Submission to NZ Commerce Commission Opposing the Foodstuffs North Island and Foodstuffs South Island Merger

Will the merger substantially lessen competition in the market if it goes ahead?

Prepared on behalf of New Zealand Consumers
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Executive Summary:

The evidence suggests the merger will substantially lessen competition in market. Foodstuffs North Island is currently concentrating suppliers in categories and lessening competition. If the merger is to go ahead, it will dramatically increase Foodstuffs market power and concentrate an already highly concentrated market. The merged entity will exercise its increased market power, to the detriment of suppliers and consumers. With increased market power this will create a further imbalance with its supplier base, which it can use for greater concessions, margins, and concentration. The consumer will be worse off, as we have seen with the FSA and FSW merger, prices have gone up dramatically to the point where shopping for basic necessities is considered out of reach for so many New Zealanders, and reliance on charity to eat a reality. A proposed demerger or divestment of FSNI is recommended so that PaknSave stores are completely independent of New World in the North Island, which will create more competition.

About the author:
A Kiwi living in Australia, I am currently undertaking a PhD at the University of Sydney, focused on global grocery retailing, after 20 years in industry. During a trip to Auckland in January 2024, I was shocked at what I saw. I felt morally obligated to use some of my research and my time to help the New Zealand consumer by submission on the Foodstuffs merger. I was particularly moved by a shopper I met in Manukau and her story. She is now growing her own fruit and vegetables with neighbours and relies on charity for meat five times a week, as she cannot afford the high prices at the supermarket for her family. It turns out, she is one of many who can no longer afford to shop at the supermarket. If fruit, vegetables, and meat are no longer affordable, what has this country come to? This is not the New Zealand I left behind; it is broken. I hope this report will have some impact; the facts cannot be ignored.

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1. Introduction

Based on the evidence of this report, the merger of Foodstuffs North Island (FSNI) and Foodstuffs South Island (FSSI) should not be approved. The market power of the merged entity will be detrimental to competition, NZ growers, NZ producers, NZ manufactures, and most importantly the NZ consumer.

The merger of Foodstuffs Auckland (FSA) and Foodstuffs Wellington (FSW) to FSNI in 2013[1] has resulted in the consolidation of market power, which has been used to improve profit for this entity and its co-operative owners. The extent of store owners' profit is not known but speculated to be very high[2]. This has been to the detriment of competition, with consumers seeing higher prices, and demand placed on suppliers for lower prices. The FSNI and FSSI merger should not be allowed to go ahead, and based on evidence to be discussed, a divestment by FSNI should take place whereby the PaknSave (PNS) stores should be independent of New World (NW), from a procurement, management, and co-operative entity perspective.

The current system of reward within Foodstuffs, whereby operators prove their ability to benefit themselves and the system, results in them working their way into owning the top revenue generating stores in the network, largely within the PNS banner. This is evident in the "stories" of owners of the top PNS stores in the country[3], and its owners accumulating extraordinary wealth via these stores. If low-income families are reliant on charity to feed their families[4], while their local supermarket owner accumulates fortunes to rank among the wealthiest in the country, surely this represents a broken system in need of reform? If there was greater competition in the market, retailers would be forced to compete on price, this would materially impact the increasing poverty rate[5] and materially improve consumer welfare through more competition with more affordable prices.

2. Definition of the Market

The definition of market should be determined by the direct competitors and where the bulk of the revenue of the business is from. The market definition for this report is grocery supermarket retailing in New Zealand. To include the wholesale parts of both Foodstuffs businesses (Gilmours & Trents) which sell to trade, would be immaterial to the overall revenue generated from its supermarkets. The Four-Square banner and associated stores again would be immaterial to the overall revenue generated by PNS stores and NW stores. The inclusion of foodservice would only be an attempt by Foodstuffs NI and SI to dilute their claimed share of what should be of most interest here, grocery retail sales.

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[1] https://www.nzherald.co.nz/business/foodstuffs-seeks-aucklandwellington-merger/UWJEE5RQKM3JTNTEGGLLG6WDWA/
[2] https://www.interest.co.nz/business/122951/foodstuffs-co-operative-can-afford-living-wage-professor-says-union-wins-right
[3] https://www.nbr.co.nz/business/nbr-rich-list-how-grocery-barons-rise-to-the-top/
[4] https://www.newshub.co.nz/home/money/2023/10/cost-of-living-crisis-more-than-half-a-million-people-rely-on-food-charity-each-month.html
[5] https://www.newshub.co.nz/home/new-zealand/2024/01/charity-warns-poverty-is-forcing-families-to-send-children-to-work-instead-of-schools.html

Ernie Newman has made an interesting point in his objection to the merger via ComCom, whereby he calls out that FSNI and FSSI do not meaningfully compete to acquire groceries from suppliers based on their own submission, they have set geographies[6]. He asserts there appears to be cartel conduct. This is a very interesting point. FSNI and FSSI have very similar names, they operate the same banners, and each use the same Private Label brand "Pams" instore. On the face of it, they do look like the same company, however they are not. What has potentially been co-ordinating behaviour towards no competition and harmonization against WWNZ should not be grounds for them to merge. What is most important here, is the power of the merged entity would be detrimental to competition overall as the bargaining power would increase, and the lack of competition provides incentives to not pass that onto the shopper/consumer.

3. Market Concentration Issues

Based on data, New Zealand is a highly concentrated market for grocery retailing. Concentration will be measured by two economic measures of competition, C4 and HHI. Consideration is given to pre-merger and post-merger.

The first measure of market concentration is C4 which sums the top 4 firms' market share to simply detail concentration of the top players. If the number is below 40%, it is considered low concentration, 40%-70% represents a medium level and likely an Oligopoly, 70%-100% is considered highly concentrated and ranges from Duopoly to Monopoly. The C4 ratio based on the IGD data analyzed which includes supermarkets only (not Four-Square as it's considered convenience or Costco as it's a wholesale warehouse) is 100%, therefore highly concentrated. Highly concentrated is an issue, as it means there is low incentive to price compete, and easy to gain higher profits through lack of competition.

