

## **Executive summary to determination**

**Foodstuffs North Island Limited and Foodstuffs South Island Limited [2024]  
NZCC 22**

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## Executive summary

- X1. On 15 December 2023, Foodstuffs North Island Limited (FSNI) and Foodstuffs South Island Limited (FSSI) (together, the Parties) sought clearance to merge into a single national grocery entity, potentially also together with the existing Foodstuffs (N.Z.) Limited entity (the Proposed Merger).
- X2. The Commerce Commission declines to give clearance for the Proposed Merger.
- X3. We are not satisfied that the Proposed Merger would not have, or would not be likely to have, the effect of substantially lessening competition in multiple acquisition and retail grocery markets in New Zealand.
- X4. The Parties operate as separate co-operatives that focus on serving the island in which they are located and do not compete in any local retail or wholesale grocery markets. While operating as separate co-operatives, the Parties currently work together in a range of ways and share ownership of several other entities. Although the Parties both procure private label products together, they otherwise currently acquire most grocery products from suppliers independently and represent separate options for suppliers to get their products on the shelves of major grocery retailers in New Zealand.
- X5. In assessing the competitive effects of the Proposed Merger, we considered the effects it would have on competition in:
- X5.1 acquisition markets: where the Parties acquire grocery products from suppliers;
  - X5.2 retail grocery markets: where the Parties supply grocery products to New Zealand consumers, largely through their New World, PAK'nSAVE and Four Square banners; and
  - X5.3 wholesale markets: where the Parties supply grocery products to wholesale customers (both foodservice customers and other grocery retailers).
- X6. Although we have considered the competitive effects in each of these markets separately, we have been mindful that there are commercial dependencies between grocery acquisition markets and markets for the retail and wholesale supply of groceries. For example, the market power of the merged entity in markets for the acquisition of grocery products is connected to its scale or market share in retail and wholesale grocery markets.
- X7. Competition in grocery markets in New Zealand is already not working well for many suppliers or for consumers. Grocery markets are currently (and have been for many years) highly concentrated and barriers to entry are high. New Zealand's major grocery retailers have maintained significant combined market shares for many years. Suppliers are typically more dependent on major grocery retailers than retailers are on suppliers. The intensity of competition between major grocery retailers is muted, as the Commission has noted in previous work.<sup>1</sup>

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<sup>1</sup> Market study final report (8 March 2022) at 324 and [8.50] and first annual grocery report (4 September 2024) at 5, 22 and 104-106.

- X8. The Proposed Merger would result in a permanent structural change to the New Zealand grocery industry. We are concerned about the impact this would likely have on competition and New Zealand consumers.

### **Acquisition markets**

- X9. The Commerce Act is intended to promote competition for the long-term benefit of consumers. Competition refers to independent rivalry between buyers and between sellers in a market. Such competition is desirable because it ultimately leads to lower consumer prices, higher quality goods and services, greater variety, and more innovation. If a merger reduces the extent of independent rivalry between buyers, it may significantly impede competition in acquisition markets and be harmful to the competitive process in those markets.
- X10. We envisage serious risks to competition for the acquisition of grocery products and are not satisfied that the Proposed Merger would not have, or would not be likely to have, the effect of substantially lessening competition in multiple markets for the acquisition of grocery products.
- X11. The prices and terms by which the major grocery retailers acquire grocery products are usually determined through negotiations between suppliers and each buyer individually. Outcomes of negotiations depend on the relative bargaining power of the negotiating parties. These outcomes depend on factors such as the alternatives, or “outside options”, available to either party if an agreement is not reached and the risk appetite of the negotiating parties.
- X12. We consider that each of FSNI and FSSI currently provide competitive constraint on each other by acting as outside options in negotiations between a supplier and another buyer. This effect operates even when a supplier could satisfy the demand of both of the Parties. It is through the bargaining process that the Parties compete to acquire grocery products from suppliers in acquisition markets. The Proposed Merger would effect a permanent structural change in the grocery industry and eliminate this competition.
- X13. We are concerned that the loss of competition with the Proposed Merger would be substantial, because:
- X13.1 there is already muted competition in the relevant acquisition markets and high barriers to retail entry and expansion. The Parties and Woolworths New Zealand Limited (Woolworths), as New Zealand’s major grocery retailers, are the three largest buyers of grocery products in New Zealand and a key route to market for many suppliers;
- X13.2 the Proposed Merger would reduce the number of major buyers of many categories of grocery products in New Zealand from three to two. It would create the largest single acquirer of groceries in New Zealand, and result in many suppliers selling most of their output to (at most) just two remaining major grocery retailer customers (the merged entity and Woolworths) rather than the existing three (FSNI, FSSI and Woolworths);

