

# Market study into the retail grocery sector

## Draft report

Date: 29 July 2021



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## Glossary

<b>ACCC</b>	Australian Competition and Consumer Commission.
<b>Delisting or delist</b>	Where a grocery retailer: <ul style="list-style-type: none"> <li>• removes a supplier's product(s) from the range of products it stocks across its store(s); or</li> <li>• reduces the distribution of a supplier's product(s) across its store(s), and that reduction has or is likely to have a material effect on the supplier.</li> </ul>
<b>Dry groceries</b>	Product group consisting of non-perishable food products and certain non-food products. These are most grocery items excluding fresh, perishable products such as baked items, dairy, deli, meat, frozen foods, and fresh fruit and vegetables. Examples of dry groceries include biscuits, toilet paper, pasta, rice, dishwashing detergent and canned products.
<b>Groceries or products</b>	A range of food and drinks, including meat, fruit and vegetables, canned goods, dairy products, and non-alcoholic and alcoholic drinks. Groceries also include a range of other household products, like toilet paper, cleaning products, pet food, and includes tobacco. These products can usually all be purchased at a supermarket, and many are available through other shops as well.
<b>Grocery retailers</b>	Businesses which sell grocery products directly to final consumers in New Zealand. Examples include: <ul style="list-style-type: none"> <li>• Major grocery retailers (eg, Foodstuffs North Island Limited (Foodstuffs NI), Foodstuffs South Island Limited (Foodstuffs SI), Woolworths NZ Limited (Woolworths NZ));</li> <li>• Other grocery retailers, which include:           <ul style="list-style-type: none"> <li>○ International food stores (eg, Tai Ping, Japan Mart, Yogijis Food Mart);</li> <li>○ Other supermarkets (eg, Farro Fresh, Moore Wilson's, Bin Inn);</li> <li>○ Single-category or specialist grocery retailers (eg, greengrocers, butchers, bakeries);</li> <li>○ General merchandisers (eg, The Warehouse);</li> <li>○ Convenience stores (eg, dairies, petrol stations, Night 'n Day);</li> <li>○ Meal kit providers (eg, Hello Fresh, My Food Bag);</li> <li>○ Food box operators (eg, Foodbox, Oooby);</li> <li>○ Online-only supermarkets (eg, The Honest Grocer, Supie);</li> <li>○ Specialist online retailers (eg, Hypermeat).</li> </ul> </li> </ul>

<b>Grocery wholesalers</b>	Intermediaries who on-sell products to grocery retailers. Examples include fresh produce wholesalers/distributors (eg, T&G Fresh, MG Marketing, Fresh Direct), and foodservice wholesalers where they supply grocery retailers (eg, Trents, Gilmours and Bidfood).
<b>International food stores</b>	Stores specialising in grocery products from or relating to the cuisine of a particular country or region.
<b>Main shop</b>	A shop typically happening weekly or at another regular interval based on the convenience of using one grocery store to get all necessities in one place.
<b>Major grocery retailers</b>	<p>Grocery retailers that operate a large number of supermarkets. The major grocery retailers are Woolworths NZ, Foodstuffs NI, and Foodstuffs SI.</p> <ul style="list-style-type: none"> <li>• Woolworths NZ's retail banners are Countdown, FreshChoice and SuperValue.</li> <li>• Foodstuffs NI's retail banners are PAK'nSAVE, New World, and Four Square.</li> <li>• Foodstuffs SI's retail banners are PAK'nSAVE, New World, Four Square, Raeward Fresh, and On the Spot.</li> </ul>
<b>NZFGC</b>	New Zealand Food and Grocery Council (NZFGC) is an industry association that represents the manufacturers and suppliers of food, beverage, and grocery brands in New Zealand.
<b>Private label</b>	Also known as home brands, own brands, store brands or generic products. These are products that are manufactured for sale under a retailer's brand.
<b>Product categories</b>	Groups of products sold by grocery retailers that are of a similar type. For example, product categories may include fruit and vegetables, bread and cereals, and non-alcoholic beverages.
<b>Secondary shop</b>	A visit to one or more store(s), other than the store the main shop is carried out at, to shop for specific products.
<b>Specialist grocery retailers</b>	Retailers of grocery items in particular product categories, for example, meat (butchers) or fresh fruit and vegetables (greengrocers).
<b>Supermarkets</b>	Large grocery retailers selling a wide variety of foods (such as dry groceries, fresh produce), household goods, non-alcoholic beverages, and usually some alcoholic beverages.
<b>Top-up shop</b>	A quick shop for a small number of items that can be conducted for a range of reasons across a range of retailers.

# Chapter 1 Introduction and purpose

## Introduction

- 1.1 This draft report sets out the preliminary findings of the New Zealand Commerce Commission (Commission) market study into the retail grocery sector (our study). In preparing this draft report, we have received submissions and evidence from a wide range of parties. We seek feedback on our draft.

## The Minister issued the terms of reference for a retail grocery market study

- 1.2 On 17 November 2020, the Hon Dr David Clark, Minister of Commerce and Consumer Affairs (Minister), published a notice under section 51(1) of the Commerce Act 1986 (the Act) requiring the Commission to undertake a study into any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand.
- 1.3 We must carry out our study in accordance with the terms of reference issued by the Minister. However, we may also consider any ancillary matters that are related to, but not explicitly covered by, the terms of reference.<sup>1</sup>
- 1.4 The terms of reference for our study are set out in the box below.<sup>2</sup>

### Notice for a Competition Study into the Retail Grocery Sector

I, Dr David Clark, Minister of Commerce and Consumer Affairs, pursuant to section 51(1) in Part 3A of the Commerce Act 1986, require the Commerce Commission to carry out a competition study into any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand. Matters to be considered in the study must include, but are not restricted to:

1. the structure of the grocery industry at the wholesale and retail levels;
2. the nature of competition at the wholesale and retail levels of the grocery industry;
3. the pricing practices of the major grocery retailers;
4. the grocery procurement practices of the major grocery retailers; and
5. the price, quality, product range and service offerings for retail customers.

The Commerce Commission should make its final report for this study publicly available by **23 November 2021**.

<sup>1</sup> Section 51A(4)(b) of the Act.

<sup>2</sup> New Zealand Gazette “Notice for a Competition Study into the Retail Grocery Sector” (16 November 2020), available at: <https://gazette.govt.nz/notice/id/2020-go5278>.

- 1.5 The high level of concentration in the sector, potential competition concerns and the prices consumers pay for their groceries were cited by the Minister as reasons for asking us to undertake this study.<sup>3, 4</sup>

### Scope of our study

- 1.6 We have defined groceries to include meat, fruit and vegetables, canned goods, dairy products, and non-alcoholic and alcoholic drinks. A range of other household products are also 'groceries', like toilet paper, cleaning products and pet food. Tobacco is also included.
- 1.7 We consulted on the scope of the category of 'groceries' we should consider for our study and some submitters suggested that our study scope should include alcohol and tobacco.<sup>5</sup> These products can usually all be purchased at a supermarket, and some are available through other shops as well. Our study has therefore included certain kinds of alcohol and tobacco where these are sold by grocery retailers.<sup>6</sup>

### Our framework for analysing competition

#### Competition that works well for consumers

- 1.8 Our study considers 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 we consider may improve competition.<sup>7</sup>

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<sup>3</sup> Cabinet paper "Initiating a Commerce Commission market study into supermarkets" (13 November 2020) at [4], available at: <https://www.mbie.govt.nz/dmsdocument/12272-initiating-a-commerce-commission-market-study-into-supermarkets-proactiverelase-pdf>; Hon Dr David Clark "Supermarkets announced as Government's second market study" (17 November 2020) <https://www.beehive.govt.nz/release/supermarkets-announced-government%E2%80%99s-second-market-study>.

<sup>4</sup> Paragraph 18.1 of the Cabinet paper referenced above notes several indicators which may suggest there are lower levels of competition than would be expected in a workably competitive market: unequal bargaining power which may allow supermarkets to push prices unreasonably low for suppliers which could impede innovation and quality; research indicating most of the competition measures for supermarkets, grocery stores, and specialist food retailers have tended to trend downwards over time; the discounting practices of some supermarkets had been called into question by a Consumer NZ study, a practice which they indicated may mislead consumers; and concerns about the availability of suitable land for potential competitors to enter markets due to strategic land acquisitions by supermarkets.

<sup>5</sup> For example: Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 1; The Warehouse Group "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 2; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 8.

<sup>6</sup> Under s 58 of the Sale and Supply of Alcohol Act 2012, the holder of an off-licence issued for premises that are or form part of a supermarket or grocery shop and premises that can be reached from a supermarket or grocery shop without leaving it, can sell beer, mead, wine that is no more than 15% ethanol by volumes measured at 20 degrees Celsius.

<sup>7</sup> Sections 48, 51A and 51B of the Act and our terms of reference.



- 1.9 Our study does not enquire into compliance with the provisions of the Act relating to anticompetitive conduct or mergers. Therefore, a conclusion that particular conduct affects competition, and may be the subject of a recommendation, is not a conclusion that it breaches provisions of the Act. We retain the ability to separately investigate anticompetitive conduct if information collected during our study, or outside of it, gives us reason to believe that anticompetitive conduct may be occurring. Similarly, we may separately investigate conduct which we consider could breach the Fair Trading Act 1986 (FTA).
- 1.10 Our study also does not enquire into wider policy issues which may impact on food and alcohol supply and retail within New Zealand, such as the impact of GST on grocery prices, or policy matters relating to healthy eating, alcohol consumption or environmental issues such as packaging.
- 1.11 The overriding aim of our study is the same as the purpose of the Act itself: to promote competition in markets for the long-term benefit of consumers within New Zealand.<sup>8</sup>
- 1.12 Competition is defined in the Act as meaning “workable or effective competition”.<sup>9</sup> It does not mean the theoretical concept of perfect competition. The Court has noted that there is no consensus on precise conditions that define workable competition, rather:<sup>10</sup>

... workable competition is a practical description of the state of an industry where government intervention to make the market work better is not justified because the socially desirable outcomes generated by competition already exist to a satisfactory degree.

A workably competitive market is one that provides outcomes that are reasonably close to those found in strongly competitive markets...

The degree of rivalry is critical. In a workably competitive market no firm has significant market power and consequently prices are not too much or for too long significantly above costs...

In our view, what matters is that workably competitive markets have a tendency towards generating certain outcomes.

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<sup>8</sup> Section 1A of the Act. This was emphasised by the Transport and Infrastructure Select Committee in its report-back to Parliament on the draft market studies legislation – Commerce Amendment Bill 2018 (45-2) (Select Committee report) at 1, available at: [https://www.parliament.nz/en/pb/sc/reports/document/SCR\\_80263/commerceamendment-bill](https://www.parliament.nz/en/pb/sc/reports/document/SCR_80263/commerceamendment-bill).

<sup>9</sup> Section 3(1) of the Act.

<sup>10</sup> *Wellington International Airport Ltd and Others v Commerce Commission* [2013] NZHC 3289 at [13]-[15] and [18], available at: [https://forms.justice.govt.nz/search/Documents/pdf/jdo/53/alfresco/service/api/node/content/work space/SpacesStore/1c117dea-b8ba-491e-ba1d-d4cd30dbe522/1c117dea-b8ba-491e-ba1d-d4cd30dbe522.pdf](https://forms.justice.govt.nz/search/Documents/pdf/jdo/53/alfresco/service/api/node/content/work%20space/SpacesStore/1c117dea-b8ba-491e-ba1d-d4cd30dbe522/1c117dea-b8ba-491e-ba1d-d4cd30dbe522.pdf).

- 1.13 We have developed Market Studies Guidelines to assist stakeholders to understand our approach to a market study.<sup>11</sup> Our Market Studies Guidelines describe characteristics of competitive markets that are working well and those that may be observed in markets that are not working well. They also describe market features that could affect competition and that are relevant to our study.<sup>12</sup> In summary, when markets work well for the long-term benefit of consumers, firms compete to win customers based on factors such as price, quality, choice, and service.

**Our study is not a review of the grocery sector’s response to the COVID-19 pandemic**

- 1.14 We are aware that the COVID-19 pandemic has had a major impact on many businesses operating in New Zealand. In the New Zealand grocery industry, at various times over the past 18 months there may have been:
- 1.14.1 short-term effects on prices, choice and availability of groceries; and
  - 1.14.2 collaboration between supermarkets to stabilise supply and protect consumers’ access to groceries.
- 1.15 However, this study does not analyse or comment upon the grocery sector’s response to the COVID-19 pandemic, or its effects on competition.
- 1.16 Rather, we are undertaking a wider assessment of competition in the sector. As part of this assessment, we have considered whether any issues that have emerged during the pandemic are likely to affect competition over a longer period.

**Our approach to assessing competition in this market**

- 1.17 To assess whether competition is working well, we first consider the market outcomes we can observe. Our observations focus on commonly understood measures that are indicative of whether competition is working well or not. This includes the profitability of grocery retailers and the prices they charge to consumers, but also includes the extent of innovation that they engage in, as well as the quality, range and services that are offered to consumers.
- 1.18 Looking across these observed market outcomes we consider whether they are consistent with what we would expect in a workably competitive market, and if not, the extent to which they depart from what we would expect. In forming expectations of what we would expect in a workably competitive market, we consider a range of benchmarks including observations from other markets, such as those overseas or in other industries.

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<sup>11</sup> Referred to as Competition Studies in Part 3A of the Act.

<sup>12</sup> Commerce Commission “Market Studies Guidelines” (19 November 2020) at [12]-[20].

- 1.19 We then look at the nature of competition in the retail and wholesale grocery sectors to identify market features and aspects of competition that might be contributing to the market outcomes that we have observed. In our final recommendations chapter, we present a spectrum of options for recommendations for improvements to those features and aspects, which in turn, we would expect to produce better long-term market outcomes for consumers, including the right prices, quality, range and service.
- 1.20 To this end, in Chapter 2 we begin with a broad description of the key characteristics of the New Zealand grocery sector to provide an overview of the sector we have considered. We introduce the key sector participants, focussing on providing details about the operations of the major grocery retailers. We provide an overview of several key features of the market, including other grocery retailers, the grocery supply chain, and other sector themes. This provides context for the discussion that follows later in the report.
- 1.21 In Chapter 3 we set out our observations on market outcomes and our view on what these indicators can tell us about whether competition is working well or not. We explain our profitability assessment for the major grocery retailers, and compare New Zealand grocery prices with those seen overseas. We also discuss the level of innovation that we have observed among grocery retailers. We provide brief observations about the quality, range and service being offered to New Zealand grocery consumers. Our conclusions in relation to these matters contribute to our overall assessment of whether competition is delivering the kind of market outcomes that we would expect if the retail grocery sector was workably competitive.
- 1.22 In Chapter 4 we draw on evidence gathered during our study to identify the dimensions upon which competition is occurring in the retail grocery market. We describe consumer product and shopping preferences, the types of retailers offering groceries, and how they operate nationally and locally in different regions in New Zealand. The conclusions we draw here help to focus our analysis of the effectiveness of competition on the topics most likely to be relevant to the overall study.
- 1.23 We build on this in Chapter 5 by further considering the intensity of competition along the dimensions of competition identified in Chapter 4. Focussing on short-run dynamics, we draw some conclusions about the intensity of competition in retail grocery markets in New Zealand and identify features of the market that might be contributing to the effectiveness of competition.
- 1.24 In Chapter 6 we consider longer-run competitive dynamics by assessing how the features of the retail grocery sector affect the ability of retailers to enter the sector and expand their operations, an important aspect impacting the effectiveness of competition. We draw conclusions in relation to a wide range of factors, including the nature of the sector and relevant regulations, and the conduct of current retailers.