The second measure of market concentration is the Herfindahl-Hirschman Index (HHI) (Herfindahl, 1950), which sums the square root of a firm's market share. If this number is <20% it is considered perfect competition, 20%-60% considered an Oligopoly, and >60% and above is considered monopolistic. The NZ market already has a high HHI of 39.3% which demonstrates it is highly concentrated, and if the merger is to go ahead will increase to 50.5% which makes it a strong duopoly, very close to a Monopoly.

Lack of competition and highly concentrated markets, lack incentives to compete. Although FSNI and FSSI do not currently "compete" with one another based on geography, the market power and thus bargaining power that would occur from a merged entity, could then be used to bargain harder with suppliers for concessions, and increase prices to shoppers, as there is only one competitor, WWNZ. This should be regarded as a red flag by the regulator. The market is already too concentrated; therefore divestment of stores should be a more logical approach than allowing higher market concentration and power. The issues of market concentration in Australia are currently under a senate inquiry, with calls requesting a cap on market share of 23%[7]. WWNZ and FSNI already have over 40% each, therefore further concentration should not occur.

[6] https://comcom.govt.nz/__data/assets/pdf_file/0024/342384/Ernie-Newman-submission-on-SoPI-revised-5-February-2024.pdf

[7] https://www.afr.com/politics/federal/limit-supermarket-markups-to-ease-price-pressure-government-told-20240212-p5f453

When comparing how NZ stacks up against other developed nations, it is clear no other nation is as concentrated which can help explain the high prices. Australia is almost as concentrated, but the presence of Aldi has had an impact on pricing seen by Australians.

The most concentrated markets are 1. NZ, 2. Australia, 3. Canada. Comparing NZ to Australia and Canada is simply comparing it to other troubled markets. Although Germany does look concentrated at an aggregate level, there is innovation in store format/differentiation to each parent company, with a high percentage of Hard Discounters (eg. Aldi, Lidl) as a format which focuses on price. Hard Discounters have a positive effect on low prices in markets they operate (Steenkamp & Sloot, 2019).

There is a clear issue of current market concentration in NZ. Considerations of divestment rather than merger should be considered to increase competition and benefit NZ consumers.

4. Why do New Zealanders have so few stores to shop at?

What could be considered another measure of concentration is the number of people per supermarket in a country. Based on IGD proprietary data on supermarkets which excludes convenience and warehouse stores, New Zealand shoppers have less options of where to shop based on the population per grocery retailer.

Not only is the market concentrated by retailers at industry level by market share, but it also appears this concentration is leading to a lack of incentive to open more stores. NZ has 4x more people per supermarket than Germany, this is a striking number. NZ also has 2x more people per store than the UK, and 3x more per store than Italy, Spain and the Netherlands. The land covenant

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issue which was addressed in the market study in 2022[11] explains some of the barriers to entry for other retailers, but the current power and concentration appears to be impacting physical store availability for NZ shoppers. The store numbers suggest there is room for more players, and the market is far from saturated. This high population per store also helps demonstrate why large store owners are able to accumulate considerable wealth, they have a captive market, which will be discussed further in a later section.

Germany which is the home of the Hard Discounter (Aldi or Lidl, a low assortment, low price model), have the lowest population per supermarket, and arguably the cheapest prices. Despite the cost-of-living crisis through 2023, Germans pay only 10% of their income towards groceries, versus 15% average for the rest of the EU (Gielens, 2023). It is hard to benchmark this to New Zealand with fragmented data, but households are acutely aware of their grocery bill each week to calculate for themselves and how it contrasts to 10%. With increasing rates of poverty, the ability for a NZ household to be able to afford its weekly shop is becoming further out of reach due to a lack of competition driven by concentration at the grocery retail level.

5. Private Label in New Zealand – an additional form of concentration and market power

Private Label (PL) are also known as store brands or home brands, which are exclusively developed and sold by a retailer (Kumar & Steenkamp, 2007). PL expansion is a function of retailer market concentration, and is enabled by its ongoing market concentration (Sethuraman & Gielens, 2014). The value share of PL in NZ in 2022 was 13%[12] on the back of steady growth, so ~$3b of an estimated $19b[13] scanned through their stores in 2023. This number represents the retailer's **dual role** of customer and competitor to its own suppliers. It is an unusual position to possess commercially sensitive information about suppliers' products and their performance and revenue, and then compete against them with your own brand, or launch products very similar via a copycat strategy (ter Braak & Deleersnyder, 2018). As this happens within the retailers' store, it could be argued they are at their discretion to choose who is stocked in their stores. This dual role and conflict of interest is prevalent in Europe with much higher PL market share rates. Precedent is set in practice, largely due to Europe also having a large Hard Discounter presence (Aldi, Lidl etc.) which stocks mainly private label brands which drives up the high PL market share (Steenkamp & Sloot, 2019). Regulation has yet to regulate this in the EU, however multiple EU investigations have occurred in the last 20 years probing at this issue particularly within the food industry and its impact on prices, competition, and innovation[14]. It is highly likely FSNI will argue it has low PL share versus other countries, however no Hard Discounter is in the NZ market. Hard Discounters stock 90% PL products, which has driven high expansion in Europe across dual stocking retailers.

