adjacent industries such as butchery, greengrocers, pharmacy, liquor, and petrol. The power of the duopoly seems to have almost no limit to its horizontal expansion, If these practices are not challenged and curtailed, the prospect of a competitive market future for our grocery sector appears grim.

## **3 Historical Context**

Our grocery distribution sector at one time was highly competitive. In the 1980s for example, there were half a dozen retail groups competing for the "main shop" – Foodtown, Woolworths, the four regional Foodstuffs cooperatives' banner groups, Three Guys, and Shoprite.

The Foodstuffs-aligned retailers were far more independent from their wholesalers than today. Manufacturers not only had multiple groups to peddle their wares to, but also routinely sold direct from vans store by store as a safeguard against falling foul of the wholesaler. It was a vibrant and effective example of the free market at work, with a healthy power balance between the manufacturing, wholesale and retail arms of the industry, to the benefit of the consumer.

In those days the two major wholesalers – Foodstuffs and Woolworths – advocated heavily for what they called “Central Warehousing” – an environment where all goods went through a wholesaler’s warehouse and manufacturers ceased dealing store by store. The manufacturers resisted strongly, arguing that the economies of scale from consolidation of logistics would be heavily outweighed by the excessive power shift in favour of the wholesalers, with both manufacturers and consumers becoming the losers.

In effect those manufacturers correctly predicted the market failure of today. The muscle power of Foodstuffs and Woolworths forced the smaller operators out of the market. The middle man now controls both suppliers and customers.

A seminal event was the Commerce Commission’s approval of Woolworths acquisition of Foodtown in 2002, putting New Zealand consumers in an invidious position similar only to Iceland and Latvia in having two competing supermarket chains (as demonstrated by research firm Coriolus in 2023.)

## **5 The Commission’s Role – Past and Future**

While having every confidence in the expertise the Commission brings to its work I am surprised by the apparent lack of pace in its drive to improve the lot of consumers. Progress since the government referred the grocery sector to the Commission for investigation in November 2001 has been painfully slow.

The Commission in its excellent Draft Report acknowledged the existence of a serious competition issue, including the symptoms listed above. Since then the pace appears to have slowed. Time extensions for the various reports, and a long delay in appointing the Grocery Commissioner have been at the core of the problem. Over this period the Consumer Price Index has repeatedly shown inflation in food prices substantially outpacing non-food prices. For example, in a statement on 12 October 2023 Statistics NZ noted that grocery prices had increased 10.7% in the previous year compared to 5.6% for inflation overall.

In the three years the grocery sector has been on the Commission’s “to do” list about 10 billion individual products have been sold at our supermarkets, arguably every one of them in a failed market. Surely there is a compelling case for the pace at which the Commission and the government deal with this issue to increase dramatically.

### **6 The Commission’s “Statement of Preliminary issues”:**

#### **a. “Our Framework” – paras 16-19**

The Foodstuffs businesses by their own admission “do not meaningfully compete to acquire groceries from suppliers.” (See para 8.2 and elsewhere in their “Notice Seeking Clearance.”)

On the face of it, this has the look of cartel-like behaviour on a massive scale. It has seemingly occurred for many years with no apparent attention from any regulatory authority, hidden in broad daylight.

I submit that the Commission should investigate the legality of this situation before proceeding further, and:

- If it is unapproved and illegal, deal with it decisively with retrospective effect, or
- If it has been approved, review such approval in the light of the subsequent detrimental effects on competition, or
- If the current legislation does not allow such action, take urgent steps to modernize such legislation

If the situation identified did not exist there are numerous ways in which FSNI and FSSI and their constituent businesses could compete against one another. Some random examples:

- FSSI-aligned retailers in the Nelson/Marlborough region could negotiate for their transport and warehousing to be contracted to FSNI instead of FSSI to improve logistics.
- A geographic sub-set of a banner group, for example the South Island New World owners, could decide FSSI was charging them too much for distribution costs and could negotiate a competitive deal from FSNI.
- Similarly a geographic sub-set such as Four Square owners in the North Island could conclude that they could be more profitable if their marketing were managed by FSSI who, having no conflict of interest with North Island PaknSave stores, would be free to attack PaknSave NI on price.
- Either FSNI or FSSI could bow to regulatory and customer pressure and decide to restructure itself with a full separation between wholesale and retail. Such a decision would become much more complex with a single nationwide entity.