- 1.25 In Chapter 7 we discuss the features affecting consumer shopping and decision making and their ability to compare retail offers, make informed decisions, and choose the best retail option for themselves in more detail. We draw conclusions about the impact on competition of retail pricing and promotion practices and loyalty programmes.
- 1.26 In Chapter 8 we discuss how competition is working for the acquisition of groceries by retailers from suppliers and growers. We discuss the relative bargaining position between retailers and their suppliers and the extent to which retailers may have buyer power over them. We then discuss the grocery procurement practices of the major grocery retailers. We draw conclusions about the potential impact these procurement practices may have on competition and market outcomes. We identify features that may be contributing to the conclusions we have reached.
- 1.27 In Chapter 9 we summarise our preliminary views on the features of the sector that are affecting competition and contributing to market outcomes that we consider inconsistent with what we would expect in a market with workable competition. We then discuss a spectrum of options for recommendations that may change the features we have identified as impacting competition. These options identify different possible ways to improve competition and produce better long-term market outcomes for consumers, including prices, quality, range and service.
- 1.28 We have included additional information in the attachments to our draft report:
- 1.28.1 *Attachment A: Next steps and how you can have your say* provides information on how you can have your say on this draft report, and details about our consultation conference.
- 1.28.2 *Attachment B: Additional maps of grocery retail stores* includes maps additional to those included in our draft report showing supermarket locations in New Zealand.
- 1.28.3 *Attachment C: Our assessment of retail grocery profitability* provides details about how we have assessed profitability within the retail grocery sector, the analysis we have undertaken and our preliminary findings from this analysis.
- 1.28.4 *Attachment D: International price comparison* provides details about the analysis we have conducted to compare the prices of groceries in New Zealand with prices internationally.
- 1.28.5 *Attachment E: Promotions and pricing data analysis* provides details of our analysis of pricing and promotion data that has been provided by the major grocery retailers.
- 1.28.6 *Attachment F: Consumer survey* provides further information about our consumer survey.

- 1.28.7 *Attachment G: Supplier survey* provides further information about our supplier survey.
- 1.28.8 *Attachment H: Store density analysis* provides details about the analysis we have conducted to compare store density in New Zealand with international comparators.
- 1.29 We have also commissioned separate research which is published alongside this draft report (see paragraphs 1.37 to 1.38 below).

## Our process so far

### Papers we have published

- 1.30 On 19 November 2020 we released our [statement of process](#), outlining the process we intended to follow over the course of our study.<sup>13</sup>
- 1.31 On 10 December 2020, we released our [preliminary issues paper](#), seeking responses from interested parties on the preliminary issues we intended to explore during our study.<sup>14</sup> We received 13 submissions on our preliminary issues paper – public versions of submissions are published [on our website](#).
- 1.32 On 26 March 2021, we sought comments on submissions on our preliminary issues paper. We received comments from five parties – public versions of these comments are also published [on our website](#).

### Information collection

- 1.33 The grocery sector services a diverse range of consumers, with different wants, needs, and demographics. We have therefore sought to collect information and documents from a wide range of sources and to meet with a wide range of parties.<sup>15</sup> These parties include industry participants, grocery industry representatives, government agencies, and a range of consumer groups with differing perspectives on the sector. To date we have met with 73 parties in total.
- 1.34 We thank all these parties for the information they have provided, and for their ongoing engagement in our study. In particular, we appreciate the input we have received from the major grocery retailers, as we are aware our study has imposed an additional burden in a high-intensity period for them during New Zealand's ever-evolving COVID-19 pandemic response.

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<sup>13</sup> Commerce Commission "Market Study into the Retail Grocery Sector – Statement of Process" (19 November 2020) at 3.

<sup>14</sup> Commerce Commission "Market study into the retail grocery sector – Preliminary issues paper" (10 December 2020).

<sup>15</sup> We have issued some compulsory information notices under section 98 of the Act as well as being provided with information voluntarily by interested parties and sources.

- 1.35 On 4 March 2021, we asked consumers and suppliers of grocery retailers to complete surveys to help build a detailed picture of how competition is working at different levels of the grocery sector. We received 12,269 responses to our consumer survey, and 126 responses to our supplier survey. The feedback we received was both valuable and important for informing our study and has contributed to our preliminary views set out in this draft report.
- 1.36 We will continue to collect information throughout our study, as we pursue enquiries, receive comments, conduct a consultation conference to hear the views of stakeholders, and deliberate on the content of our final report.

### Expert advice and reports

- 1.37 We have also engaged experts to advise us in a number of areas:
- 1.37.1 We engaged Ipsos to undertake qualitative research to inform our understanding of consumers' behaviour when they shop for groceries.<sup>16</sup>
- 1.37.2 We engaged Frontier Economics to provide quantitative analysis to examine how local grocery market structures affect outcomes for consumers in New Zealand.<sup>17</sup>
- 1.37.3 We engaged the New Zealand Institute for Business Research (NZIBR) at The University of Waikato through the Waikato Experimental Economics Lab (WEEL) to undertake experimental economics research into consumer decision making under complexity.<sup>18</sup>
- 1.37.4 We engaged Professor Philip Gendall, an experienced survey designer, to provide advice on the design of our consumer survey.
- 1.38 Where these experts have provided us with reports, we have published these on our website alongside this draft report. We welcome comments on these reports as well as any feedback you provide us on our draft report.

### Confidential information shared with us

- 1.39 We are making our draft report publicly available in accordance with statutory requirements.<sup>19</sup>

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<sup>16</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021), available at: <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector#projecttab> (Ipsos report).

<sup>17</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021), available at: <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector#projecttab> (Frontier report).

<sup>18</sup> The University of Waikato "Consumer Decision-Making Under Complexity" (May 2021), available at: <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector#projecttab> (WEEL report).

<sup>19</sup> Section 51C(1) of the Act.

- 1.40 We have endeavoured to make our draft report as accessible to readers as possible. However, some information within this report must of necessity be redacted from view, as is indicated by the use of square brackets like this: [ ].
- 1.41 Much of the information we have collected in the course of our study is considered confidential or commercially sensitive by the supplying party.
- 1.42 It is important that interested parties and others providing us with relevant information continue to feel confident participating in our study and supplying us with information that we can use to develop our views.
- 1.43 Accordingly, when deciding whether information provided to us is commercially sensitive and/or confidential or can be published, we consult with the party who has provided it and balance these considerations against our obligations to adhere to the principles of natural justice in the course of our study, operate as transparently as practicable, and comply with our legal obligations under the Official Information Act 1982 (OIA).
- 1.44 If we receive a request for any information referred to or collected in connection with this draft report, we will consider whether to make the information available in accordance with the OIA.
- 1.45 Our Market Studies Guidelines contain further information about how we protect confidential information provided to us during our study and how we respond to OIA requests related to our study.<sup>20</sup>

## Next steps and how you can have your say on matters covered by this report

### Participation opportunities

- 1.46 We invite interested parties to comment on our draft report. This includes providing comment on any aspect of this draft report, including any issues you consider relevant that have not been covered.
- 1.47 We will have regard to any comments received on our draft report within the time allowed.
- 1.48 We are seeking feedback on this draft report in the following ways:
- 1.48.1 Written comments on this draft report are due **4pm, Thursday 26 August 2021**.
- 1.48.2 We have scheduled a consultation conference to be held at a hotel in central Wellington from **Tuesday 21 September to Friday 24 September 2021**.<sup>21</sup>

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<sup>20</sup> Commerce Commission “Market Studies Guidelines” (19 November 2020).

<sup>21</sup> The conference will likely be held online if COVID-19 Alert Levels increase to Level 2 or above.

1.48.3 Further comments, including comment on matters raised at the conference and in published comments made by others, are due **4pm, Thursday 7 October 2021**.

1.49 Please see Attachment A for further information about how to provide written comments and on our consultation conference.

### **Publishing our final report**

1.50 In accordance with the terms of reference, we must publish our final report by **23 November 2021**.<sup>22</sup>

1.51 Our final report will set out the findings of our study, and any recommendations that we make to the Minister to improve competition, having had regard to comments we have received on our draft report.

1.52 We are not obliged to recommend that any actions be taken by the Government or any other person.<sup>23</sup> The types of recommendations that we may make are described in section 51B(3) of the Act. These include:

1.52.1 changes to legislation or other instruments;

1.52.2 changes to the policies or practices of central or local government;

1.52.3 changes to the policies or practices of a person or an organisation responsible for the oversight or regulation of a specified industry;

1.52.4 changes to the amount or type of information made available by a person or an organisation in relation to a specified industry;

1.52.5 that a person or an organisation research or monitor a specified matter;  
and

1.52.6 that persons within a specified industry change their behaviour.

1.53 The Minister is required to respond to our final report within a reasonable time after it is made publicly available.<sup>24</sup>

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<sup>22</sup> We are required to make our final report available to the Minister at least five working days prior to publishing our final report on 23 November 2021 (see section 51D(1) of the Act).

<sup>23</sup> Section 51B(2) of the Act.

<sup>24</sup> Section 51E of the Act.



## Chapter 2 Market characteristics and sector background

### Purpose and structure

- 2.1 This chapter provides a broad description of the characteristics of the New Zealand grocery sector. It introduces the key sector participants, focussing on providing details about the operations of the major grocery retailers, and provides an overview of other grocery retailers, the grocery supply chain, and other sector themes.
- 2.2 The chapter provides context for chapters later in this report, where we develop our discussion of these features as part of our assessment of whether competition is working well within the retail grocery sector.
- 2.3 This chapter discusses the following:
- 2.3.1 grocery consumers;
  - 2.3.2 grocery retailers;
  - 2.3.3 major grocery retailers' offerings;
  - 2.3.4 pricing and promotional practices;
  - 2.3.5 grocery supply chain; and
  - 2.3.6 other sector themes.

### Grocery consumers

- 2.4 Groceries are an essential purchase for all New Zealanders. In the year to December 2020, more than \$22 billion was spent at supermarkets and grocery stores.<sup>25</sup> In the year to June 2019, food was the second largest expenditure item for New Zealand households, with households spending an average of \$234 a week on it.<sup>26</sup>

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<sup>25</sup> Statistics NZ "Retail trade survey: December 2020 quarter" (21 February 2021) at Table 1, excludes GST, available at: <https://www.stats.govt.nz/assets/Uploads/Retail-trade-survey/Retail-trade-survey-December-2020-quarter/Download-data/retail-trade-survey-december-2020-quarter.xlsx>.

<sup>26</sup> Statistics NZ "Household Expenditure Statistics: Year ended June 2019". Includes GST. Note this includes spend on restaurant and ready-to-eat food, and excludes alcoholic beverages and tobacco. See: <https://www.stats.govt.nz/information-releases/household-expenditure-statistics-year-ended-june-2019>.

- 2.5 New Zealanders are a diverse group with different wants, needs, and demographics. Results from our consumer survey and Ipsos report suggest that, convenience and price are the key considerations that inform choice of grocery store for most consumers.<sup>27, 28</sup> Other factors such as product range, service quality, opening hours and access to car parking also inform choice for some consumers.
- 2.6 Consumers undertake different types of shopping trips (or shopping missions) to purchase groceries, including a 'main shop' and other 'secondary' and 'top-up shops'.<sup>29</sup> Consumer shopping behaviour and drivers of store choice vary according to the type of shopping mission a consumer is engaged in. Grocery retailers offer products and services to consumers to cater for this diverse range of needs.
- 2.7 Consumer shopping missions and the dimensions upon which competition takes place in the retail grocery sector to satisfy them are discussed further in Chapter 4 and Chapter 5.

### Grocery retailers

- 2.8 There are many different types of grocery retailers operating across New Zealand. In addition to the three major grocery retailers there is a range of other grocery retailers such as specialist grocery retailers and international food stores. Major grocery retailers typically offer consumers the opportunity to shop for all their grocery needs as a main shop. Other grocery retailers provide a range of offerings.
- 2.9 The three major grocery retailers operate retail banners with nationwide reach. They are Woolworths New Zealand Limited (Woolworths NZ), Foodstuffs North Island Limited (Foodstuffs NI), and Foodstuffs South Island Limited (Foodstuffs SI). The two Foodstuffs co-operatives do not compete in the same geographic market, so there are two major grocery retailers operating stores under national brands on each island – Woolworths NZ and one of the Foodstuffs co-operatives.
- 2.10 Other grocery retailers are typically located in urban areas and have a smaller number of stores, although this varies by retailer.

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<sup>27</sup> See paragraph F5 in Attachment F.

<sup>28</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 8.

<sup>29</sup> A 'main shop' is a shop typically happening weekly or at another regular interval based on the convenience of using one grocery store to get all necessities in one place; a 'secondary shop' is a visit to one or more store(s), other than the store the main shop is carried out at, to shop for specific products; and a 'top-up shop' is a quick shop for a small number of items that can be conducted for a range of reasons across a range of retailers.

## Woolworths NZ

- 2.11 Progressive Enterprises Limited (Progressive Enterprises) acquired a former Woolworths New Zealand entity in 2002, merging Woolworths, Big Fresh, Foodtown, Countdown, Price Chopper, Super Value and Fresh Choice brands into one entity.<sup>30</sup> Woolworths Group Limited (Woolworths Australia) acquired Progressive Enterprises in 2005 and later renamed it.<sup>31</sup>
- 2.12 Initially, Big Fresh and many Price Chopper stores were converted to Countdown or Woolworths stores. In 2009, Progressive Enterprises announced it would also convert Woolworths and Foodtown stores to Countdown supermarkets over a five-year period.<sup>32</sup>
- 2.13 Progressive Enterprises changed its name to Woolworths NZ in June 2018.<sup>33</sup> Its retail banners are shown in Figure 2.1 below.

**Figure 2.1 Woolworths NZ's retail banners**



- 2.14 Woolworths NZ operates and supplies more than 180 Countdown stores throughout New Zealand. Woolworths NZ also owns Wholesale Distributors Limited, which is the franchisor to 71 locally owned and operated SuperValue and Fresh Choice stores.<sup>34</sup> In 2019, it estimated that three million customers were served at its Countdown stores every week.<sup>35</sup>

<sup>30</sup> Commerce Commission “Decision No. 438, Application for clearance involving: Progressive Enterprises Limited and Woolworths (NZ) Limited” (13 July 2001), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/73073/438.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/73073/438.pdf); Commerce Commission “Decision No. 448, Application for clearance involving: Progressive Enterprises Limited and Woolworths (NZ) Limited” (14 December 2001), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0016/73123/448.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0016/73123/448.pdf).

<sup>31</sup> Progressive Enterprises Limited changed its name to Woolworths New Zealand Limited in June 2018. Countdown “Our history” <https://www.countdown.co.nz/about-us/our-history>.

<sup>32</sup> NZ Herald “Foodtown, Woolworths brands on way out” (21 September 2009) <https://www.nzherald.co.nz/nz/foodtown-woolworths-brands-on-way-out/ZARV4ZK5IYP7N3WXHVAKPO5IHQ/>.

<sup>33</sup> Countdown “Our history” <https://www.countdown.co.nz/about-us/our-history>.

<sup>34</sup> Information provided by major grocery retailers, as at 31 December 2020, [ ].

<sup>35</sup> Luke Kirkness “How do we shop for groceries? Supermarkets' highest stocked items shine light on how we spend” (February 2020) New Zealand Herald [https://www.nzherald.co.nz/nz/news/article.cfm?c\\_id=1&objectid=12304565](https://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=12304565).