Private label is not a brand that is consumer driven, but a brand which is pushed by the retailer to its customers as a lower cost alternative to brands (Kumar & Steenkamp, 2007). What is striking

[11] https://comcom.govt.nz/__data/assets/pdf_file/0024/278403/Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf
[12] https://www.foodticker.co.nz/nz-private-label-trends-the-nz-categories-with-30-plus-growth/
[13] https://figure.nz/chart/LTs7JqJ7QRyeT8Ba-FWKqcnUrVplrZzVq
[14] https://www.responsibleglobalvaluechains.org/images/PDF/FTAO_-_EU_Competition_Law_and_Sustainability_in_Food_Systems_Addressing_the_Broken_Links_2019.pdf

given the timing of the merger review, that Foodstuffs release a campaign on its private label brand Pams 2nd February 2024[15]:

> *"The new campaign, titled "The most popular grocery brand in the land," demonstrates that Kiwis can find affordable food options at any Foodstuffs supermarket."*
>
> *"Pams is a key part of Foodstuffs' 'Here for NZ' social promises, particularly the promise to provide New Zealanders with healthy and affordable food," said Foodstuffs' own brands head of brand & communications, Melissa Steffensen."*
>
> *"This campaign is about showing Kiwis that they can shop with confidence and be proud to put Pams in their trolley as over a million others are also choosing Pams products each week too."*

What the press release fails to mention, is that the retailer makes higher margins on private label than suppliers' brands, so it is in the retailers best interests to grow their private label as it enhances their profit margin (Kumar & Steenkamp, 2007). The press release also calls out a "social promise", which is misleading. The only way for Pams to increase its space on shelf is to delete its smaller suppliers and remove competition, allowing it to represent the cheapest product on shelf. It appears the reason many kiwis are choosing Pams, is a consequence of not being able to afford anything else and competitive choice being removed. If FSNI and FSSI merge, the harmonization of range across islands will happen, and competition from small suppliers in the South Island is at risk, further lessening competition.

By removing smaller brands from shelves, can assist the retailer in finding more room for its private label products. As detailed in the FGCNZ supplier survey submitted to ComCom in 2021 (hereby referred to as "the supplier survey")[16], FSNI has requested brands who are already on their shelves to "tender" lowest pricing to remain in their range as it rationalizes brands. As private label only needs to be cheaper than the cheapest brand, this concentration in categories can also lead to price creep of private label as it is indexed to other brands and across retailers. Therefore with less competition, prices can go up.

In the supplier survey, multiple suppliers quote having to move to a "net net price" with FSNI. This means the supplier has to hand over control of promotional frequency, level of discount to the retailer, historically it was negotiated, and it allowed competitive reaction to market conditions. Now, the retailer is in control of price competition amongst brands in a category. How is this competitive? This change in how promotions are agreed, removes competition by brands and hands this over to the retailer to manage the competition, however it also has its own brand. The deliberate removal of brands unwilling to meet margin expectations of FSNI would then be extended to the South Island, impacting competition.

When you add private label into the mix, as the promotional discount on brands is at the discretion of the retailer, it can continue to keep it above its own private label products such as Pams. This results in a price incentive for shoppers to trade into its private label, and therefore increase its profit margin and power over suppliers. Does this feel like fair competition at play? Or a potential

[15] https://insidefmcg.com.au/2024/02/02/tough-times-make-foodstuffs-pams-most-popular-grocery-brand-in-nz/
[16] https://comcom.govt.nz/__data/assets/pdf_file/0023/253148/NZFGC-Members-Survey-February-2021.pdf

abuse of bargaining power by the retailer and manipulation of competition? If the merger goes ahead, it will lessen competition as the emerging practice of FSNI will be rolled out through FSSI.

6. Global grocery retailers' profitability versus New Zealand grocery retailers – How can such a small market deliver such high profits?

It should be noted historical margins for Foodstuffs as per the Australian Commerce Commission report in 2008[17] shows a breakdown of Foodstuffs margins prior to FSNI merger. It appears historically FSSI have enjoyed higher EBIT% margins during this time ~6.95% despite being more geographically isolated. Foodstuffs Wellington saw declining margins during reported periods to 2.88%, while Foodstuffs Auckland increased to 4.78%. The details of 2008-2013 were not locatable online to fill in the missing years, however this paints a picture of competition in the North Island prior to the 2013 FSNI merger. The question has to be asked on why a merger of these entities was approved? It has concentrated the grocery market, positioning New Zealand as the most concentrated market.

	02–03	03–04	04–05	05–06	06–07
Foodstuffs Auckland EBIT margin			2.92%	2.83%	4.78%
Foodstuffs Wellington EBIT margin	4.50%	4.15%	3.77%	2.84%	2.88%
Foodstuffs South Island EBIT margin	6.96%	6.96%	6.79%	6.65%	7.40%

Source: ACCC inquiry on price gouging 2008

When we look at global retailers which have more stores and overall population reach, this helps us understand what is considered average for a global grocery retailer with scale. The numbers reported below are in $USD, unless otherwise specified.

	USA						Europe		
	Kroger			Costco			Carrefour - France		
	Jan-23	Jan-22	Jan-21	**Aug-22**	**Aug-21**	**Aug-20**	Dec-22	Dec-21	Dec-20
Revenue	148,258	137,888	132,498	226,954	195,929	166,761	83,088	71,761	72,150
Cost of Goods Sold	116,480	107,539	101,597	199,382	170,684	144,939	66,776	56,865	56,705
Gross Profit	31,778	30,349	30,901	27,572	25,245	21,822	16,312	14,896	15,445
Gross Profit Margin	21.43%	22.01%	23.32%	12.15%	12.88%	13.09%	19.63%	20.76%	21.41%
Operating Income EBIT	4,126.00	3,477.00	2,780.00	7,793.00	6,708.00	5,435.00	2,342.00	2,170.00	2,155.00
Operating Margin EBIT%	2.78%	2.52%	2.10%	3.43%	3.42%	3.26%	2.82%	3.02%	2.99%