- X13.3 competition from the remaining competing buyers in relevant acquisition markets is unlikely to be sufficient to constrain the merged entity from exercising increased buyer power. We are not satisfied that Woolworths would have an incentive to constrain the merged entity, and rival grocery retailers other than Woolworths account for only a small portion of grocery retailing and buying in New Zealand; and
- X13.4 grocery suppliers would be unlikely to be able to exert countervailing power to the extent that they could constrain an exercise of buyer power by the merged entity.
- X14. Our acquisition market concern is with the impact of the Proposed Merger on the process of independent rivalry between buyers in the acquisition markets and on the merged entity's buyer (or market) power. In our view, the Proposed Merger would result in increased buyer power for the merged entity, and materially shift the balance of bargaining power in favour of the merged entity during negotiations with suppliers. This would substantially lessen competition in acquisition markets. In summary, this is because:
- X14.1 the Proposed Merger would remove an important alternative option for many suppliers, although the Proposed Merger would affect suppliers differently depending on the strength of their options (alternative outside supply channels);
- X14.2 for suppliers who currently only supply one of the Parties (but could supply both or either), the Proposed Merger would remove an important outside option and reduce their bargaining power;
- X14.3 for suppliers who currently supply both of the Parties, such as some suppliers in product categories such as dry/ambient and chilled or frozen groceries, the Proposed Merger would raise the stakes and cost of disagreement with the merged entity compared with the Parties individually by removing the option of just selling to one of the Parties. This would reduce their bargaining power in negotiations with the merged entity; and
- X14.4 the removal of one of three major buyers of many categories of grocery products with the Proposed Merger would further entrench the bargaining imbalance that is already present between many suppliers and the Parties separately. This would increase the merged entity's buyer power and enable it to extract lower prices and less favourable terms from suppliers than the Parties would be able to obtain separately in the counterfactual (and better than they would have been able to obtain in a competitive market). This includes "cherry picking" the most favourable terms from those currently offered to each of FSNI and FSSI. Indeed, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers:
- [ ]

X15. For these reasons alone, we cannot grant clearance to the Proposed Merger. In addition to substantially lessening competition in the relevant acquisition markets, we also consider that the Proposed Merger could harm suppliers' ability and incentive to innovate, with consequent harm to consumers. In summary, this is because:

X15.1 each of FSNI and FSSI provide separate opportunities for new grocery products to be listed in New Zealand, and their consolidation with the Proposed Merger would remove one such opportunity. That could slow the pace and development of new product innovation for some suppliers, resulting in reduced consumer choice and/or quality of grocery products; and/or

X15.2 the increased buyer power gained as a result of the Proposed Merger could have a potentially significant effect on margins and profitability of suppliers. This would adversely affect the ability and incentive of suppliers to invest, resulting in effects such as reduced capacity, quality or innovation in the affected acquisition markets.

X16. The Parties submit the Proposed Merger would give rise to cost savings, bring about efficiencies and be good for consumers. We do not accept this submission in making our determination for a mix of legal and evidential reasons. First, the clearance test asks whether we are satisfied that competition would not be substantially lessened in any market, so we are obliged to examine competition in acquisition markets separately from any retail market impact that might affect consumers. Moreover, we are not satisfied that the bulk of any cost savings would be passed through to retail consumers, and, for reasons explained below, we consider that consumers are likely to be worse off overall if the Proposed Merger proceeded. Second, we do not consider that the Proposed Merger is likely to give rise to rivalry-enhancing efficiencies in the relevant acquisition markets that would offset the likely substantial lessening of competition that would otherwise result.

### **Retail grocery markets**

X17. We considered the potential for the Proposed Merger to raise competition concerns in markets for the retail supply of groceries in a number of ways. We considered whether:

X17.1 the Proposed Merger could result in a loss of actual or potential competition at the retail level between the Parties;

X17.2 the increased buyer power of the merged entity in acquisition markets could raise the barriers to entry and expansion for rival grocery retailers; and

X17.3 coordinated effects could arise from the Proposed Merger at the retail level through increasing the potential for the merged entity and Woolworths to reach a tacit agreement on the level of retail prices.

- X18. The Parties do not currently compete in any retail grocery markets. Our assessment of the factual evidence before us is that there is not a real chance of a counterfactual scenario where the Parties enter each other's island and compete in any retail grocery markets. Given this, we are satisfied that the Proposed Merger would not result in a loss of actual or potential competition at the retail level between the Parties.
- X19. However, we are not satisfied that the Proposed Merger would not increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets. We consider that this would substantially lessen competition, potentially depriving consumers of a more competitive grocery industry in the future.
- X20. We are also not satisfied that the Proposed Merger would not increase the likelihood, completeness or sustainability of coordination between the merged entity and Woolworths. In particular, we consider that there is a real chance that the reduction in the number of major grocery retailers from three to two and the creation of a national Foodstuffs entity would make price coordination between the merged entity and Woolworths more likely, more complete or more sustainable.

#### **Wholesale grocery markets**

- X21. We considered the potential for the Proposed Merger to raise competition concerns in markets for the wholesale supply of groceries, in terms of both wholesale supply to foodservice customers and wholesale supply to grocery retailer customers, and in terms of both commercial and regulated wholesale supply.
- X22. We are satisfied that the Proposed Merger is unlikely to substantially lessen competition in any markets for the wholesale supply of groceries. We consider that the merged entity would face competitive constraint in wholesale markets from other wholesalers, and wholesale customers buying direct from grocery suppliers. We do not consider that the Proposed Merger would make coordination in wholesale markets more likely, more complete or more sustainable.