## Foodstuffs NI and Foodstuffs SI

- 2.15 The first Foodstuffs co-operative was formed in Auckland in 1922. Foodstuffs SI and two regional co-operatives in the North Island were formed as a result of various mergers of grocers over time. Foodstuffs NI was formed in 2013 as a result of the merger of Foodstuffs (Wellington) Ltd (Foodstuffs Wellington) and Foodstuffs (Auckland) Limited (Foodstuffs Auckland). Today Foodstuffs SI and Foodstuffs NI operate as separate co-operatives serving the South Island and North Island respectively.
- 2.16 Foodstuffs (N.Z.) Limited (Foodstuffs NZ), is a non-trading entity. It represents “the two co-operatives' interests on issues of national or grocery-specific importance”.<sup>36</sup> It owns the retail banner brands for all Foodstuffs stores and provides other shared services to both co-operatives. Its shares are owned by Foodstuffs NI and Foodstuffs SI. Foodstuffs NI and Foodstuffs SI also own Foodstuffs Own Brands Limited and a number of other entities. Foodstuffs Own Brands Limited manages private label products.
- 2.17 Retail stores are owner-operated franchises which are supplied by Foodstuffs co-operatives. Owner-operators own shares in, and provide funding to, their co-operative. Models for this funding differ across the two Foodstuffs co-operatives.
- 2.18 The Foodstuffs co-operatives own the land and buildings on which many stores are located, as well as supply chain infrastructure and IT assets. They also provide other services to their owner-operator members, including wholesale purchasing, warehousing and distribution of groceries, and they undertake marketing, IT, and a range of other support functions.<sup>37</sup>
- 2.19 More than 300 retail stores operate in the North Island under the New World, PAK’nSAVE and Four Square retail banners, and more than 100 in the South Island.<sup>38</sup> Five Raeward Fresh and 99 On the Spot retail stores also operate in the South Island.<sup>39</sup>

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<sup>36</sup> Foodstuffs NI “Who we are” <https://www.foodstuffs.co.nz/about-foodstuffs/who-we-are/>.

<sup>37</sup> This includes merchandising services including product sourcing, ranging and promotional planning, retail execution support, management of marketing, IT and digital systems development, developing and renting properties for owned retail stores, transactional shared services, HR and legal support.

<sup>38</sup> As at 31 December 2020. Foodstuffs NI supplies 101 New World, one Fresh Collective by New World, 43 PAK’nSAVE, one PAK’nSAVE mini and 167 Four Square stores. Information provided by Foodstuffs NI. Foodstuffs SI supplies 42 New World, 12 PAK’nSAVE and 62 Four Square stores. Information provided by Foodstuffs SI, [ ].

<sup>39</sup> Information provided by Foodstuffs SI, [ ]. Foodstuffs also has other retail and wholesale brands, including Gilmours, Trents, Fresh Collective, Henry’s and Liquorland.

2.20 Foodstuffs' retail banners are shown in Figure 2.2 below.

**Figure 2.2 Foodstuffs' retail banners**



2.21 Foodstuffs NI stores serve an average of 2.7 million customers every week through its physical stores or online shopping.<sup>40</sup> Foodstuffs SI's stores serve over 600,000 customers each week.<sup>41</sup>

### Other grocery retailers

2.22 Other grocery retailers operating in New Zealand include retailers operating in the following categories:

- 2.22.1 international food stores (eg, Tai Ping, Japan Mart, Yogiji's Food Mart);
- 2.22.2 other supermarkets (eg, Farro Fresh, Moore Wilson's, Bin Inn);
- 2.22.3 single-category or specialist grocery stores (eg, greengrocers, butchers, bakeries);
- 2.22.4 general merchandisers (eg, The Warehouse);
- 2.22.5 convenience stores (eg, dairies, petrol stations, Night 'n Day);
- 2.22.6 meal kit providers (eg, Hello Fresh, My Food Bag);
- 2.22.7 food box operators (eg, Foodbox and Ooooby);
- 2.22.8 online-only supermarkets (eg, The Honest Grocer, Supie); and
- 2.22.9 specialist online retailers (eg, Hypermeat).

2.23 They provide a range of different retail grocery offers, many of which are focussed on specific shopping missions, product categories, or consumer groups.

<sup>40</sup> Foodstuffs NI "Our Concise Annual Report FY20" (2020) at Our Customers, available at: <https://annualreport.wearefoodies.nz/our-customers/>.

<sup>41</sup> Foodstuffs SI "Foodstuffs South Island Annual Report" (2019), at 2, available at: [https://www.foodstuffs-si.co.nz/-/media/Project/Sitecore/Corporate/Corporate-South-Island/Who-we-are/Annual-Reports/FSSI\\_AR\\_2019\\_Web.pdf](https://www.foodstuffs-si.co.nz/-/media/Project/Sitecore/Corporate/Corporate-South-Island/Who-we-are/Annual-Reports/FSSI_AR_2019_Web.pdf).

- 2.24 They also include a number of new entrants. Chemist Warehouse entered as a single-category retailer in 2017.<sup>42</sup> Meal kit providers, food box operators, online-only supermarkets, and specialist online retailers have also entered with new retail grocery services.<sup>43</sup>

### **There has been no large-scale retailer entry to the sector in the last decade**

- 2.25 While the range of retail grocery offerings has expanded in recent years, no large-scale retail grocers with an offering comparable to PAK'nSAVE, Countdown or New World have entered the sector in the last decade.
- 2.26 The Warehouse launched its Warehouse Extra hypermarket format in 2006 and planned a chain of hypermarkets, which included grocery offerings. The company abandoned plans to continue with the format in 2008 and stores were converted to the standard stores.
- 2.27 However, Costco has confirmed that it intends to open a store in Auckland in 2022, and it is speculated that it is actively looking for store sites in Christchurch and Wellington.<sup>44</sup>
- 2.28 Further discussion of entry and expansion in the retail grocery sector is provided in Chapter 6.

### **Major grocery retailers' offerings**

- 2.29 While they typically offer consumers the opportunity to shop for all their grocery needs as a main shop, the major grocery retailers differentiate their retail banners from one another and the relative distribution of their stores varies across New Zealand.

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<sup>42</sup> Chemist Warehouse "Game changer: All Blacks great teams up with Chemist Warehouse"

<https://www.chemistwarehouse.co.nz/CWH/media/Documents/Chemist-Warehosue-Release.pdf>.

<sup>43</sup> For example: Hello Fresh "We save you serious money" <https://www.hellofresh.co.nz/>; My Food Bag "Your answer to "What's for dinner?"" <https://www.myfoodbag.co.nz/>; Woop "Delicious Homemade dinners should take time. Just not yours" <https://woop.co.nz/>; Foodbox "Fresh, Seasonal, Local" <https://foodbox.co.nz/>; Ooooby "Local and organic food made easy and fair" <https://www.ooooby.org/>; The Honest Grocer "The Honest Grocer" <https://thehonestgrocer.co.nz/>; Supie "Supie" <https://supie.co.nz/>; Hyper Meat "Hyper Meat" <https://hypermeat.co.nz/>.

<sup>44</sup> Melanie Carroll Stuff "Costco delays its New Zealand launch, but is actively looking for additional sites" (29 October 2020) <https://www.stuff.co.nz/business/industries/123230944/costco-delays-its-new-zealand-launch-but-is-actively-looking-for-additional-sites>.

[ ]

## The major retail grocery banners

- 2.30 Foodstuffs SI markets its offerings as providing an enjoyable shopping experience based around quality, convenience, and value.<sup>45</sup> Foodstuffs NI indicated that to make sure New Zealanders get the best out of life, it aims to be one of the most customer driven retailers in the world.<sup>46</sup> Their three main retail banners provide differentiated retail offerings:
- 2.30.1 PAK'nSAVE stores are the largest of the Foodstuffs groups' stores and are located generally in larger towns and cities. PAK'nSAVE's policy is to provide New Zealand's lowest food prices and to "never stop looking for ways to keep costs down in order to pass those savings on" to consumers.<sup>47</sup>
- 2.30.2 Although New World stores are typically smaller, they are also located in high traffic areas. New World prides itself on its friendly staff and quality service, and indicates "we'll do our best to make your shopping experience as good as it can be".<sup>48</sup>
- 2.30.3 "Four Square stores range from small neighbourhood shops in larger towns and cities, perfect for picking up last-minute ingredients for dinner or dessert, to larger grocery stores in rural and provincial regions that serve their communities' everyday shopping needs". Their product range varies depending on store size and location. The Four Square retail banner is positioned as "one of New Zealand's iconic identities" and a "heritage brand".<sup>49</sup>
- 2.30.4 Raeward Fresh offers customers "quality fresh fruit and vegetables, a full butchery range, and all [their] grocery essentials".<sup>50</sup>
- 2.30.5 On the Spot positions itself as "here, ready when you need us", and offers "a great range of products to cover all requirements: butter for those last-minute scones, ice creams for the afterschool run or tasty Food to go".<sup>51</sup>

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<sup>45</sup> Foodstuffs SI "Homepage" <https://www.foodstuffs-si.co.nz/>.

<sup>46</sup> Foodstuffs NI "Who we are" <https://www.foodstuffs.co.nz/who-we-are/our-purpose>.

<sup>47</sup> Foodstuffs SI "Our brands" <https://www.foodstuffs-si.co.nz/our-brands>.

<sup>48</sup> Foodstuffs SI "Our brands" <https://www.foodstuffs-si.co.nz/our-brands>.

<sup>49</sup> Foodstuffs SI "Our brands" <https://www.foodstuffs-si.co.nz/our-brands>.

<sup>50</sup> Foodstuffs SI "Our brands" <https://www.foodstuffs-si.co.nz/our-brands>.

<sup>51</sup> Foodstuffs SI "Our brands" <https://www.foodstuffs-si.co.nz/our-brands>.

- 2.31 Woolworths states that its goal is to provide the best possible convenience, value, range and quality to the Kiwis it serves each week.<sup>52</sup> Its three retail banners also provide differentiated offerings:
- 2.31.1 Countdown stores are generally the largest stores, and operate in high traffic areas. Countdown positions itself as “New Zealand’s leading supermarket brand” and says it is committed to providing its “customers with choice, value and convenience, so they’ll enjoy the best overall shopping experience”.<sup>53</sup>
  - 2.31.2 FreshChoice and SuperValue stores are generally smaller than Countdown stores. Their product range varies depending on store size and location. They aim to provide “locals quick and friendly service with a range that has everything you want and is just what you need”.<sup>54</sup>

### **Major grocery retailer store locations across New Zealand**

- 2.32 Figure 2.3 shows the locations of Woolworths NZ and Foodstuffs stores across the South Island of New Zealand. A further map of store locations across the North Island is provided in Attachment B. Chapter 4 provides further information on how major grocery retailers operate nationally and locally in different regions.
- 2.33 Larger supermarkets (such as Countdown, PAK’nSAVE and New World) appear to be typically located near larger populations, while smaller supermarkets (such as Four Square) appear more likely to be located in more remote areas. Most larger towns have a mix of larger supermarkets, as well as some smaller supermarkets. Many smaller and regional towns only have one supermarket.

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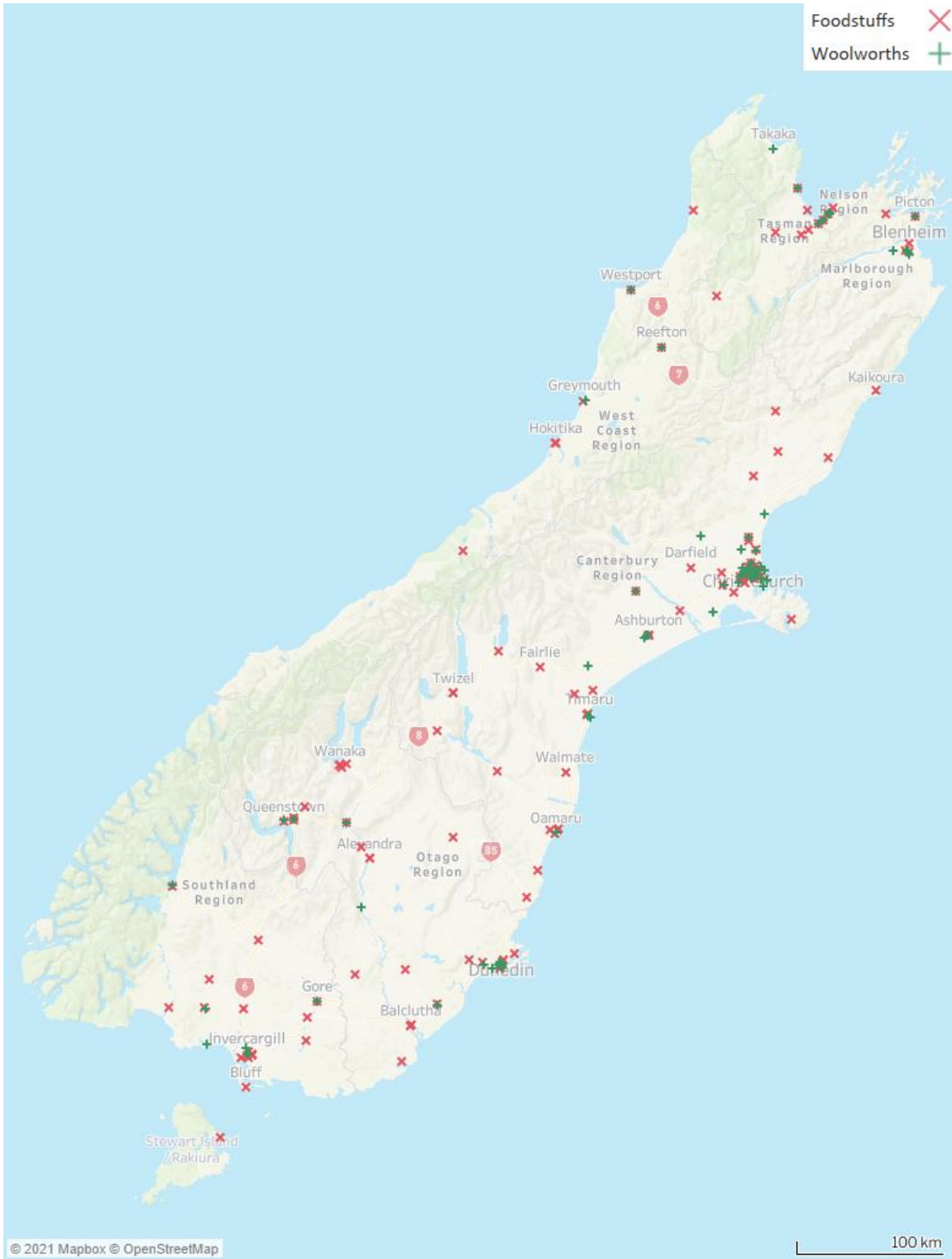
<sup>52</sup> Woolworths NZ “Home page” <https://www.woolworthsnz.co.nz/>.

<sup>53</sup> Countdown “Our company” <https://www.countdown.co.nz/about-us/our-company>.

<sup>54</sup> Fresh Choice “About Fresh Choice Supermarkets” <https://www.freshchoice.co.nz/about/>; SuperValue “About SuperValue Supermarkets” <https://www.supervalue.co.nz/about/>.