	Casino Group - France & LATAM			Tesco (UK)			Sainsburies (UK)		
	Dec-22	Dec-21	Dec-20	Feb-22	Feb-21	Feb-20	Feb-23	Feb-22	Feb-21
Revenue	34,004	31,053	32,510	61,383	57,887	58,091	31,491	29,895	29,048
Cost of Goods Sold	26,108.00	23,436.00	24,314.00	56,750	54,111	53,993	29,487	27,529	27,283
Gross Profit	7,896.00	7,617.00	8,196.00	4,633	3,776	4,098	2,004	2,366	1,765
Gross Profit Margin	23.22%	24.53%	25.21%	7.55%	6.52%	7.05%	6.36%	7.91%	6.08%
Operating Income EBIT	1,108.00	1,136.00	1,405.00	2,599.00	1,933.00	2,283.00	562.00	1,156.00	60.00
Operating Margin EBIT%	3.26%	3.66%	4.32%	4.23%	3.34%	3.93%	1.78%	3.87%	0.21%

Source: Hoover D&B Reports + Company Annual Reports

[17] https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p. 114

Based on the above global financial data which compares UK, Europe and the US supermarkets, an average EBIT% one can expect as a grocery retailer is ~3% in competitive markets. The companies used to illustrate this point are large retailers with significant market power, however, operate in more competitive markets with more competition.

When we compare this to New Zealand, WWNZ has historically had EBIT% 39%-66% higher than much larger global players at 5.05% and 4.18%, with only the last 12 months it is reaching the average level a grocery retailer might expect of 3.15%. As WW Australia trade at almost double this EBIT% at 6%, as a parent company to the NZ business, WWNZ is considered profit dilutive, however it is globally average. The duopoly in Australia is a contributing factor to Woolworths Australia's EBIT%, which is outside of the scope of this submission.

	NZD	NZD	NZD						
	WWNZ	WWNZ	WWNZ	FSSI	FSSI	FSSI	FSSI	FSSI	FSSI
	Jun-23	Jun-22	Jun-21	Feb-23	Feb-22	Feb-21	Feb-20	Feb-19	Feb-18
Revenue	7,912	7,563	7,146	3,413	3,311	3,055	2,978	2,950	2,895
Cost of Goods Sold	6,084	5,642	5,338	-3,098.00	2,876.17	2,853.19	2,787.10	2,765.28	2,716.59
Gross Profit	1,828	1,921	1,808	314.29	201.74	210.77	190.74	184.48	177.99
Gross Profit Margin	23.10%	25.40%	25.30%	9.21%	6.09%	6.90%	6.41%	6.25%	6.15%
Operating Income EBIT	249.00	316.00	361.00	21.96	67.02	71.28	88.05	104.97	106.12
Operating Margin EBIT%	3.15%	4.18%	5.05%	0.64%	2.02%	2.33%	2.96%	3.56%	3.67%

Source: Company Annual Reports

When comparing FSSI to global average, it has historically traded FY20 and prior at slightly elevated EBIT% of just over 3%, and much higher in the prior ACCC summary. Only since FY21 has it started to see EBIT% decline, which provides a very clear motivator for why FSSI would want to merge with FSNI, so that it can improve its EBIT% level and profit return to owners.

	FSNI	FSNI	FSNI	FSNI	FSNI	FSNI	FSNI	FSNI	FSNI	FSNI	FSA
	Feb-23	Feb-22	Feb-21	Feb-20	Feb-19	Feb-18	Feb-17	Feb-16	Feb-15	Feb-14	Feb-13
Revenue	4,299	4,021	3,719	3,543	3,332	6,640	6,393	6,439	6,239	5,480	3,832
Cost of Goods Sold	3,385.00	3,156.62	2,917.31	2,769.25	2,577.51	6,164.63	5,909.79	5,929.15	5,740.53	5,046.25	3,545.48
Gross Profit	913.41	864.23	801.83	739.44	677.05	475.80	483.49	509.43	498.36	433.92	286.32
Gross Profit Margin	21.25%	21.49%	21.56%	20.87%	20.32%	7.17%	7.56%	7.91%	7.99%	7.92%	7.47%
Operating Income EBIT	264.46	270.06	205.27	218.50	289.78	210.35	216.42	219.34	212.64	189.00	138.24
Operating Margin EBIT%	6.15%	6.72%	5.52%	6.17%	8.70%	3.17%	3.39%	3.41%	3.41%	3.45%	3.61%

Source: Company Annual Reports

FSNI is currently delivering double the global average for a grocery retailer EBIT% in excess of 6%, with significantly less stores, but high market share, and thus market power. This number should be alarming for the Commerce Commission, as it defies global average of much larger retailers, and displays the market powers at play in NZ. To concentrate further with improved market power by Foodstuffs would only be to their benefit and the detriment of the consumer, suppliers and competition.

From the financial data, reporting changes in FY19-FY20 plus the partnership of FSNI with Tesco owned data analytics company Dunnhumby[18] announced in October 2019 have resulted in exponentially growing gross profit and EBIT. Exerts from an article discussing the partnership:

[18] https://www.afr.com/companies/retail/dunnhumby-signs-partnership-with-woolworths-nz-rival-foodstuffs-20191022-p532xh

"Dunnhumby Chief Executive Guillaume Bacuvier said the company would help Foodstuffs analyse sales and customer data to make decisions about store locations, product range, pricing, promotions and loyalty programs."

""We have a track record of helping companies in retail, in particular, do this and they typically outperform their peers – in the case of Foodstuffs that's the goal as well – strengthen them and make them a leader in the market," Mr Bacuvier told The Australian Financial Review."