The reasons for the lack of new entry have been well canvassed - a dominant duopoly, lack of sites (it will take decades for the effect of the infamous land covenants to disappear), already too many shops, geographic monopolies, etc. I contend that for the Commission to grant this application would further depress the likelihood of new entrants. It would be a powerful acknowledgement to potential challengers that New Zealand's market watchdog does not have the necessary tools to affect market competition – in other sectors as well as this one.

The “Countervailing power of (wholesale) customers” (18.4) is effectively nonexistent. This is evidenced by Night and Day's claim that when purchasing from wholesalers it is paying a premium of 35-45% over retail prices. The

voluntary code which the Commission has been developing shows no sign of making a difference.

The “countervailing power of suppliers” (18.5) would be significantly enhanced if the Commission required FSNI and FSSI to act as independent competitors, with a concrete wall of confidentiality around the terms and prices for suppliers to each of their 2 businesses.

b. “Market Definition” – para 20-24

As explained above, the premise that the parties “operate in separate geographic markets” is based on the assumption that existing cartel-like behaviour will continue. Irrespective of the outcome of this Application, that behaviour must be stopped, a point addressed under Section 6 above.

c. “Without the Merger” – para 25

An alternative approach would be for the Commission to offer the applicants a choice. In return for granting the proposed merger, the applicants would undertake to reassign functions to their various entities and ensure they operated at total arm’s length from one another under strict sanctions within the legislation. For example:

- FSNZ could become solely a logistics business, handling wholesale physical distribution and transport for all the existing retail banner groups
- Each of the banner group businesses (New World NZ, PaknSave NZ, Four Square NZ etc) could assume the procurement and marketing functions for their own banner group.

The complexity of such a change is acknowledged but is heavily outweighed by the counterfactual of perpetuating the failed status quo.

d. “Preliminary Issues” – Para 26-27

Again, I submit that for the Commission to grant this application without a meaningful quid pro quo would result in potential local and global competitors in this and other industries walking away to invest in markets where there is the protection of an effective regulator focused on the best interests of the consumer.

e. “Unilateral Effects” – Para 28-4

If the Commission were to demand cessation of the current situation with accompanying structural changes, then the merger between FSNI and FSSI might not be detrimental to competition.

f. “Coordinated Effects” – para 43-50

The Commission’s Statement in 46.1 notes that “the parties disagree with the Commission’s finding in the 2022 Market Study that some features of the retail supply of groceries make it vulnerable to tacit collusion or accommodating behaviour.” In my view the parties are being disingenuous. I agree with the Commission’s 2022 finding. In fact, tacit collusion and accommodating behaviour are cornerstones of this market. Examples include:

- The various Foodstuffs banner groups collude by failing to compete against one another – to the point of condoning the use of common suppliers (Foodstuffs) in the critical commercial functions of procurement, pricing and marketing.
- Woolworths and Foodstuffs tacitly collude by avoiding aggressive competition for market share. Instead both appear to focus on confusing consumers through constantly-changing prices, changing pack sizes, and aggressive brand advertising.

The Commission’s Statement in 46.2 records the parties’ assertion that certain features of the market would be a very material hindrance to coordination. I disagree. Retailers have made strong efforts to have consumers lose track of the “right”, or “normal” price for any product. Consumers are bombarded with information and shell shocked. Untrammelled coordination has been the enemy of the consumer. Therefore I reject their thesis in 46.3 – the proposed merger would allow even more dominance of the market from a central control room, to the detriment of consumers.

The Commission’s statement in 47.1 that the parties assert “the cooperatives have no visibility of their competitors’ terms...and the proposed merger would not change that” is debatable. For example, The Warehouse was recently threatened with discontinuation of supply of Weetbix because it was selling below the prevailing retail market price. This shows that “visibility of competitors terms” is not confined to ability to access the competitor’s IT system – there are many ways in which normal market interplay allows a purchasing entity to draw conclusions about a competitor’s terms of purchase. Consolidation of the market would make this dynamic even more advantageous to Foodstuffs.

G Vertical Effects” – para 51-53

No comment

7 **Conclusion**

The decision the Commission makes will send a profound and enduring signal about whether the government system has the muscle or the will to deal with extreme concentration of market power, or whether the political and financial power of the incumbents will prevail.

New Zealanders have a lot at stake in the Commission's work on groceries over coming months. For some lower paid people, the Commission's work determines how many meals they have each day.

I support the Commission in your work and look forward to rapid, effective change in the grocery market.

## **8 Contact**

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