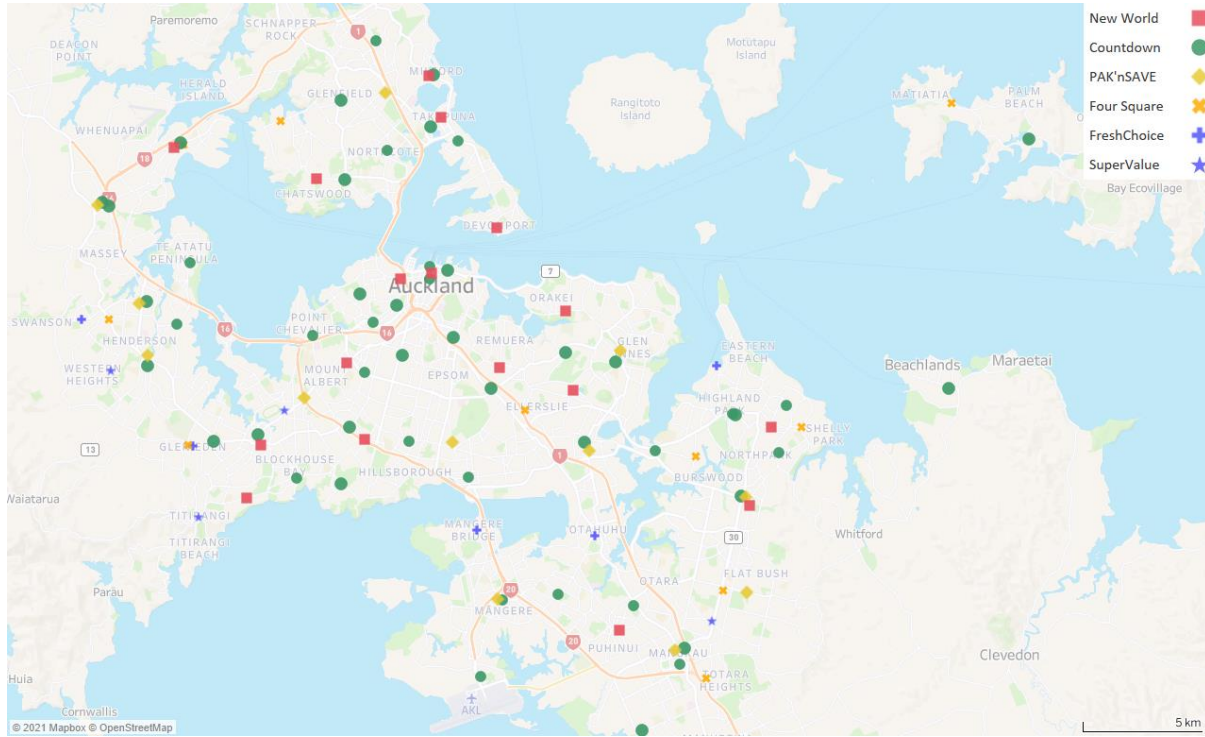
Figure 2.3 Major grocery retailer store locations in the South Island



Source: Commission analysis of information provided by major grocery retailers, as at December 2020.<sup>55</sup>

2.34 Figure 2.4 shows locations of major grocery retailer stores by retail banner in Auckland. Attachment B provides further maps of Wellington and Christchurch.

**Figure 2.4 Major grocery retailer store locations in Auckland by retail banner**



Source: Commission analysis of information provided by major grocery retailers, as at December 2020.<sup>56</sup>

2.35 This Auckland map shows relatively more Countdown supermarkets than PAK'nSAVE and New World supermarkets. Maps of Wellington and Christchurch included in Attachment B show relatively more PAK'nSAVE and New World supermarkets than Countdown supermarkets.

2.36 Chapter 4 provides further discussion on the regional variations in grocery store options available to consumers.

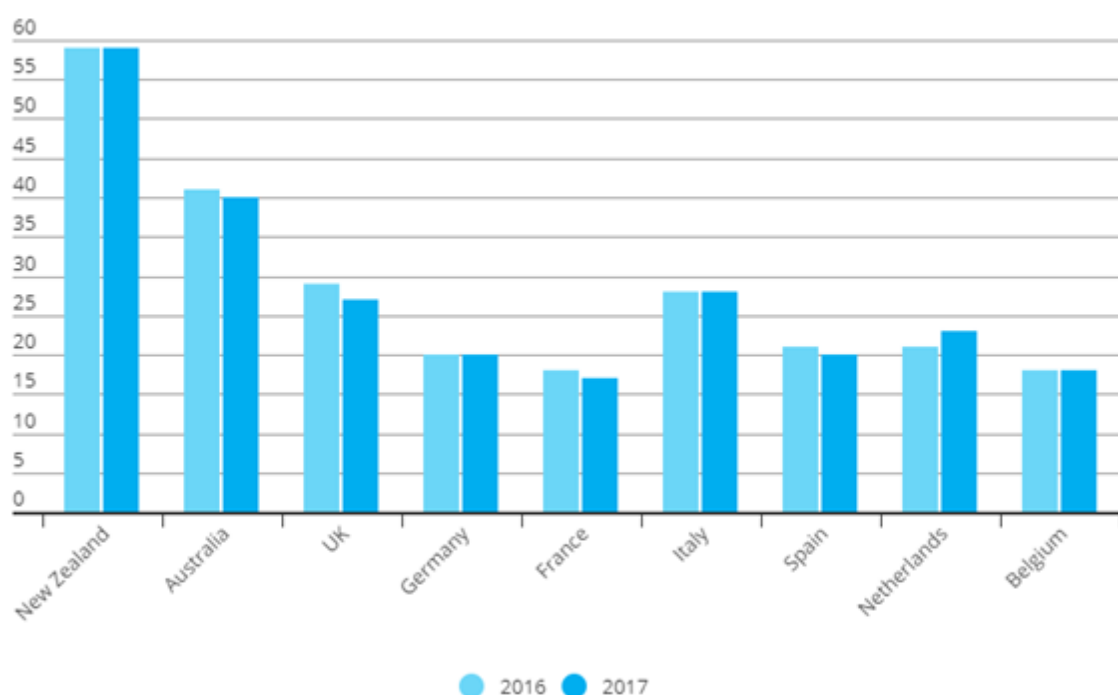
**Pricing and promotional practices**

2.37 Grocery retailers commonly use a range of discounting mechanisms to encourage consumers to shop at their stores and purchase certain products. It is also common for New Zealand grocery consumers to be members of loyalty programmes.

### Promotional pricing is a feature of the New Zealand retail grocery sector

- 2.38 Promotional mechanisms used by major grocery retailers range from specials or short-term discounts, to multi-buys, loyalty programme member-only discounts, and everyday low prices (EDLP) where pricing strategy is based on offering a “low” price on certain products for an extended period. Any one store typically runs a number of these kinds of promotions at any one time, and quite frequently more than one offer can apply in relation to a single product.
- 2.39 A significant proportion of groceries in New Zealand are purchased on these promotions. Between around one and two thirds of total revenue earned by major grocery retailers in 2019 was from sales of products on promotion.<sup>57</sup>
- 2.40 Nielsen also reported that almost \$6 in every \$10 spent on groceries was spent on products sold on promotion in 2017. As shown in Figure 2.5, the proportion of groceries bought on promotion in New Zealand was ahead of other developed markets around the world.<sup>58</sup>

**Figure 2.5 Percentage of grocery products sold on promotion**



Source: Nielsen Scantrack and Nielsen Homescan.<sup>59</sup>

<sup>57</sup> See Table E2 in Attachment E.

<sup>58</sup> Nielsen “The \$470m opportunity: Changing the game with price and promotions” (15 May 2018) <https://supermarketnews.co.nz/opinion/the-470m-opportunity-changing-the-game-with-price-promotions/>.

<sup>59</sup> Commerce Commission “Market study into the retail grocery sector – Preliminary issues paper” (10 December 2020) at Figure 4.

- 2.41 Chapter 7 discusses major grocery retailers' pricing and discounting practices, their frequency and prevalence and the potential effects on consumer decision making and competition.

### **Loyalty programmes are offered by all major grocery retailers**

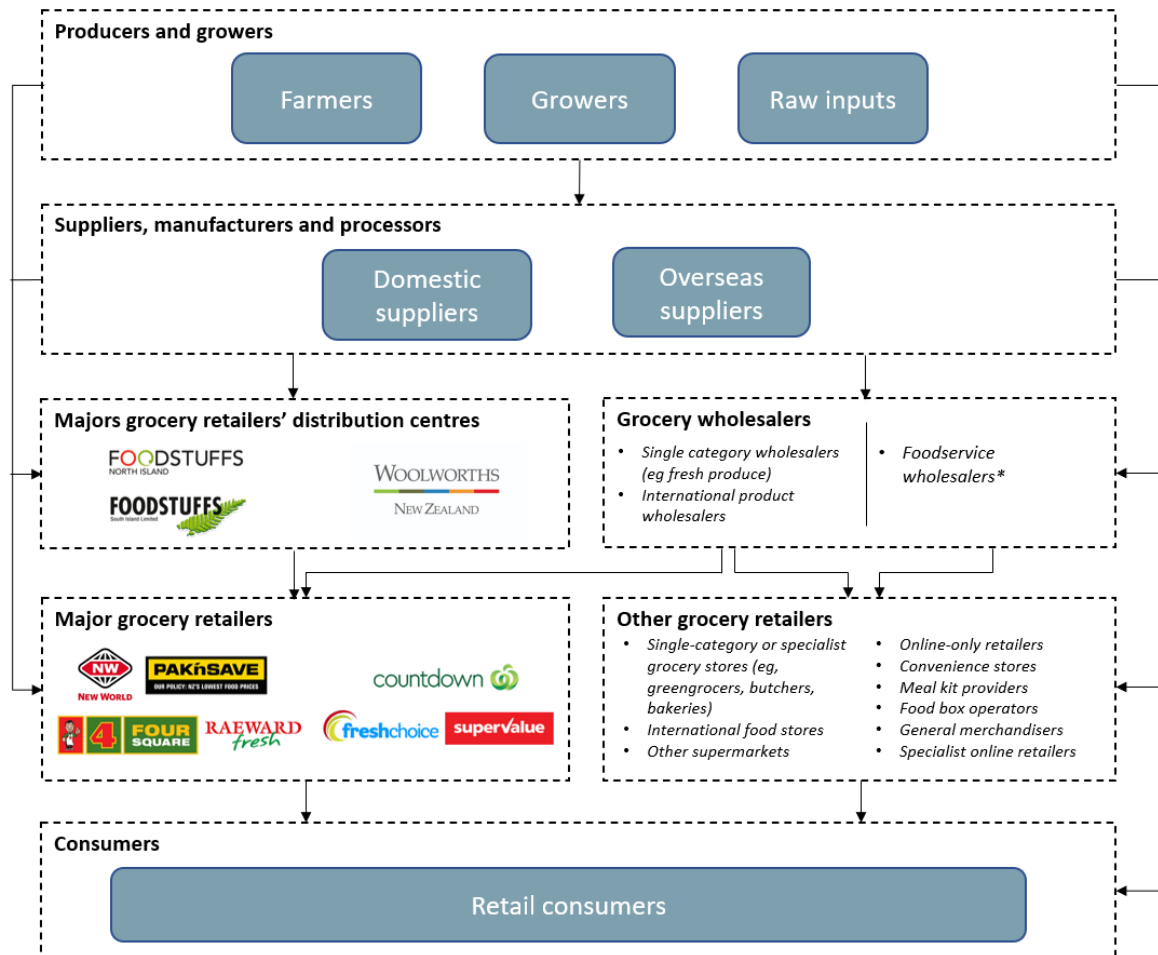
- 2.42 Both New World and Countdown offer loyalty programmes and most grocery consumers in New Zealand are members of at least one.
- 2.43 Key features of loyalty programmes include:
- 2.43.1 access to member-only discounts: instant discounts provided to loyalty club members;
  - 2.43.2 accumulated rewards: fuel, food or other travel rewards such as Flybuys and Airpoints earned by loyalty club members; and
  - 2.43.3 personalised offers: rewards or benefits that are more targeted at individual consumers.
- 2.44 Through these programmes, retailers can gather consumer data, including on consumers' preferences and purchasing behaviour. This data can be used to inform business decision making, for example, in relation to product ranges, and to offer a more personalised consumer experience.
- 2.45 Chapter 7 discusses the nature of loyalty programmes offered by the major grocery retailers and their potential effect on consumer decision making and competition. Chapter 6 discusses the extent to which loyalty programmes may provide a constraint on entry and expansion in the retail grocery sector.

### **Grocery supply chain**

- 2.46 The grocery supply chain broadly consists of suppliers, wholesalers, and grocery retailers. Suppliers may be growers of fresh produce, farmers, manufacturers or processors. Grocery wholesalers are intermediaries who on-sell products to grocery retailers. Retailers sell directly to consumers and may acquire products either from a wholesaler or directly from a supplier.
- 2.47 New Zealand's three major grocery retailers' operations are vertically integrated, meaning that they are wholesalers but largely only to themselves. They own and operate central distribution centres which supply their retail stores throughout the country. Suppliers either deliver products to the major grocery retailers' distribution centres or directly to their retail stores.

2.48 Figure 2.6 shows a simplified version of the supply chain for grocery products to retail consumers in New Zealand. The grocery supply chain is likely to be more complicated in practice, as it includes different supply chains for different types of products.<sup>60</sup>

**Figure 2.6 High-level summary of the supply chain for the NZ retail grocery sector**



\* For the purposes of this study, we are interested in wholesalers which supply retail grocery stores. We are aware that some foodservice wholesalers sell to some grocery retailers. We have therefore included them in Figure 2.6 even though this is not the focus of their business.

### Wholesale supply to grocery retailers

2.49 There does not appear to be any large-scale independent wholesalers of a full range of grocery products in the New Zealand retail grocery sector.

<sup>60</sup> We published a similar diagram in our preliminary issues paper. This revised version reflects our updated understanding of the structure of delivery chains within the sector. Rather than name specific companies, we have included descriptive categories of “other grocery retailers”, and “grocery wholesalers” to reflect the diversity in the supply chain.

- 2.50 However, there do appear to be at least some wholesale options for:
- 2.50.1 single product categories such as fresh produce (eg, T&G Fresh, Fresh Direct, MG Marketing)<sup>61</sup> and meat (eg, JR Wholesale Meats, Wholesale Meats Direct); and
  - 2.50.2 international products (eg, Tai Ping, Wang Mart, MZ Holdings).
- 2.51 Retailers have also indicated that they are able to acquire some groceries from wholesalers of imported products. This appears to largely be the case for international products (eg, Indian, Chinese, Korean)<sup>62</sup> and some categories of globally branded products (eg, confectioneries).<sup>63</sup> However, we note that importing does not grant access to locally branded products.
- 2.52 Separate wholesalers also exist to supply to restaurants and other foodservice retailers (foodservice wholesalers). Two of these are part of the Foodstuffs group. Trents is owned by Foodstuffs SI and Gilmours store owners are part of the Foodstuffs NI group. Although their businesses focus on foodservice, they also supply some convenience stores and other grocery retailers.<sup>64, 65</sup> There are also other independent foodservice wholesalers such as Bidfood and Service Foods.
- 2.53 Chapter 6 provides further analysis of the grocery supply chain and wholesale sector.

## Other sector themes

- 2.54 This section provides an overview of some of the notable themes we have observed in the grocery sector. We have looked at the growth of the sector over the last 10 years, the impact of the COVID-19 pandemic and growth in online grocery sales.

## Size of the grocery sector

- 2.55 The sector appears to have grown in line with growth in the New Zealand population, as seen in Figure 2.7 below.

