



# Draft Report for Market Study into the Retail Grocery Sector

Federated Farmers of New Zealand

26 August 2021



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## SUBMISSION ON MARKET STUDY INTO THE RETAIL GROCERY SECTOR – DRAFT REPORT

**TO:** Commerce Commission

**DATE:** 26 August 2021

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### ABOUT FEDERATED FARMERS

Federated Farmers of New Zealand is a membership organisation, which is mandated by its members to advocate on their behalf and ensure representation of their views. Federated Farmers does not collect a compulsory levy under the commodities levy act and is funded from voluntary membership.

Federated Farmers represents rural and farming businesses throughout New Zealand. We have a long and proud history of representing the needs and interests of New Zealand's farmers.

Federated Farmers aims to empower farmers to excel in farming. Our key strategic outcomes include provision for an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of a vibrant rural community; and
- Our members adopt responsible management and sustainable food production practices.

## **SUBMISSION TO THE COMMERCE COMMISSION ON THE DRAFT REPORT FOR MARKET STUDY INTO THE RETAIL GROCERY SECTOR**

- 1.1 Federated Farmers of New Zealand welcomes the opportunity submit to the Commerce Commission on the Draft Report for its Market Study into the Retail Grocery Sector.
- 1.2 As a representative of food producers (and consumers), Federated Farmers is keen to ensure that the retail grocery sector is competitive.
- 1.3 It is concerning but perhaps not surprising that the Commission has found problems with how the market is operating. The draft report finds that the major retailers are enjoying 'persistently high profits' charging 'high grocery prices when compared internationally' with only 'modest' levels of innovation. It says the major retailers appear to avoid competing strongly with each other, while competitors wanting to enter the market or wanting to expand face significant challenges. Complexity of major retailers' pricing strategies, promotions, and loyalty programmes can confuse consumers and make it harder for them to make informed purchasing decisions.
- 1.4 The problems are not just for consumers. The draft report found that many suppliers have few alternatives but to supply the major retailers, allowing them to exercise buyer power to push excess risks, costs, and uncertainty onto suppliers. This includes the threat of delisting their products from supermarket shelves if a supplier doesn't agree with the retailer. Food & Grocery Council's Katherine Rich highlighted some of these practices in a widely reported LinkedIn article<sup>1</sup>.
- 1.5 In 2019 Federated Farmers and Horticulture NZ asked economic research company NZIER to produce a report for us on retail food prices. Overall, only 20% of the retail price gets back to farmers and growers, with that share being stable over the period 2008-2019<sup>2</sup>.
- 1.6 Federated Farmers therefore supports the attention the Commission has placed on supermarkets, both in terms of their duopoly market power (i.e., dominance as sellers to consumers) and their duopsony market power (as buyers of produce from suppliers).
- 1.7 In terms of solutions, Federated Farmers would support measures to reduce barriers for entry to new players in the market and provide meaningful competition to the current duopoly, including reducing RMA barriers. However, we wish to focus our feedback on the draft report's findings and recommendations relating to suppliers.
- 1.8 The vast majority of milk and red meat produced by New Zealand's farmers is acquired by large processors (such as Fonterra, Silver Fern Farms, etc.), with much of it processed and sold for export. A considerable amount is sold by these processors domestically into the retail grocery sector. As paragraph 8.56.1 of the draft report acknowledges:

*"Suppliers who export a significant proportion of their products are less dependent on New Zealand grocery retailers, which may improve their negotiating position. Red meat*

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<sup>1</sup> <https://www.stuff.co.nz/business/125882108/new-world-store-owner-spoke-of-trying-to-break-people-says-suppliers-body>

<sup>2</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0015/237102/Horticulture-NZ-Submission-on-retail-grocery-market-study-preliminary-issues-paper-Attachment-4-9-February-2021.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0015/237102/Horticulture-NZ-Submission-on-retail-grocery-market-study-preliminary-issues-paper-Attachment-4-9-February-2021.pdf)

*is an example, where a large proportion of production from New Zealand suppliers is sold into overseas markets.”*