Customer data is referring to the loyalty card transaction data which tracks shoppers purchasing against shopper demographics and profiles, then commercializes it by selling some of it to suppliers who are willing to pay, and internally using it to increase revenue and profit. Through the gross profit line from FY19-FY23, it is evident this is working for FSNI, as it has jumped from $475m in Feb-18 to $913m in Feb-23. Profit at this line is derived from higher prices charged to shoppers or from suppliers' lower prices or rebates to achieve lower prices or a combination of both for the retailer. The other driver is driving "trade up" to more expensive items from cheaper items[19]. It is important to note the collection of customer data of this nature and using it to generate increased revenue or profit is unregulated. The question should be asked, should the customer own their own data or the retailer?

It appears Dunnhumby is helping FSNI grow its profit, through customer data. The "track record" of working with companies to "outperform their peers" on paper looks like enhancing gross margin through use of customer data. If brands are being deleted on substitutability (as noted in the supplier survey), then the use of data is not about benefiting the customer but monetizing the collection of customer data for greater profit generation by the retailer.

If the two entities merged it is likely we would see EBIT% dilution temporarily, before it gets back to its current state, as was seen with FSNI merger, with the combined market power. Based on the confidence of Dunnhumby, we may likely see EBIT% continue to increase. As multiple FSNI owners featured on the NBR Rich List in 2018[20] with fortunes ranging from $60m-$75m for 5 operators[21], this is quite a striking fact. The grocery industry is considered high volume, low margin business globally, yet it's surprising to see single site owners in New Zealand being listed as among the wealthiest people in the country. Coincidentally we are seeing more and more NZ families go into poverty, and not afford basic food[22].

"We can't keep up with demand. This is the worse it's ever been, and is a direct result of the cost-of-living crisis that we are in. – Julie Chapman, CEO of Charity KidsCan who help 55,000 children across the country".

The inequity here cannot be overlooked.

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[19] https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p. 115
[20] https://www.stuff.co.nz/business/money/106288425/supermarket-owners-banking-super-profits-nbr-rich-list-shows
[21] https://www.nbr.co.nz/business/nbr-rich-list-how-grocery-barons-rise-to-the-top/
[22] https://www.rnz.co.nz/news/national/493454/worst-it-s-ever-been-kidscan-says-need-for-families-children-at-all-time-high

Firms with inelastic market demand curves, can maximize firm profits and have more incentives to raise prices (Cotterill, 1986), this was proven empirically by Cotterill in a captive market, and it's evident in NZ. Groceries are an everyday need; therefore, the market is relatively inelastic as food is required as a basic need for survival. The maximizing of firm profits is clearly evident with FSNI with the increasing gross margins reported, and the burgeoning wealth of its owner operators. The retailers are using their market share and concentration to derive higher firm profits in an uncompetitive market (Shepherd, 1972), which is consistent with theory.

With the expansion of private label and store brands, the concentration of power and profit margins is accelerated. This therefore does not appear right to concentrate power further with the merger and provides another reason to review the last merger, and proposed demerger or divestment of PaknSave in the FSNI network, so that it is independent.

7. How is Foodstuffs Delivering Higher Gross Margin and EBIT Margin?

High profitability detailed in the last section has been achieved for FSNI through higher concessions from suppliers which has been captured in the supplier survey[23]. The shift of paid/off location funds instore to head office as a % of "Retail Sales Value" to then be redistributed back to members. Plus, the Dutch auction of rationalizing brands on shelf by banner referred to as a "tender", have contributed towards higher margins or rebates given by suppliers in exchange for remaining on shelf, FSNI using its market power.

> *"Our DH payments (cost is significant) excludes the substitutability data which is the big stick that they are using in the reviews."*

The above statement is a supplier referring to the money it is paying for Dunnhumby data, and the omission of key data used to determine ranging decisions being withheld which is substitutability. The supplier is being charged a large amount of money with missing information. Knowledge is power, and it appears in this instance, despite this supplier being able to access the information, it is still disadvantaged. "Substitutability data" is measuring whether deleting a brand will result in a shopper changing stores, or whether that volume could easily be picked up by remaining brands. How to calculate something like this is through brand repertoire. If people buy different brands based on what's on promotion or whatever is there or the cheapest, then they have demonstrated they will buy multiple brands. So, if a supplier cannot provide enough margin through the "tender", and shoppers/customers have a purchase history of buying other brands then it is substitutable.

Smaller suppliers would not only lack access to this data due to cost, but they would be more significantly impacted, as tendering for a category requires margin to be handed to the retailer of which smaller companies do not have. This was captured in verbatim from the supplier survey[24]:

> *"Retailers range reductions are currently unfair to smaller players leaf terms and outcomes. Margin grab from suppliers while we are all dealing in uncertain conditions. FSNI clearly not listening to suppliers and staying on a course that only benefits them and the owner*

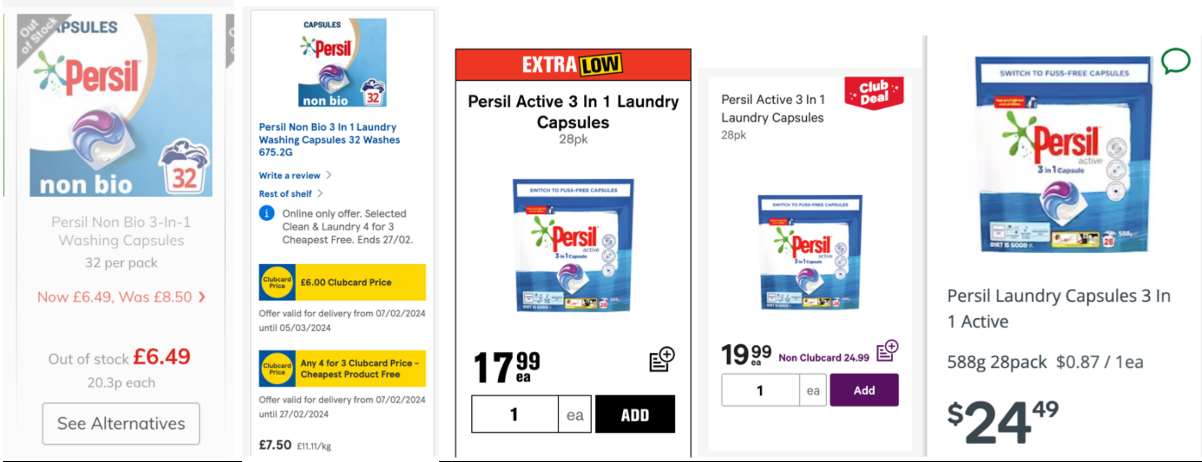
[23] https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector?target=documents&root=253147
[24] https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector?target=documents&root=253147

network. They say it's Consumer focused but all extra terms we have had to agree to have not lead to lower retails they have gone to retailer margin so question is how does this benefit consumers?”