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<sup>61</sup> T&G Fresh “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 6; United Fresh “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 17; Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 53.

<sup>62</sup> [ ]; [ ];

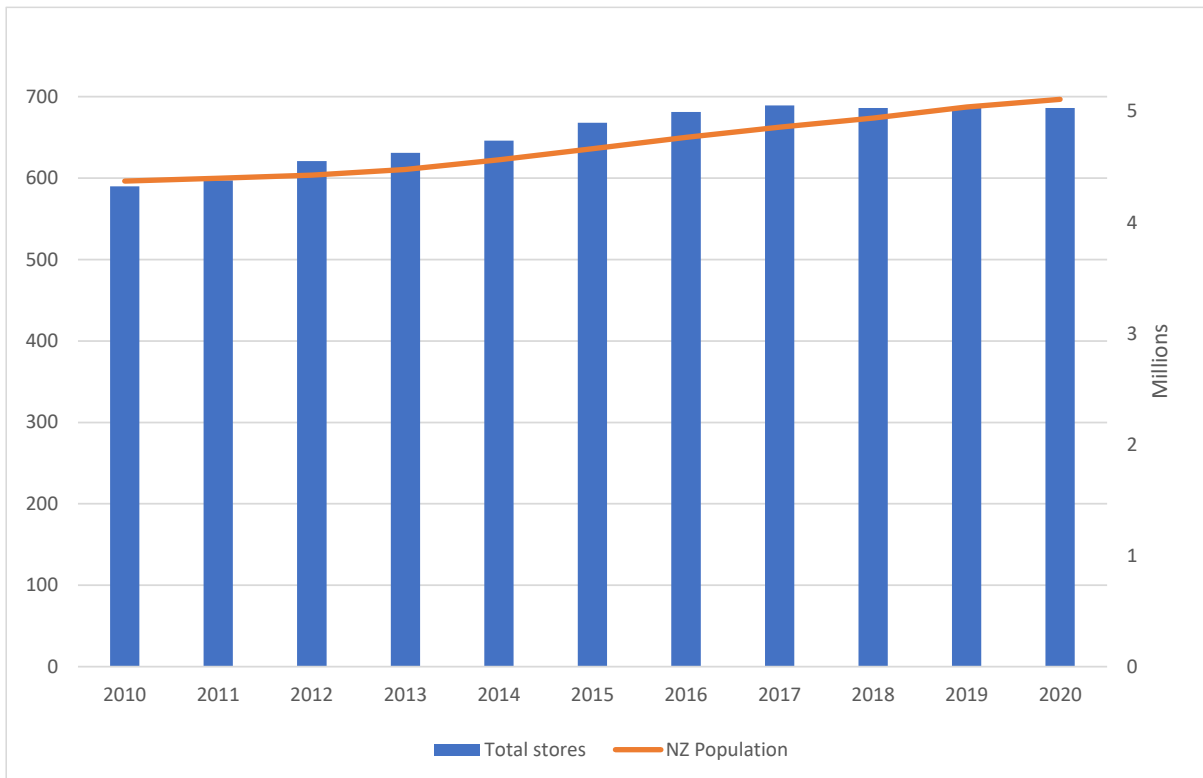
<sup>63</sup> [ ].

<sup>64</sup> [ ];

<sup>65</sup> [ ].

<sup>64</sup> [ ]; [ ];

<sup>65</sup> [ ].

**Figure 2.7 Total number of major grocery retailer stores**

Source: Commission analysis of information provided by major grocery retailers.<sup>66</sup>

- 2.56 There has been an increase in the total number of stores of the major grocery retailers in the last 10 years. This has stabilised from 2017. The flattening off from 2017 appears to reflect a number of Four Square stores exiting the Four Square retail banner, and others that have closed.<sup>67</sup>
- 2.57 The average annual growth rate of the number of stores for the period 2010 to 2020 is 1.6%, while the average annual population growth over the same period has been 1.7%.
- 2.58 Figure 2.8 demonstrates an increase in supermarket and grocery store sales over the last 10 years. The average annual growth rate of retail sales for the period 2011 to 2020 is 1.7%.

<sup>66</sup>

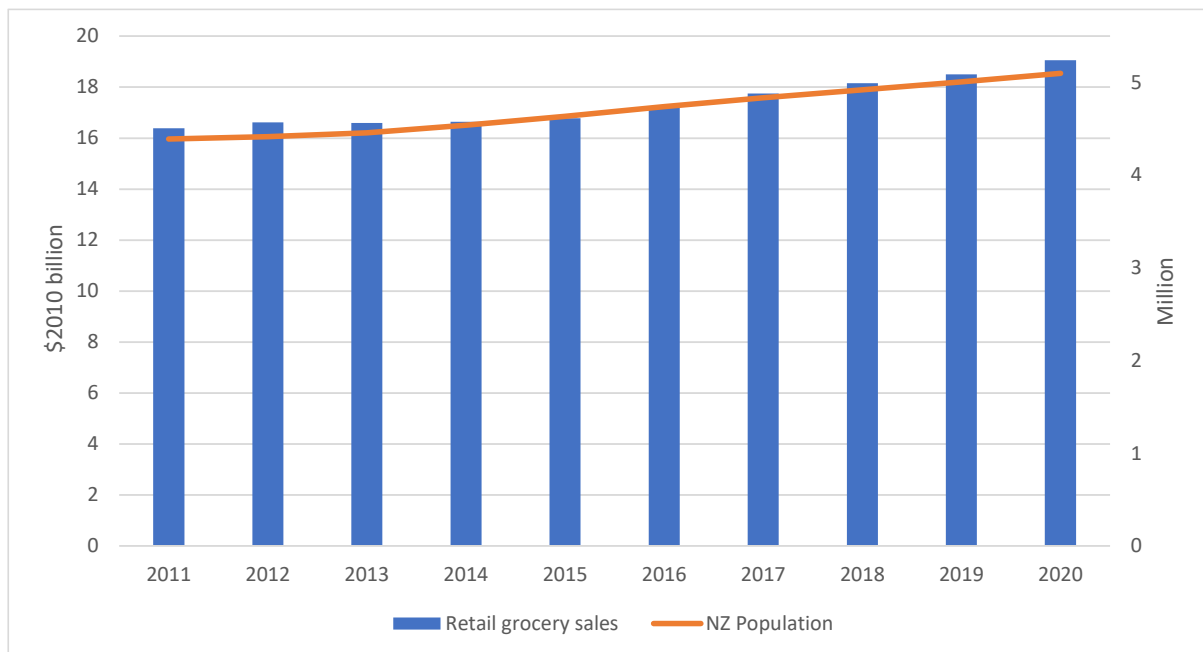
[

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<sup>67</sup>

See: Chapter 6; [

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**Figure 2.8 Supermarket and grocery store industry sales**

Source: Statistics NZ “Retail trade survey” Supermarket and grocery stores Sales (operating income), deflated at September 2010 quarter prices.<sup>68</sup>

### Impact of the COVID-19 pandemic on the retail grocery sector

- 2.59 As an essential service, supermarkets were able to operate during the Government-mandated level 4 lockdown period (25 March to 27 April 2020).
- 2.60 Many other grocery retailers, such as greengrocers and butchers, were unable to open their stores during this period. Some retailers that were not able to open have since changed their business models or even ceased trading. However, some businesses who had not previously sold groceries to retail consumers began selling online during lockdown.<sup>69</sup>
- 2.61 Concerns were raised about price gouging during the level 4 lockdown. For example:
- 2.61.1 there was significant media coverage regarding price rises for several grocery products;<sup>70</sup>
  - 2.61.2 the Ministry of Business, Innovation and Employment (MBIE) set up an online Price Watch service for consumers to report concerns about price increases for essential goods and services; and

<sup>68</sup> See: <http://infoshare.stats.govt.nz>.

<sup>69</sup> For example: Bidfood <https://www.bidfood.co.nz/>; Service Foods <https://www.servicefoods.co.nz/>; Trade Me <https://www.stuff.co.nz/business/121373859/coronavirus-trade-me-launches-fresh-food-boxes>; Mighty Ape <https://mightymart.co.nz/>.

<sup>70</sup> For example: Cherie Howie “Price Gouging complaints pour in to Government’s ‘price watch’ inbox” (3 April 2020) [https://www.nzherald.co.nz/nz/news/article.cfm?c\\_id=1&objectid=12322407](https://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=12322407).



- 2.61.3 consumers complained that some stores may have temporarily stopped offering promotional discounts.
- 2.62 Many consumers changed their behaviour through the lockdown period, for example, by making larger, less frequent purchases, or by purchasing groceries online.<sup>71</sup> It is unclear whether this trend will continue in future.
- 2.63 While many non-supermarkets likely lost sales during the COVID-19 pandemic, sales appear to have recovered for many following lockdown. Sales of some niche products also appear to have increased over the period as a consequence of disposable incomes not being spent on international travel.<sup>72</sup>
- 2.64 However, this study does not analyse or comment upon the grocery sector's response to the COVID-19 pandemic, or its effects on competition.
- 2.65 Rather, we are undertaking a wider assessment of competition in the sector. As part of this assessment, we have considered whether any issues that have emerged during the pandemic are likely to affect competition over a longer period.

### Online trends

- 2.66 The majority of New Zealand consumers purchase groceries by visiting a retail store. However, there has been an increase in online sales fuelled by the COVID-19 pandemic lockdowns.
- 2.67 NZ Post indicated that online sales of specialty food, groceries and liquor increased by 47% to \$1.3 billion between 2019 and 2020. Over the same period, overall sector sales grew by 8%. At the same time, the total number of online consumers increased significantly, rising from 380,000 to 1.09 million. Customers also carried out 41% more online purchases in 2020 and online basket size increased by 5%.<sup>73</sup>
- 2.68 Woolworths NZ has indicated its "online penetration continues to grow, having increased from 3% total sales in FY2014 to over 12% in the current financial year to date".<sup>74</sup>

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<sup>71</sup> For example: [ ].

<sup>72</sup> [ ].

<sup>73</sup> NZ Post "The Full Download: 2020 New Zealand eCommerce Review" (2021) at 59, available at: [https://thefulldownload.co.nz/sites/default/files/2020-07/The\\_Full\\_Download\\_2020\\_0.pdf](https://thefulldownload.co.nz/sites/default/files/2020-07/The_Full_Download_2020_0.pdf).

<sup>74</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 18.

- 2.69 Foodstuffs NI has indicated that there has been “significant investment by Foodstuffs NI and Woolworths and their respective supply chains in putting in place the necessary processes and infrastructure to support the online offering.”<sup>75</sup> Foodstuffs SI has very recently launched an online offering in Rangiora, and it has indicated that this will be expanded to all South Island New World stores by the end of the year. Foodstuffs SI has also indicated that its online sales platform is intended to compete with, and in response to, the presence of meal kits and online offerings.<sup>76</sup>
- 2.70 Other grocery retailers have launched online offerings, with a number being launched during or shortly after the COVID-19 pandemic.<sup>77</sup>
- 2.71 Chapter 3 provides further information about innovation and investment in online shopping services.

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<sup>75</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 15.

<sup>76</sup> Karen Coltman “Foodstuffs steps up its South Island online shopping service” (21 July 2021) <https://www.stuff.co.nz/business/125796178/foodstuffs-steps-up-its-south-island-online-shopping-service>; Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 7.

<sup>77</sup> [ ]; [ ];  
[ ].

## Chapter 3 Market outcomes in the retail grocery sector

### Summary of chapter

- Our preliminary view is that the market outcomes that we have observed are not consistent with what we would expect to see in a workably competitive market.
- We have observed consistently high levels of profits being earned by all of the major grocery retailers. These have been above what we consider to be normal levels of profit that would be observed in a market with effective competition, and these returns appear to be persistent.
- These levels of profit have been observed using a variety of profitability measures. The Return on Average Capital Employed (ROACE) profit measure appears to be significantly and persistently above our estimate of normal return for these businesses, the Weighted Average Cost of Capital (WACC) for all three of the major grocery retailers in all of the years reviewed.
- Expected future profits are also at similar levels to ROACE, with profit expectations for new grocery retailing investments also well in excess of WACC over the time period we have assessed them for those major grocery retailers that provided forecasts.
- The three major grocery retailers are also earning greater levels of profit margin than a sample of international grocery retailers.
- While it is difficult to compare grocery prices internationally, the data appears to show that New Zealand prices are high by international standards. New Zealand ranks as one of the most expensive Organisation for Economic Co-operation and Development (OECD) grocery markets, and New Zealanders appear to spend a relatively high proportion of their income on groceries. Survey participants have also indicated they consider prices are high and that they are higher than those they have experienced overseas.
- It is not clear whether the quality, range and service offered to consumers differ materially from what we would expect in a workably competitive market.
- We have observed that there has been some innovation in the sector directed at product and service differentiation. However, it is modest when compared to overseas. High profits do not appear to represent returns on investment in innovation since they are also being enjoyed by slow adopters.
- It is also unclear how much consumers are benefitting from additional investments in supply chain investment.
- None of these observed market outcomes is, on its own, a conclusive indicator that competition is not effective. However, viewed in the round, our preliminary view is that they are not consistent with what we would expect to see in a workably competitive market.

## Introduction

- 3.1 This chapter sets out our observations on market outcomes in the retail grocery sector and our preliminary view on what these indicators can tell us about whether competition is working well or not.
- 3.2 We focus on commonly understood measures that are indicative of whether competition is working well or not. This includes the profitability of grocery retailers and the prices they charge to consumers, but also includes the extent of innovation that they engage in, as well as the quality, range and services that are offered to consumers.
- 3.3 Looking across these observations we consider whether they are consistent with what we would expect in a workably competitive market and, if not, the extent to which they depart from what we would expect. In forming expectations of what we would expect in a workably competitive market, we consider a range of benchmarks including observations from other markets, such as those overseas or in other industries.
- 3.4 In a workably competitive market we would expect to see:
  - 3.4.1 levels of profitability which are not persistently above normal returns;
  - 3.4.2 prices which are lower in the long run than those in markets where competition is not working effectively; and
  - 3.4.3 firms which are innovating and investing in research and development to drive competitive advantage and further profitability by creating more efficient or attractive offerings for consumers.
- 3.5 Our analysis indicates that while it is not clear whether the quality, range and service offered to consumers differ materially from what we would expect in a workably competitive market, excess returns are being made in the retail grocery sector and these appear to be persistent. Prices paid by New Zealanders for groceries also appear high and the level of innovation appears low. This is not what we would expect to see in a workably competitive market.
- 3.6 The remainder of this chapter discusses:
  - 3.6.1 profitability of grocery retailers in New Zealand;
  - 3.6.2 price outcomes;
  - 3.6.3 quality, range, and service outcomes; and
  - 3.6.4 innovation and investment.