- 1.9 Federated Farmers agrees that large export-oriented suppliers will have more market power compared to domestically-oriented suppliers and even more again than farmers and growers who supply their often perishable produce directly to retailers. Although there are many factors influencing the farmer share of retail food prices, relative market power of suppliers will be one such factor. The NZIER report shows large differences in farmer shares of retail food prices, with meat (31%) significantly higher than fruit (10%) and vegetables (16%).
- 1.10 Federated Farmers acknowledges that some suppliers are satisfied with the relationships they have with retail grocery companies. They might not consider there to be a problem in need for a regulatory ‘fix’.
- 1.11 However, Federated Farmers is concerned about the examples of power imbalances discussed in the draft report. While retailers’ strong position can result in cost savings for consumers, the apparent high profits enjoyed by retailers and relatively high prices for groceries compared internationally suggests this ‘pass through’ is not always happening as well as it should. As the stated in paragraph 8.138 of the draft report, *“There is limited evidence of retailers passing through cost reductions to consumers”*. This should be further investigated.
- 1.12 The draft report also finds that retailers’ strong position means they can limit suppliers’ ability or incentive to provide competitive supply terms to other retailers; transfer costs and risks to suppliers, despite retailers being better placed to manage them; and reduce transparency and certainty over terms of supply. For example, when a supermarket wishes to ‘special’ a product, the reduction in cost is often borne by the supplier and not the supermarket. A Wairarapa farmer noted to us that *“In the case of one of our local supermarkets, the supermarket then ‘forgot’ to promote the product (sheep milk drink) at a reduced rate. The farmer only realised because they went into the supermarket and the milk was not on special as agreed. This essentially ripped off the supplier and the customer.”*
- 1.13 The draft report says these can disincentivise suppliers to innovate and invest, which could have negative implications for production, capacity, product quality, and new product offerings. If this is indeed happening it should be of great concern not just for suppliers but also for consumers and even for retailers.
- 1.14 An example of this can be seen with grains, a key ingredient into many grocery products, including bread. Federated Farmers is deeply concerned about new buying practices and competition from the feed wheat industry which has seen the nation’s arable growers cut back on sowing milling wheat – down 27% on last year. Last year there were three buyers purchasing New Zealand-grown milling wheat for local flour mills. This year just one agent is handling the purchase of milling wheat for two of the buying mills that Feds understands represent up to 60% of the home-grown product. Of further concern is that the agent owns one of the mills. Federated Farmers is keen for the Commerce Commission to investigate<sup>3</sup>.
- 1.15 Turning to solutions, the Fair Trading Amendment Bill’s provisions on business-to-business unfair contracts and prohibition of unconscionable conduct should be helpful

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<sup>3</sup> [https://www.fedfarm.org.nz/FFPublic/Media-Releases/2021/Competition\\_concerns\\_spook\\_bread\\_wheat\\_growers.aspx](https://www.fedfarm.org.nz/FFPublic/Media-Releases/2021/Competition_concerns_spook_bread_wheat_growers.aspx)

for suppliers. But we would also support the consideration of further actions to address power imbalances. We note the two key options put forward in the draft report:

- (a) A code of conduct regulating the relationship between grocery retailers and their suppliers; and
- (b) Collective bargaining on behalf of suppliers.

- 1.16 Federated Farmers submits that both options are worthy of consideration, subject to work programmes being undertaken on each of them. If either or both options proceed it will be important that they are designed and implemented so they are effective in improving the negotiating position between suppliers and retailers. For example, there should be consideration on whether there should be a separate code of conduct for dry/frozen goods and one for fresh goods and also consideration on whether a \$10 million limit for collective bargaining is too low.
- 1.17 It is also important that work is done to ensure the options do not have unintended consequences, such as high compliance costs or the prevention of innovative arrangements.
- 1.18 These work programmes should be informed by constructive engagement with representatives of suppliers and of the retail grocery sector.
- 1.19 Horticulture NZ will have more to say on these options in its submission. Based on discussions with it prior to submitting (including viewing its draft submission), we would support its points.
- 1.20 Finally, although we acknowledge that this market study is not a review of the grocery sector's response to the COVID-19 pandemic, we also suggest that the Commission consider the effect of Government regulatory and policy decisions on the relative market power of supermarkets versus small competitors. A prime example is the Government's COVID-19 alert level framework that has provided preferential treatment to supermarkets to the clear detriment of their smaller competitors (such as butchers and greengrocers) which has harmed the ongoing financial viability of small retail suppliers and those that supply them with goods. We note this situation has been mentioned in the draft report (paragraphs 2.59 to 2.65) but there are no findings or recommendations to remedy this un-level playing field.

**ENDS**