“NWNI state their goal is to is to be the most shopper centric retailer in the world but the NWNI Tender Process is at odds with this as the Tender disregard what NWNI shoppers want and they are looking to significantly rationalise number of brands in each category ranging products where they have screwed the suppliers down to minimal margins which is not sustainable. NWNI are using their market power (a result of the Foodstuffs Auckland and Wellington Merger being allowed to occur) and threatening deletions if suppliers don't meet their margin expectations which are in many cases over triple the trading margin they have historically made. This is not about making prices cheaper for New World Shoppers it is about making Foodstuffs Owner Operators even more wealthy than they already are!”

The lower margin availability of smaller suppliers is due to it often being built into price over time, and this level of foresight and sophistication is lacking with smaller suppliers, but not from multinational suppliers. This premise is supported by increased EBIT margins being achieved for large multinationals over time in this region[25] [26] [27] [28]. For the retailer and multinational to both enjoy growing margins over this time at gross margin and EBIT margin, points to the fact that with subsequent price increases, they are taking larger chunks of the increase for their own profits and shareholders, to the detriment of the consumer. Lack of price competition at the retailer and manufacturer level are drivers of this. As FSNI is rationalizing brands in categories according to multiple suppliers in this supplier survey, this benefits the retailer and the remaining manufacturers who pay to play. Allowing Foodstuffs to merge, would harmonize this practice and reduce competition within the supplier base further.

<u>Case Study – Persil Capsules:</u>



Morrisons Tesco PNS NW WWNZ

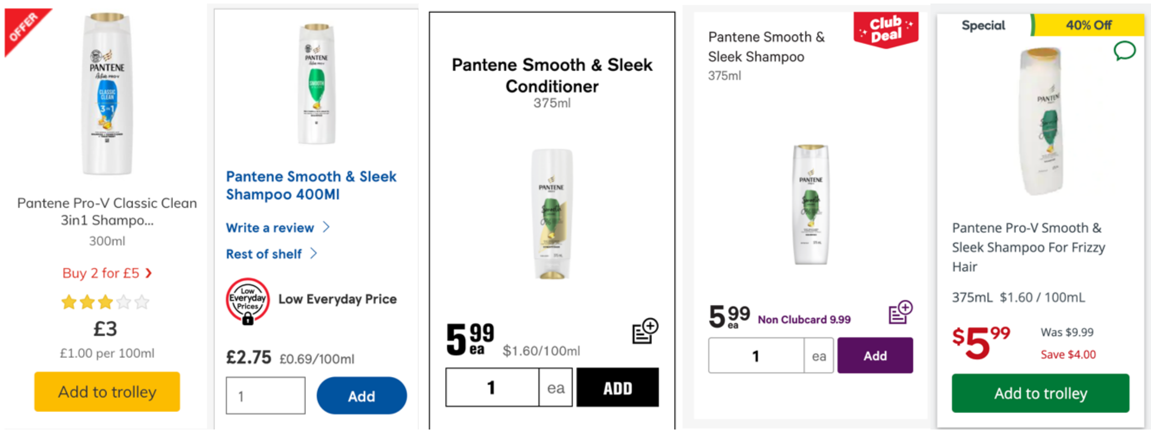
In February 2024, a market comparison between retailers in the UK (Tesco and Morrisons) was done against retailers in NZ. Adjusting for forex to NZD and VAT/GST differences, on a unit basis NZ

[25] https://www.unilever.com/files/7b16737e-82ce-45dc-91b3-98a56ffdb5fa/unilever-charts-2013-to-2022.pdf
[26] https://ir.cocacolaep.com/static-files/152e51dc-0bab-43a1-a2fd-182d910968a5
[27] https://www.pginvestor.com/financial-reporting/press-releases/news-details/2024/PG-Announces-Fiscal-Year-2024-Second-Quarter-Results/default.aspx
[28] https://reckitt.com/media/k2bbe500/reckitt-rns-q3-2023.pdf

full-service supermarkets were 72% more expensive at shelf price and 55.1% more expensive on promotion. When adjusting to the NZ pack size, this variance was 97% more expensive at shelf and 77% more expensive on promotion. Neither country manufactures the product anymore, so shipping costs or local production cannot be argued. This is a staggering premium NZ is paying versus the UK.

Case Study - Pantene Shampoo/Conditioner:

Reviewing Pantene Shampoo between NZ and the UK shows a similar picture, when comparing PaknSave, New World and Countdown to UK retailers Tesco and Morrisons. Once we adjust for VAT/GST and forex, NZ full-service supermarkets shelf price is 72% more expensive than the UK. The promotional price was 23.9% more expensive than Morrisons promotional price, that's on a unit basis. Once we adjust for volume to NZ sizing, NZ full-service shelf prices are 84% more expensive and on promotion 32% more expensive. It's important to note NZ had a 40% off promotion, while the UK had 50p off which is 16.7% discount. We are seeing larger discounts in NZ, but ultimately this is still significantly more than the UK market. If a 40% reduction or 50% reduction still has the promotional price materially above another market, this suggests the retail price is inflated to discount to this level.