## **Profitability of grocery retailers in New Zealand**

- 3.7 In a market where competition is effective, we would not expect to see levels of profitability which are persistently above a normal return. Persistence of excess levels of profitability may therefore indicate that competition is not working as well as it should for the long-term benefit of consumers.
- 3.8 Levels of profit above normal returns are not necessarily indicative of a lack of competition. Profits are a reward to businesses which can achieve lower costs than their rivals or attract additional customers by improving their offers.
- 3.9 High levels of profitability also provide a signal for new entry or expansion in a market. When entry or expansion occurs, output increases and prices should subsequently fall, so that excess profitability is likely to be temporary. If high profitability is persistent in a competitive market, it will generally be confined to a subset of firms that have some form of enduring competitive advantage such as relatively lower costs.
- 3.10 However, if all firms in a sector are persistently earning above a normal return, this suggests that current competition and the threat of entry or expansion by others are not effective in maintaining sufficient rivalry between incumbent firms to push prices close to efficient costs. In a workably competitive market, we would expect that over time, firms would tend to earn normal rates of return and prices would reflect efficient costs.
- 3.11 We have therefore focused our analysis on understanding whether returns in the retail grocery sector have tended towards normal returns or returns that would be expected in a workably competitive market over time.
- 3.12 We set out our assessment of profitability and our preliminary findings below under the following headings:
- 3.12.1 our approach to assessing profitability;
  - 3.12.2 excess returns appear to be persistent in the retail grocery sector;
  - 3.12.3 major grocery retailers are earning excess levels of profit based on their ROACE;
  - 3.12.4 other smaller grocery retailers are also earning high levels of ROACE;
  - 3.12.5 business cases show high expected rates of return;
  - 3.12.6 profit margins have been consistent over time and above international comparators; and
  - 3.12.7 our overall preliminary findings on profitability.

- 3.13 Attachment C provides more details about how we have assessed profitability within the retail grocery sector, the analysis we have undertaken and our preliminary findings from this analysis.

### **Our approach to assessing profitability**

- 3.14 Our approach for assessing profitability is an economic one. Economic profit is calculated using the economic costs of the resources used in the business and is benchmarked against the opportunity cost of investing the assets (or capital) employed elsewhere. This differs to an accounting concept of profit, which is aimed more at estimating financial surplus in a period and uses accounting conventions such as for non-cash expenses.
- 3.15 The time period we have used to assess profitability has generally been between 2015 to 2019. We have excluded 2020 from the period we have assessed in relation to profitability in order to avoid the effects of the COVID-19 pandemic.
- 3.16 Our approach to assessing the profitability of the grocery retailers in New Zealand has been to use a number of well-accepted profitability measures:
- 3.16.1 our primary profitability measure is the ROACE measure;
  - 3.16.2 we have examined profit margins that grocery retailers have earned over time; and
  - 3.16.3 we have also examined forward-looking expectations of anticipated profitability from new investments.
- 3.17 We have compared each of these profitability measures against relevant benchmarks to assess the level of profitability and its persistence over time.

### *Return on Average Capital Employed*

- 3.18 The ROACE measure derives an annual return based on the amount of earnings a company has made in a financial year relative to the value of the assets that were employed in that year to generate those earnings. The specific ROACE formula we have used in this study is shown in Figure 3.1 below. This is broadly the same formula that was used in our fuel market study.

**Figure 3.1 Our ROACE formula**

$$\text{ROACE} = \frac{\text{Net Profit after Tax} + (\text{Net Interest Expenses} \times (1 - \text{Corporate Tax}))}{\text{Average Assets Employed}}$$

**Where:** Net Interest Expenses = Interest Expenses - Interest Income

Average Assets Employed = ( Total Assets - Goodwill - Current Liabilities + Interest Bearing Current Liabilities )  
taken at the start and end of the financial year

- 3.19 We have benchmarked the ROACE profitability measure against our estimate of what is a normal rate of return, or the WACC for firms in the New Zealand retail grocery sector.
- 3.20 The WACC is the expected financial return that investors require for an investment given the riskiness of that investment. We have estimated the WACC for firms in the New Zealand retail grocery sector for the time period between 2015 and 2019 to be within the range of 4.6% to 6.1% after tax. The calculation of WACC rests on a number of assumptions and calculations. Attachment C provides further details on how we have estimated WACC.
- 3.21 Our ROACE formula adjusts the earnings so that the results are comparable to a post-tax WACC. It also adjusts the assets employed to reflect the market value, or opportunity cost of the assets, or the amount of “capital” being employed.
- 3.22 Our analysis has focussed primarily on the three major grocery retailers: Woolworths NZ, Foodstuffs NI and Foodstuffs SI. As discussed in Chapter 2, Woolworths NZ and Foodstuffs operate through different business models. As such, we have adopted slightly different approaches for assessing the profitability of each retailer.

#### *ROACE approach for Woolworths NZ*

- 3.23 For Woolworths NZ we have focussed on the entire company except for two non-grocery subsidiaries it owned during the 2015 to 2019 period. We have also adjusted its asset base upwards to reflect our estimates of the current market value of its land and buildings it owns. This is to capture the actual amount of capital that is being employed by the company and its true opportunity cost.
- 3.24 We have removed all of the intangible assets relating to goodwill and brands from Woolworths NZ’s asset base. These two items are materially significant in scale relative to the total assets in the balance sheet of its financial statements. They have been removed because they do not constitute an asset that was employed in generating earnings. Rather they are assets that reflect future expected earnings. These items arose out of Woolworths Australia’s acquisition of Progressive Enterprises in 2005. Our reasoning for this approach and Woolworths NZ’s arguments for their inclusion are discussed in greater detail in Attachment C.

#### *ROACE approach for the Foodstuffs Group*

- 3.25 Our profitability assessment of the two Foodstuffs groups of companies has focussed on the owner-operated retail grocery stores because they directly engage in grocery retailing. By contrast, the co-operatives are service providers to the grocery retailers, including wholesale purchasing, warehousing and distribution of groceries, and administration and coordination of operations, for which they receive payment from the retail stores.<sup>78</sup>

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<sup>78</sup> Further detail is provided about their operations in Chapter 2.

- 3.26 Given the interrelated nature of the Foodstuffs co-operatives with their member stores, we adjusted certain transactions between the stores and their co-operatives to reflect our estimates of market rates so that the stores can be considered stand-alone grocery retailers.<sup>79</sup>
- 3.27 We also tested the profitability of the co-operative companies. This was to check whether our retail store profitability estimates were biased in either direction as a result of store owners' joint ownership of their respective co-operatives. For example, we checked whether the co-operatives were making economic losses that distorted the true profitability of their member stores (making the retail stores appear more profitable).
- 3.28 We also considered the profitability of a number of other grocery retailers to understand how these compared to the major grocery retailers. Other grocery retailers analysed were Moore Wilson's, Farro Fresh and Commonsense Organics. Given their relatively small scale, we have focussed our assessment of profitability on the major grocery retailers.

#### *Profit margins*

- 3.29 We examined the historic profit margins of the three major grocery retailers in New Zealand. Profit margins have been calculated as the annual level of profitability as a percentage of the annual sales turnover. Three measures of profit margin have been calculated: Gross Profit (GP) margin, Earnings before Interest and Tax (EBIT) margin, and Net Profit after Tax (NPAT) margin. These have been assessed in terms of longer-term trends and against a sample of international grocery retailers' profit margins.

#### *Profit expectations for new investments*

- 3.30 We also examined the returns that the major grocery retailers expect to earn from proposed new investments, and the level of financial return that the major grocery retailers require for new business cases to be approved. This has been compared against the WACC of the firm.

#### **Excess returns appear to be persistent across the three major grocery retailers**

- 3.31 Our preliminary finding on profitability is that all three major grocery retailers are earning excess rates of return as measured by ROACE relative to their WACC, and that these levels of return appear to be persistent.

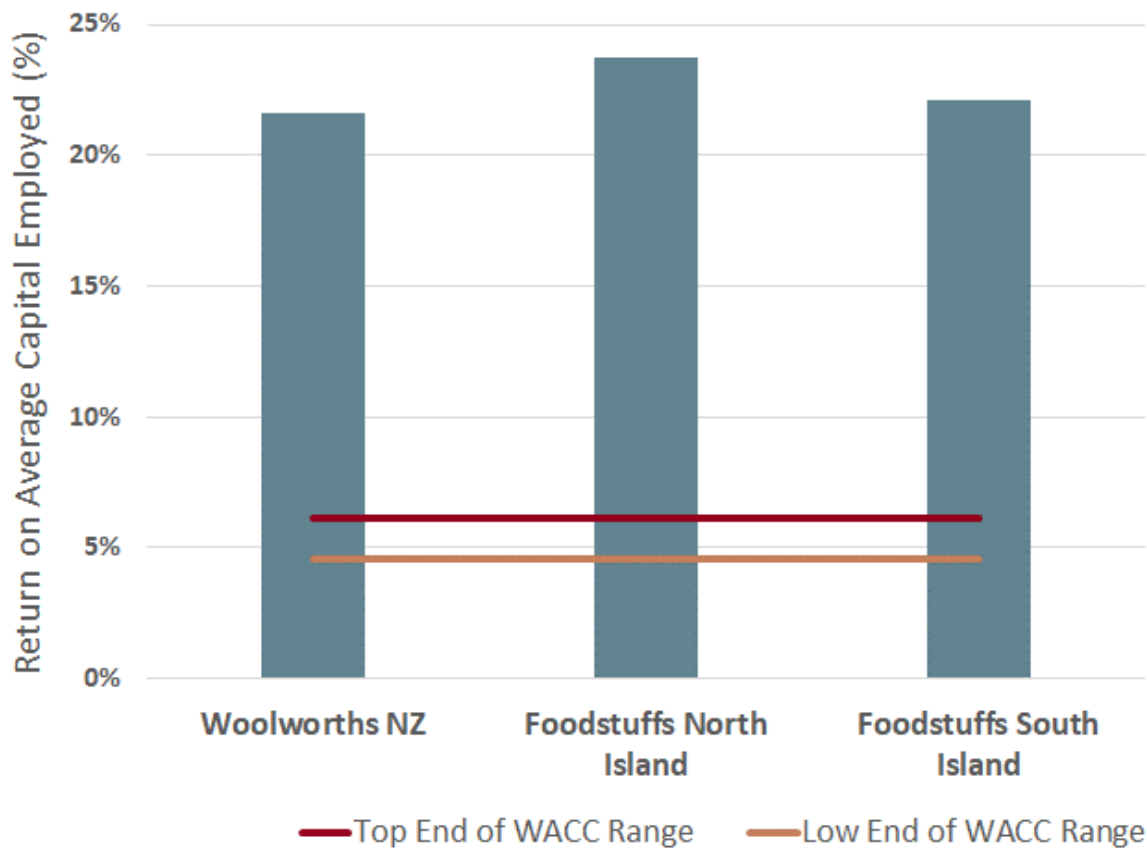


- 3.32 The ROACE profitability of the Foodstuffs co-operatives (as distinct from the stores within the co-operatives) was initially observed to be below the WACC range. This would have indicated the Foodstuffs co-operatives may be making economic losses, and there is a transfer of economic profit from the Foodstuffs co-operatives to the stores. However, these estimates did not include adjustments to market rates for certain transactions between the stores and their co-operatives. After these adjustments were made, the Foodstuffs co-operatives' profitability increased to a level within our estimate of WACC, while the ROACE profitability of the retail stores remains well in excess of our estimated WACC range.
- 3.33 The various profitability margins for the three major grocery retailers have been at relatively stable levels from 2010 to 2019. The analysis suggests that the New Zealand grocery retailers have been earning greater levels of profit margin over this period than a sample of international grocery retailers.
- 3.34 The profit expectations for new grocery retailing investments for all three major grocery retailers also appear to be in excess of WACC over the six years we have assessed them. In addition, based on the evidence we have seen, it appears that these profit expectations are being met once the investments are made.
- 3.35 Our preliminary view is therefore that the three major grocery retailers have consistently earned significant excess returns at least over the period 2015 to 2019. Our indicators suggest that similar excess returns have been earned since 2010. The persistence of these returns and their consistency across all three major grocery retailers suggests that competition is not working effectively for the long-term benefit of consumers.

#### **Major grocery retailers are earning excess levels of ROACE**

- 3.36 Our analysis shows the average estimate of ROACE for the three major grocery retailers from 2015 to 2019 was between 21.6% and 23.8%. This is in excess of our estimate of WACC for these companies, which is 4.6% to 6.1%. This is illustrated in Figure 3.2.

**Figure 3.2 Average ROACE for each major grocery retailer in New Zealand compared to WACC (2015-2019)**



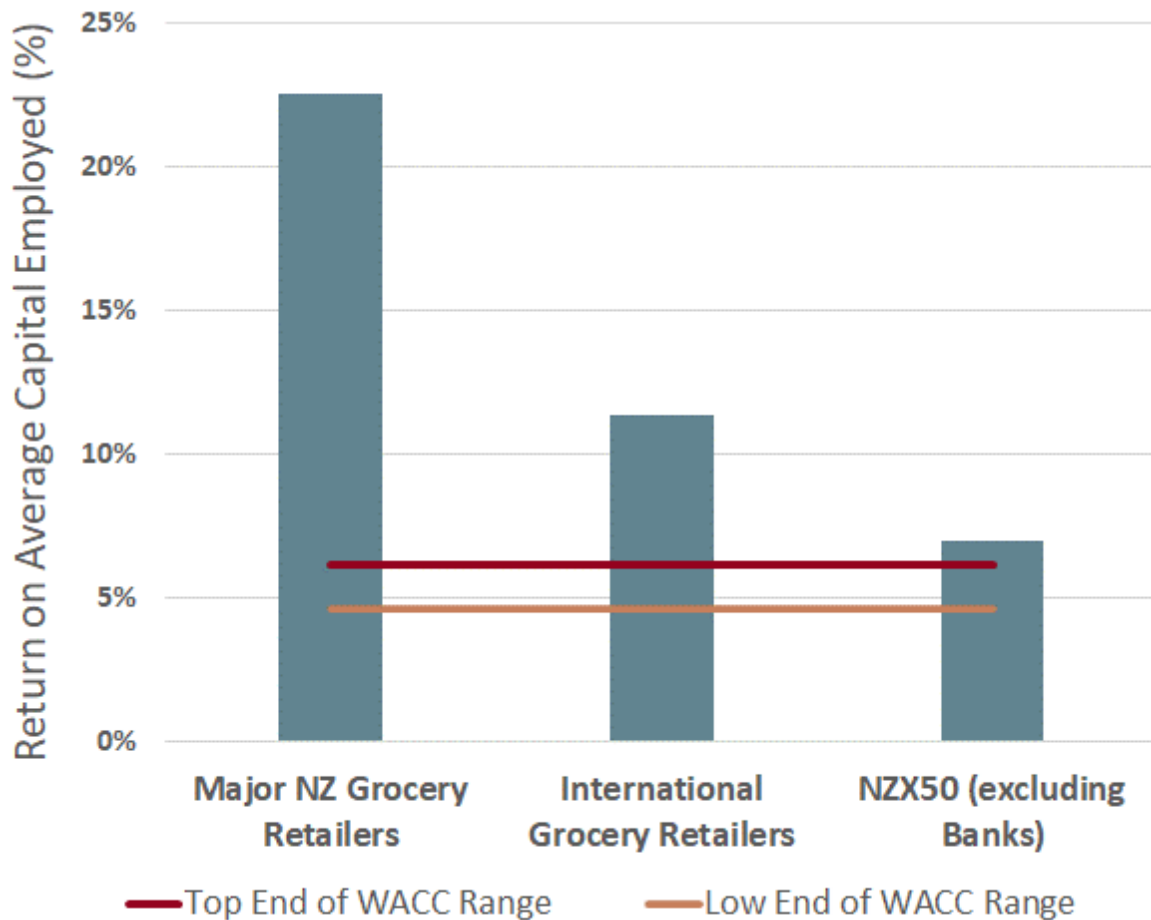
Source: Commerce Commission profitability analysis.<sup>80</sup>

3.37 We have also compared the average ROACE for the three major grocery retailers with the ROACE observed for international grocery retailers and the NZX50 over the same time period.<sup>81</sup> As shown in Figure 3.3 below, the three major grocery retailers' ROACE also exceed the returns shown from these comparator companies.

<sup>80</sup> [ ].

<sup>81</sup> The formula used for calculating the ROACE for our sample of international grocery retailers and NZX 50 listed companies is the same that we used for calculating the ROACE for the New Zealand grocery retailers. It removes goodwill from the assets employed. The overseas companies used in our sample are the same used in determining our estimate of WACC, which is described in Attachment C.

**Figure 3.3 Average ROACE for the three major grocery retailers in New Zealand compared with International grocery retailers, NZX returns and the top end of our WACC range (2015-2019)**



Source: Commerce Commission profitability analysis.<sup>82</sup>

#### *How we adjusted the data used in these results*

3.38 Figure 3.2 and Figure 3.3 above include several adjustments to the three major New Zealand grocery retailers' profit and the assets employed. We made these adjustments to ensure the earnings are based on assets that only relate to grocery retailing, and reflect the market value, or opportunity cost of the assets (or invested capital) being employed.

3.39 We also tested some of these results to understand the sensitivity of the stores' ROACE and to understand whether the relationship between the Foodstuffs member stores and their co-operative was distorting our ROACE analysis. The following paragraphs provide a summary of these adjustments and sensitivity tests, and more detailed discussion is provided in Attachment C.

### *Adjustments and tests to Woolworths NZ ROACE*

- 3.40 We made the following adjustments for Woolworths NZ:
- 3.40.1 Woolworths NZ's land and buildings are recorded at purchase price less depreciation based on its financial accounts. We adjusted this value upwards to reflect an estimate of their market value. The adjustment is based on a sample of property valuations relative to their purchase price (or book value) that the three major grocery retailers provided. This adjustment reduces the final ROACE estimate.
  - 3.40.2 We have not reflected the gain in the value of these assets in the ROACE because of a lack of robust data to estimate an annualised gain. This means that our final ROACE estimate may understate the true ROACE. However, we note that even with this, our ROACE estimate is significantly higher than our estimated WACC.
  - 3.40.3 We removed two non-grocery related subsidiaries from Woolworths NZ's financial accounts between 2015 and 2019. We determined that these two subsidiaries were material in size so removed them to ensure their business activities did not distort the ROACE results.
- 3.41 In addition to these adjustments, we also tested the sensitivity of Woolworths NZ's ROACE arising from the removal of goodwill from its asset base. As a starting point, we removed goodwill from ROACE. By definition, it does not constitute an asset in the operation of the underlying business that was employed to generate earnings. Rather it is an asset that reflects the differences in the book value of a business and the price it was purchased at, which could reflect a range of factors, including expectations relating to future earnings. We acknowledge that differences between book value and purchase price could be the result of book value undervaluing the assets of the business, which is why we adjusted book values as explained above.
- 3.42 Woolworths NZ considers goodwill should be retained in its assets employed when calculating the ROACE.<sup>83</sup> We do not agree with this approach. Nevertheless, we are concerned to ensure that our conclusions are not compromised by underestimating the value of Woolworths NZ's assets. As a sensitivity test, we tested the impact of a material increase in the total value of assets. We used an amount of \$300 million for this sensitivity test. This test is discussed in greater detail in Attachment C.
- 3.43 The inclusion of this amount reduces Woolworths NZ's average ROACE materially from an average of 21.6% to 16.5% for the period of 2015 to 2019. However, it is still significantly above our estimate of the WACC. (This sensitivity is not reflected in Figure 3.2 and Figure 3.3 above.) We therefore consider that even if we have understated the true asset value for Woolworths NZ, our overall finding that ROACE materially exceeds our estimate of WACC is robust.

*Adjustments and tests to Foodstuffs NI and Foodstuffs SI ROACE*

- 3.44 No adjustments to the capital value of Foodstuffs member stores were required given the store operators do not own the land and buildings they use. In addition, from our review of the financial statements of these stores, they do not appear to engage in any material business activities other than grocery retailing. A number of these companies operate Lotto franchises, retail fuel and other operations, but these are relatively small in scale.
- 3.45 However, we examined Foodstuffs member stores' financial interactions with their co-operative to understand whether the relationship between the retail stores and their co-operative was in any way distorting our ROACE analysis. The Foodstuffs co-operatives are both owned by the retail grocery stores and are service providers to the same retail grocery stores. This includes wholesale purchasing, warehousing, and distribution of groceries, and renting its properties to its members' stores. The individual stores pay the co-operatives for these services including rent.
- 3.46 We sought to understand whether any of these payments were distorting our assessment of profitability. We identified the following three (highlighted) areas for assessment.
- 3.46.1 We tested the **retail stores' rental payments** for the property they rent from the co-operatives. This was to ensure their rent reflects market-based costs. If these are not based on market rents it has the potential to distort the retail store profitability. For example, a lower rent charge will artificially inflate the stores' ROACE (and consequently lower the co-operatives profits).
- We examined market-based rents and observed that the rents charged by the Foodstuffs' co-operatives are materially lower. Increasing the rents paid by Foodstuffs' stores to these market-based levels lowered the stores' overall ROACE by around 3.1% to 20.1%.<sup>84</sup>
- 3.46.2 We tested **the costs that the co-operatives charge for wholesaling and distribution, and administration costs** like IT and marketing from the retail stores. We increased these costs to include the cost of capital associated with the assets employed in these services. This reduced the stores' average ROACE by around 1.2%.

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<sup>84</sup> We have been provided further information on store rents that indicates rent being charged to stores is closer to market rents. However, our analysis indicates that co-operative rents may still be below these market rates (see paragraph C177).

3.46.3 We also tested whether the **capital funding** that the Foodstuffs' stores are required to provide to their respective co-operatives is materially distorting their profitability.<sup>85</sup> This arrangement is not one that we would expect to ordinarily take place in normal commercial arrangements and could distort our assessment of profitability.<sup>86</sup> This is because it has the effect of increasing the store's total assets employed and artificially lowering the retail store's ROACE profitability.

To estimate the size of this effect, we examined a sample of Foodstuffs NI stores and removed the funding to the co-operative (called Discount Rebate Vouchers), along with the interest income the retail stores were receiving to understand the effects of this arrangement. Overall, this increased the sample's ROACE profitability by around 8.0%.

- 3.47 These three aspects of the Foodstuffs co-operative arrangements distort our assessment of ROACE. The combination of these three arrangements partially cancel each other out. If all of these adjustments were made the average store ROACE would increase by 3.7%.<sup>87</sup> Attachment C provides further details on these adjustments. On balance, we consider that these three aspects of the Foodstuffs co-operative arrangements are unlikely to be significantly distorting our findings about store profitability.
- 3.48 The ROACE profitability of the co-operative companies (as distinct from the Foodstuffs supermarkets) was also tested to assess whether they are making economic losses that disguise the true profitability of their respective retail grocery stores. The ROACE profitability of the co-operatives was observed to be below the WACC range, which indicates the co-operatives may be making economic losses, and there is a transfer of economic profit from the co-operatives to the stores.
- 3.49 When we adjusted the rents to reflect market rates and recovered the cost of capital for the co-operatives' wholesaling activities that support the retail stores, we observed the co-operatives' profitability increased to a level within our estimate of WACC, while the ROACE profitability of the retail stores still remained well in excess of its estimated WACC range. This result reinforces our view that our assessment of profitability appears unlikely to have been materially distorted by the nature of cost allocation between the co-operatives and the retail stores. Attachment C provides further details on this analysis.

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<sup>85</sup> [ ]

<sup>86</sup> It also has the effect of lowering the store's gross profit, which is observed when we assess Foodstuffs stores' gross profit margins later in this analysis.

<sup>87</sup> None of these tests are reflected in Figure 3.2 and Figure 3.3 above.

- 3.50 Therefore, in spite of the relationship between the co-operative and its member stores making it difficult to estimate the stand-alone ROACE profitability of the retail stores, it appears that overall the Foodstuffs NI and Foodstuffs SI networks (ie, the combination of the co-operative companies and their owner-operated stores) are making excess profits relative to their WACC and our store profitability estimates presented in Figure 3.2 above (which exclude any of the tests we have undertaken) are robust.

#### **Other grocery retailers we have analysed are also earning high levels of ROACE**

- 3.51 On average, the other grocery retailers we assessed have also earned ROACE returns in excess of our estimate of WACC – averaging around 14.8% between 2015 and 2019. However, this ROACE profitability has been more volatile over time. It has ranged anywhere between 3.6% to 28.9%. This may be partially due to their smaller scale and lower diversification resulting in greater earnings volatility than the major grocery retailers.
- 3.52 However, our estimate of WACC may not necessarily be appropriate for these other retailers. We are therefore unable to reach a conclusion about whether they are earning returns above WACC.

#### **Business cases show high expected rates of return**

- 3.53 We examined business cases for a range of proposed investments in grocery retailing activities by the three major grocery retailers. These have included new or rebuilt retail stores in a variety of locations, sizes, and types, as well as a small number of investments in grocery distribution centres. These business cases provide an insight into the forward-looking profit that the grocery retailers expect to earn from new investments, as well as the criteria they set for accepting or rejecting investment opportunities.
- 3.54 The weighted average Internal Rate of Return (IRR) expected from the business cases we have examined is between 15% and 25% per annum, compared to our estimated WACC range for New Zealand grocery retailers of 4.6% to 6.1%. This materially exceeds our estimated WACC range, for all years in the period from 2014 to 2019. This overall level of profit expectation is also consistent with the level of ROACE profitability that we observed earlier.
- 3.55 In the case of Foodstuffs, the IRR results described above relate to investments in the grocery retailing part of the businesses. They do not generally include those investments in land and buildings, or the property side of the business. Often the IRR returns from these investments is lower. However, we have not assessed these given they are not directly related to grocery retailing, and the investments are undertaken by the co-operative business and not the grocery store itself.

- 3.56 We have examined whether the relationship between expected and actual returns is overly optimistic. While we have been provided with a relatively small sample of post-investment reviews, these suggest that new investments in grocery retailing are meeting forecast profit expectations. Attachment C provides greater detail on the various aspects of this analysis.

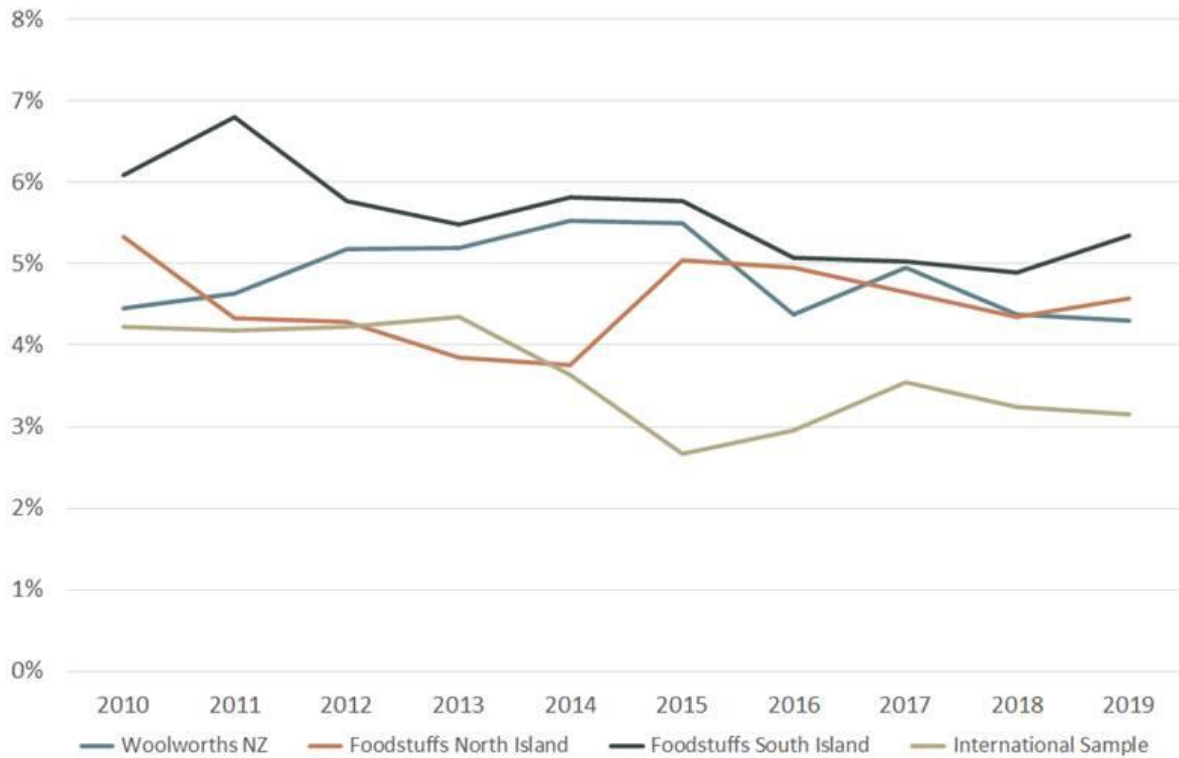
**Profit margins have been consistent over time and above international comparators**

- 3.57 While the ROACE profitability measure is our primary tool for assessing profitability, we have examined the profit margins of the three major grocery retailers to observe trends and to compare levels to a sample of 30 international grocery retailers. These come from a variety of OECD countries, including the United Kingdom (UK), Europe, the United States (US), Canada, Israel, and Turkey. These are the same companies that we used to develop our estimate of the WACC. They are described in greater detail in Attachment C.
- 3.58 Profit margins are assessed using accounting measures of profit as a percentage of the annual sales turnover. Three profit margins were assessed:
- 3.58.1 **GP margin:** GP margin is the gross profit a company makes after deducting the costs associated with purchasing its products and making them ready for sale. Put another way, it is the total sales revenue the company receives, less the total cost of the goods sold. The GP margin is the total GP divided by total sales for a financial year.
- 3.58.2 **EBIT margin:** EBIT is the profit a company has made before the interest expenses on debt and the tax on its profit have been paid. It reflects the amount of pre-tax profit that is available to service the providers of a company's debt and equity. The EBIT margin is the total EBIT divided by total sales for a financial year.
- 3.58.3 **NPAT margin:** NPAT is a company's profit after all costs, including taxation have been paid. The NPAT margin is the total NPAT divided by total sales for a financial year.
- 3.59 There are some caveats around the comparability of these profitability measures with international benchmarks, for example due to differences in tax regimes, whether the stores own the land and buildings they operate out of or lease them, and the relative scale of their typical operations. These are also accounting-based profit margins and do not necessarily inform us about the level of economic profits.
- 3.60 Nevertheless, the overall conclusion we draw from this analysis is New Zealand's major grocery retailers have usually been earning greater levels of profit margins than our overseas sample of retailers. These additional profit margins also appear to be persistent. While profit margins are not directly comparable to a ROACE in excess of WACC, it points to profits above those we would expect in markets with effective competition.