Morrisons *Tesco* *PNS* *NW* *WWNZ*

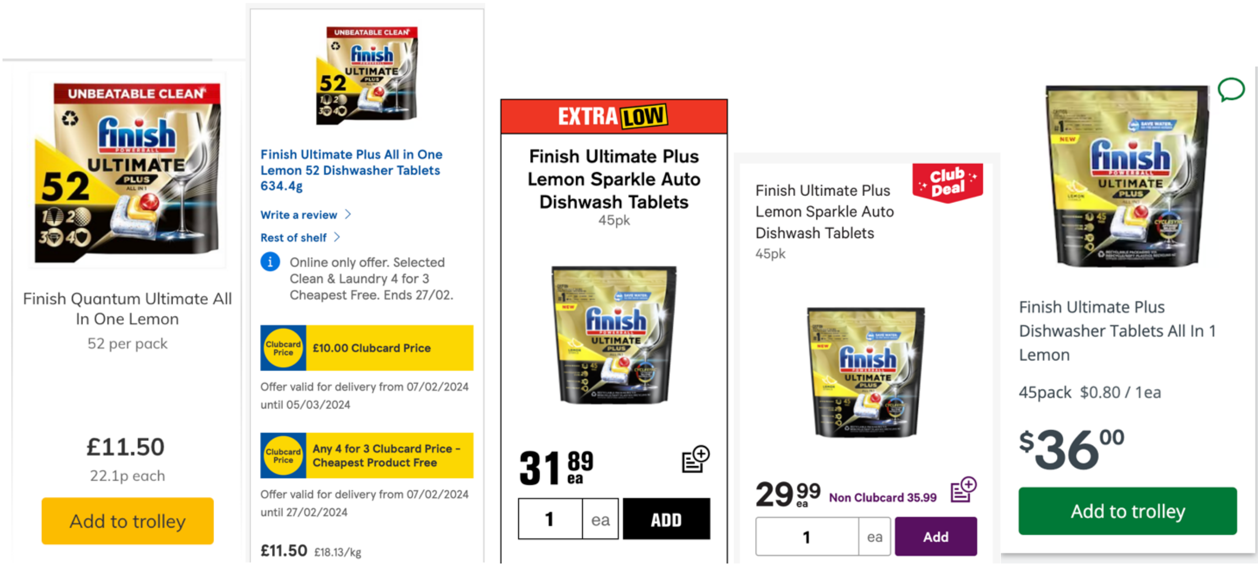
Case Study - Finish Ultimate Dishwash Tablets:

Finish Ultimate Dish shows a similar story. Finish Ultimate Dish when adjusted for VAT/GST and forex in NZ full-service supermarkets was 62% more expensive at shelf and 55.1% more expensive on promotion on a unit basis. The NZ pack was also 13% less in volume. When adjusting for volume to the NZ pack size the shelf price is 87% more expensive and promo is 79% more expensive than the UK. This does appear to be quite a large gap for New Zealanders to pay to clean their dishes. This illustrates the point that large multinationals have built cost of doing business into their pricing. The price differential and reported increased profitability of multinationals is that they appear to also be taking margin when putting through price increases, with all parent companies reporting taking price increases over the latest reporting period, with improved margins[29] [30] [31].

[29] https://www.unilever.com/files/7b16737e-82ce-45dc-91b3-98a56ffdb5fa/unilever-charts-2013-to-2022.pdf

[30] https://www.pginvestor.com/financial-reporting/press-releases/news-details/2024/PG-Announces-Fiscal-Year-2024-Second-Quarter-Results/default.aspx

[31] https://reckitt.com/media/k2bbe500/reckitt-rns-q3-2023.pdf



Morrisons *Tesco* *PNS* *NW* *WWNZ*

The push for more margin which starts at the gross margin level by retailers, was a consistent theme in the supplier survey with the below excerpt explaining[32]:

> *"Category Average Margins - both FSNI & WWNZ are continually requesting our Key Accounts team to meet 'category average margins' for which we have no control as retailers set the Retail pricing. This is grossly unfair as different products that are measured in this category have different quality & price positioning (premium vs budget) and different manufacturing processes as well as sourcing dynamics etc. It is even doubtful if this category average margin is weighted on volumes and the % is never substantiated - also it continues to increase year after year. Private label is usually included here which drives up the category average as retailers make a higher margin on these brands. Failure to meet category average margins often results in ongoing threats to reduce ranging, shelf space/positioning and even deletion."*

Suppliers are calling out the increasing margin requirement from the retailers. It further goes onto discuss the practice of price indexing, which demonstrates a move from being competitive on price, or competing on price to a focus on margin maintenance by proxy of recommended retail price points:

> *" Price Indexing - this retailer metric is used in tandem with Category Average Margins by WWNZ and FSNI. Retailers survey competition for a particular item (Often core brand) and if RRPs are above their competitor then they ask suppliers to subsidise the wholesale price down to meet this. Major issue is that suppliers have no control over Retailer margin expectations as Retailers set RRPs [Retail Price] and the margins are of course different by each retailer so again this is grossly unfair. If these RRPs cannot be 'addressed' by a supplier then retailers will often threaten reductions in ranging or shelf space/position or even deletion. Even if the price index issue is overcome, this often triggers the other retailer to drop their RRP and then ask the supplier to in turn 'address' their indexing issues".*

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[32] https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector?target=documents&root=253147

The issue of indexing is that prices must maintain relativity or status quo, and no competition. For example, WWNZ is the competitor, so it is expected that NW be slightly above at best, and PNS be below WWNZ. With Foodstuffs bookending WWNZ with two banners, and relativity in pricing enforced at supplier level to pay for differences, there's no incentive for the retailer to compete on price, only to hold relativity and margin. There would be lessening of competition if the two entities merged, as the increase in market power would harmonize practice throughout both islands and remove supplier competition further.

The following statement from the supplier survey also highlights a margin grab for a cost of doing business by FSNI:

> *"With regard to the additional Merchandising trading term, how will the stores have visibility of who has paid this fee and who hasn't and how will this be managed instore using a combination of both instore staff merchandising and external merchandising services. Logistically this seems impossible to have a mixture of both, so will FSNI enforce this charge on ALL suppliers. In the confectionary category they have said if the merchandising term was paid it would only relate to everyday lines and not seasonal or event lines, does this mean we have to send in merchandisers just for seasonal and event display times ?"*

What is being said here, is suppliers are being asked to pay FSNI head office a % of its sales to them for the stores to stock their own shelves, which is a standard cost of a grocery retailer's business. To agree to give the retailer a merchandising term either requires an increase in list price for the supplier or move of merchandising labour as a cost fully to the retailer, and the redundancy of the suppliers merchandising staff to fund this. If grocery retailers were reliable at doing this, merchandising by suppliers would not be necessary. It will be interesting to see if field teams who were made redundant are re-employed in the future, which again will add to costs of doing business, which will be reflected in higher prices. The grocery code of conduct states this cannot be done unless it is written into the trading terms with suppliers, so proactively including this is how FSNI is getting suppliers to pay for the general running costs for their stores. This brings up some additional issues, will freezer or chiller suppliers be expected to contribute to the power costs associated with their products? Will high theft items such as razors be requested to be on consignment? Innovation within concessions asked will emerge if the merger goes ahead. This drive for terms and margin by FSNI would then be applied to the South Island with a merged entity, removing suppliers and competition if they do not pay to play.

8. Foodstuffs claim there will be savings for shoppers with a merged entity. Is this true?

To understand this point, we must first look at historical precedent. When Foodstuffs Auckland and Wellington merged in September 2013 which is fiscal year 2014, they were quoted as below[33]:

[33] https://www.stuff.co.nz/business/9107913/Foodstuffs-merger-good-for-customers

Foodstuffs merger 'good for customers'

LAURA WALTERS • 05:00, Sep 01 2013

MERGED: Foodstuffs North Island managing director Murray Jordan.

> *"Both customers and members of Foodstuffs North Island would benefit from all operations running off one IT system and the integration of back-office functions, Jordan said."*
>
> *"Systems integration would mean improved efficiencies and savings, which would translate into better services and lower prices over time, Jordan said."*
>
> *"Pak 'n Save prices were currently 10 per cent below its nearest competitor, Countdown, Jordan said. Foodstuffs North Island would be able to drop those prices further as a result of the merger, he added."*

"Good for customers" and "lower prices over time" is what was promised. What is interesting to note, is that based on FSNI financial reports, where we use FY14 as the base year and FY23 as the latest, the merged entity "SG&A (sales, general and administration costs)" have gone up 114% since the merger, followed closely by gross profit growth of 111%. It appears spending within head office has increased at a faster rate than gross profit. This contrasts to FSNI original claim, of savings from integration. The lower prices they are referring to are surely only those realised by the retailer and not the shopper which is seen on the gross profit line of their annual reports and also EBIT% line. So FSNI did not deliver what they said they would with the last merger, why would it be different this time?

If the merger goes ahead, it will result in an improved bargaining position for Foodstuffs where they will realise savings for themselves through bargaining power with suppliers. Due to a lack of competition, however, are not incentivised to share those savings with shoppers. This sentiment was also shared by Jon Duffy CEO of Consumer NZ[34] in a recent press article.

Therefore, the merger should not go ahead. ComCom should also retrospectively review the merger which created FSNI, and whether this should have occurred in light of the previous sections.

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[34] https://www.thepress.co.nz/nz-news/350106030/supermarket-merger-might-not-lead-better-prices

The best solution for competition and the consumer would be a demerger or divestment of PaknSave. Although the entities are/were geographically separate, as separate entities helped suppliers and growers mitigate issues with one across others. If all are merged into one co-operative, the ability to mitigate risk across different buyers is removed. For a demerger, the most logical is to have PaknSave independent of New World and they be completely independent and competitors in the North Island. PaknSave stores used to take direct pallet shipments from suppliers, rather than coming through centralised warehousing. A divestment of this banner is not out of the question, as their ability to take on volume and sell through is very possible at high economic levels for direct delivery.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

9. A summary of why the merger should not no ahead:

- NZ is already a highly concentrated supermarket market, an approval of FSNI and FSSI merger would be to the detriment of fair competition and disadvantage the NZ consumer and NZ supplier base.
- If the merger goes ahead, the merged entity will take the current abuse of market power by FSNI detailed by suppliers, and extend this to the South Island, and exercise the abuse of market power there. This will concentrate categories and reduce competition beyond grocery retailing to categories within its stores as detailed by suppliers.
- The high levels of market concentration already without the merger are resulting in excess profits for FSNI and making its owner operators of large stores among the richest in the country.
- FSNI is currently concentrating categories by deleting brands, which is lessening competition. If the merger goes ahead, it will be highly likely this abuse of market power will extend to the South Island and lessen competition further. This then allows for the extension of Pams in their stores, to concentrate power further.
- It is proposed the Commerce Commission consider a review of the FSNI merger of FSA and FSW with proposed remedy of divestment of PaknSave stores, to be a separate buying group and entity to drive price competition in the North Island.
- The lack of competition is resulting in disproportionately high prices for consumers and excess profits for the grocery retailers and some large multinational suppliers.
- A review on use of customer data by retailers for profit should also be investigated. There are ethical issues at play here, and potential manipulation of markets and categories with big data to the interests of the retailer and detriment of NZ shoppers and fair competition.
- In summary, a merged entity will increase market power by Foodstuffs, and it is clear from current conduct reported, it would lessen fair competition across supermarkets and within categories.

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