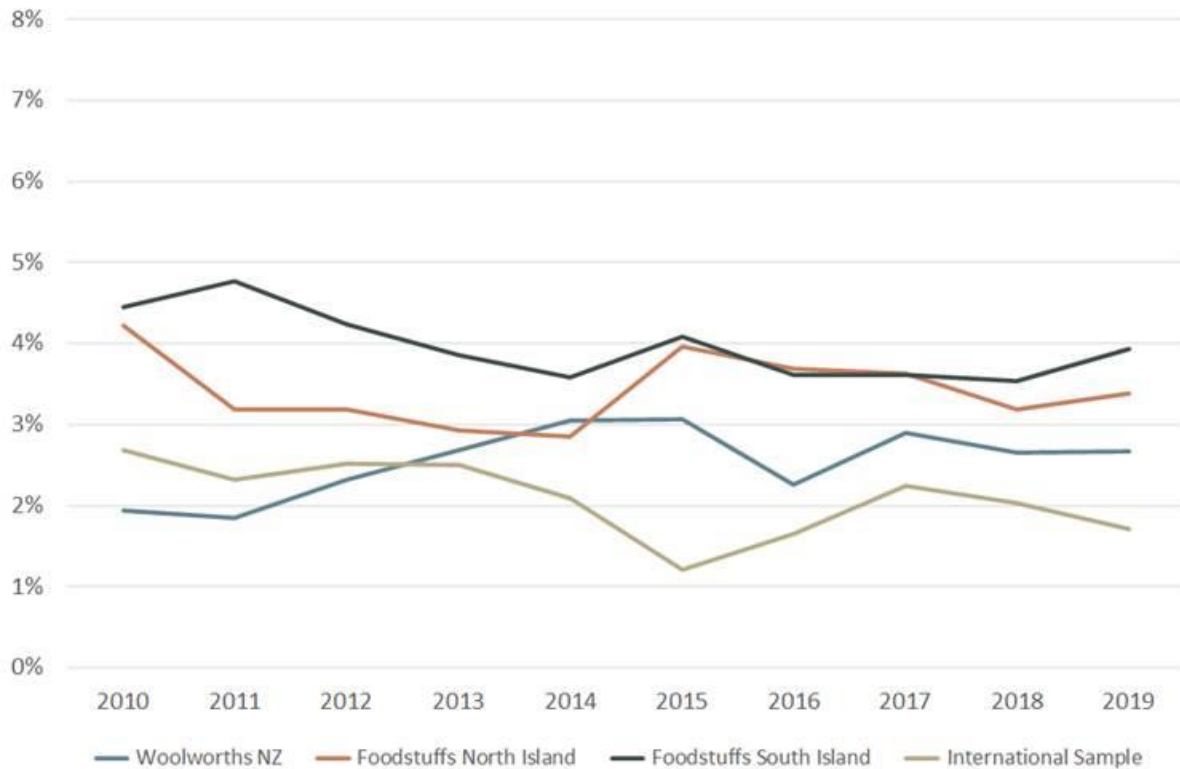
3.61 To illustrate, provided below in Figure 3.4 is the EBIT margin for the three major grocery retailers from 2010 to 2019 compared to the sample of international grocery retailers. As shown, their level of EBIT relative to their sales is materially above the international sample, and this is relatively constant over time.

**Figure 3.4 EBIT Profit Margin for the three major New Zealand grocery retailers relative to international grocery retailers (2010 to 2019)**



Source: Commerce Commission profitability analysis.<sup>88</sup>

3.62 Figure 3.5 also shows a similar trend, with the Foodstuffs member stores and Woolworths NZ having higher NPAT profit margins than the international sample.

**Figure 3.5 NPAT Profit Margin: New Zealand retailers versus International retailers**

Source: Commerce Commission profitability analysis.<sup>89</sup>

### Our overall preliminary findings on profitability

- 3.63 We have observed levels of profit being earned by all of the major grocery retailers that are persistently above what we consider we would observe in a market with effective competition. Absent of entry to the market by new competitors or intervention, these returns are expected to continue into at least the near-to-medium term future. This would suggest that there are impediments to competition for the long-term benefit of consumers.
- 3.64 These levels of profit have been observed using a variety of profitability measures, including the following:
- 3.64.1 the ROACE profitability measure is persistently above our estimate of normal return for this type of business (the WACC) for all three of the major grocery retailers in all of the years reviewed;
  - 3.64.2 the expected profits from new grocery retailing investments that are proposed in business cases are at similar levels to ROACE, and these profit expectations appear to be being met; and

<sup>89</sup>

[ ].

- 3.64.3 the profit margins for the three major grocery retailers are typically higher over time than the margins earned by a sample of international grocery retailers.

### Price outcomes

- 3.65 When competition in a market is not working well, firms have weakened incentives to compete on price, and in the long run we would expect prices to be higher than in a market where competition is working effectively.
- 3.66 Even in competitive markets, prices are likely to be impacted by a range of factors in addition to the level of competition. These include factors such as input costs and scale economies. Given the potential link between prices and competition, we have sought to understand public perceptions of price, as well as how New Zealand grocery prices compare to those overseas.
- 3.67 Information suggests that consumers consider grocery prices in New Zealand are high. Our analysis of international prices supports this view by suggesting that New Zealand's grocery prices appear to be high by international standards. A number of datasets that we have considered show that New Zealand ranks highly in terms of the prices of grocery products and the consumer expenditure on groceries.
- 3.68 When we compare New Zealand to a smaller subset of potentially more comparable countries, New Zealand still ranks highly (although is not the highest).
- 3.69 While a range of other factors may also influence price, our analysis of profitability and our analysis of competition later in this report, leads to our preliminary view that a lack of effective competition is contributing to higher grocery prices in New Zealand than we would expect in a workably competitive market.
- 3.70 The remainder of this section covers:
- 3.70.1 public perceptions of grocery prices; and
- 3.70.2 international price comparisons.

### Public perceptions of grocery prices

- 3.71 Some participants in our consumer research perceived some price variation depending on the area or store.<sup>90</sup> We have seen some price variability across different retail banners, as well as small differences in average prices by region. Prices relative to Auckland are higher in the South Island and the Central and Lower North Island.<sup>91, 92</sup> Chapter 4 provides further analysis of regional price differences and average prices across the retail banners.

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<sup>90</sup> See Attachment F.

<sup>91</sup> [ ].

<sup>92</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 18-33.

- 3.72 Despite this variation, media reports often point to the higher number of grocery store chains and alleged lower prices in other countries to indicate that New Zealand's grocery market is not operating competitively. These reports sometimes include ad hoc comparisons of prices between countries on selected products.<sup>93</sup>
- 3.73 Some participants in our consumer research perceived the overall price of groceries in New Zealand to be high.<sup>94, 95</sup> For example, comparisons were made by some participants to lower prices being available in other countries they have lived in, such as Australia and the UK. Further, some participants told us that they thought a lack of competition was the reason for prices being high.<sup>96</sup>
- 3.74 Complaints made to the Commission include complaints that grocery prices are unreasonably high. Complainants allege that some products are significantly more expensive in New Zealand than they are overseas or that they are sold at "too high" a profit.<sup>97</sup>
- 3.75 Each of these sources of anecdotal comment, and perception and complaint represent consumer perception only. They do not provide evidence that prices are in fact higher than we might expect in a workably competitive market. However, they do provide us with a view of consumers' confidence in the effect of competition in the market.<sup>98</sup>

### **International price comparisons**

- 3.76 To test how accurate these perceptions are, we sought to compare grocery prices in New Zealand with grocery prices internationally. Public perceptions of high prices appear to be supported by our analysis of publicly available datasets of international grocery prices and expenditures.
- 3.77 Our analysis of OECD, International Comparisons Program (ICP), Numbeo, and US Department of Agriculture (USDA) datasets indicates that New Zealand ranked within the top 10 most expensive grocery markets out of all 38 OECD countries in 2017.
- 3.78 Out of OECD countries, New Zealand ranked sixth highest in terms of grocery prices, as well as fourth and fifth highest in terms of grocery expenditures in the OECD and ICP datasets respectively. We consider these datasets to be the most reliable datasets of grocery prices due to their use of official data sources.

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<sup>93</sup> For example: Ernie Newman "Supermarkets: The outrageously high prices we pay for groceries can be fixed" (1 December 2020) Stuff <https://www.stuff.co.nz/business/opinion-analysis/300171098/supermarkets-the-outrageously-high-prices-we-pay-for-groceries-can-be-fixed>.

<sup>94</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 13.

<sup>95</sup> See paragraph F159 in Attachment F.

<sup>96</sup> See paragraph F158 in Attachment F.

<sup>97</sup> See paragraph 7.198.2.

<sup>98</sup> A complaint also does not necessarily mean that any law has been breached, rather it relates to alleged conduct by the trader.

- 3.79 While this data is several years old, we are not aware of any reason why the rankings would have changed significantly in that time.
- 3.80 We summarise the results of this analysis below. Attachment D provides further information about our analysis.

*Submissions on international price comparisons*

- 3.81 Major grocery retailers submitted that international price comparisons are difficult to conduct and may not be helpful. Foodstuffs SI and Foodstuffs NI noted that there are a number of technical challenges with inferring anything about competition from a comparison of prices domestically, with even more challenges comparing prices internationally.<sup>99</sup> In its submission, Woolworths NZ also stated that there are significant difficulties in making international price comparisons.<sup>100</sup>
- 3.82 Nevertheless, Woolworths NZ commissioned analysis from NERA Economic Consulting (NERA) and submitted NERA's report to us (the NERA report) as part of its submission on our preliminary issues paper. The NERA report suggests that grocery prices in New Zealand are not high compared to other countries. We discuss the analysis contained in the NERA report in more detail below.<sup>101</sup>
- 3.83 We also received a number of other submissions on international price comparisons:
- 3.83.1 many submitters told us that prices were high in New Zealand relative to other countries;<sup>102</sup>
- 3.83.2 Consumer NZ based their finding of high prices on a price comparison of 20 identical "Homebrand" and "Woolworths Select" products sold in both New Zealand and Australia.<sup>103</sup> Our preliminary view is that it is unlikely that we can infer an overall price difference for groceries from this comparison; and

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<sup>99</sup> Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 13; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 21.

<sup>100</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 33.

<sup>101</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking" (4 February 2021) at [3]-[10].

<sup>102</sup> The Warehouse Group "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [1]; NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [24]; Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [25]-[28].

<sup>103</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [25]-[28].

- 3.83.3 the NZFGC submitted preliminary analysis conducted by Coriolis saying that there is a price difference between New Zealand and the US of approximately 2-6% that is driven by competition factors ("duopoly premium" and "lack of retail format diversity").<sup>104</sup>

*Our approach to making international price comparisons*

- 3.84 We acknowledge that it is not straightforward to compare price levels between countries.
- 3.85 In our fuel market study we noted several other factors may complicate price comparisons.<sup>105</sup>
- 3.85.1 The choice of currency conversion method can potentially distort comparisons. Annual average exchange rates were used in our fuel market study to control for this rather than purchasing power parities (PPP).
- 3.85.2 Factors other than competition are likely to affect prices relative to other countries. Examples of these for New Zealand may include our geographic isolation, biosecurity regulations, labour and distribution costs.
- 3.85.3 Differences in methodologies used to collect prices for national datasets, may decrease the accuracy of results.
- 3.85.4 Taxation on products, may differ across countries.
- 3.86 Further, grocery products are not homogeneous. Lack of homogeneity makes international comparison of grocery prices more difficult because:
- 3.86.1 prices of potentially thousands of heterogeneous products need to be combined into a single average price for that country;
- 3.86.2 variation of quality and range of goods across grocery products may mean that apparently similar price levels mask substantially different outcomes for consumers;
- 3.86.3 consumer preferences and availability of different products in different countries likely further decreases the comparability of prices, as different countries may be consuming different goods; and
- 3.86.4 taxation rates may differ between different grocery products, making comparisons more complex.

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<sup>104</sup> NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [23].

<sup>105</sup> Commerce Commission "Market Study into the retail fuel sector – Final report" (5 December 2019) at 121, available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0028/193915/Retail-fuel-market-study-Final-report-5-December-2019.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0028/193915/Retail-fuel-market-study-Final-report-5-December-2019.PDF).

- 3.87 Acknowledging the difficulties outlined above, we have focussed our analysis on any insights that could be gained from existing international datasets of grocery prices. These are presented as price-level indices for grocery items. We also considered existing datasets of per capita expenditure on groceries.
- 3.88 Price-level indices, which are averages of the prices paid by consumers, can be compared to other countries. Expenditures are the amount that an average consumer would spend on a range of products over a given year. When prices are higher, we would expect that consumers will spend more on groceries, and that expenditures would also be higher.
- 3.89 When comparing prices between countries, prices need to be converted into a common unit as different countries use different currencies. Prices can be converted either using the market exchange rate, or by using PPP.
- 3.89.1 The market exchange rate is the rate of conversion between currencies that is offered on the foreign exchange market. This rate is used to convert currencies involving transactions overseas, as it reflects the actual prices paid by importers and exporters for foreign goods.
- 3.89.2 PPP is a rate for converting currencies that aims to remove price differences between countries. It is calculated by dividing the market exchange rate by the overall price level of the economy. This means that when prices are converted using PPP, the same amount of currency in one country would be able to purchase, on average, the same amount of goods in all other countries. PPP is often used when comparing the relative size of economies because it compares all currencies in terms of the amount of goods that an economy can purchase.
- 3.90 We chose to use annual average market exchange rates to convert prices. This was the same approach adopted in our fuel market study. We consider that grocery products are largely tradeable and therefore the alternative PPP method for converting currencies would not be an appropriate method. We also note that PPP methods might reduce the price effects we are interested in if the expenditure items are sufficiently large as they are themselves obtained using price-level indices from the country in question. More information about how we converted prices is available in Attachment D.
- 3.91 We used four datasets for our analysis. These are those produced by:
- 3.91.1 the OECD – price and expenditure statistics;<sup>106</sup>
- 3.91.2 the ICP – price and expenditure statistics;<sup>107</sup>

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<sup>106</sup> OECD.Stat “2017 PPP Benchmark results” (2020)

<https://stats.oecd.org/Index.aspx?DataSetCode=PPP2017>.

<sup>107</sup> World Bank “Databank | ICP 2017” (2020) <https://databank.worldbank.org/source/icp-2017>.

- 3.91.3 Numbeo – price statistics;<sup>108</sup> and
- 3.91.4 the USDA – expenditure statistics.<sup>109</sup>
- 3.92 We consider that the OECD and ICP datasets are likely to be the most reliable sources for price comparisons because they are created with price data collected from stores by national statistical organisations over a long period of time. In contrast, data contained in other datasets are not collected by national statistical organisations and may include crowd-sourced price data. Further detail on why we consider the OECD and ICP to be the most reliable sources is included in Attachment D.
- 3.93 The most recent pricing datasets from the OECD and ICP are available for 2017, and from Numbeo for 2021. The latest expenditure datasets that include New Zealand are available for 2019 from the OECD dataset, 2018 for the USDA dataset, and 2017 for the ICP dataset.
- 3.94 Our approach was to compare prices and expenditures for the most recent year where all datasets were available. We then tested our pricing analysis against more recently available datasets.
- 3.95 We also considered the analysis underlying the NERA report submitted by Woolworths NZ in its response to our preliminary issues paper.<sup>110</sup> NERA used a dataset created by the Economist Intelligence Unit that had data from as recently as 2020, but for the reasons set out in paragraphs 3.119 to 3.130, we do not consider that the results are likely to be reflective of differences in pricing levels between countries.
- 3.96 These datasets include a range of products sold at supermarkets, but some datasets exclude some categories of products such as personal health or cleaning products. Further details on the product lists included in datasets is provided in Attachment D.

*New Zealand’s grocery prices rank highly among OECD countries*

- 3.97 New Zealand ranked highly among OECD countries in terms of prices of grocery items using each of the OECD, ICP and Numbeo datasets.
- 3.98 Price levels for food and beverages (alcoholic and non-alcoholic) for OECD countries using the ICP and OECD datasets for 2017 are shown in Figure 3.6, as a percentage difference compared to New Zealand’s price level.

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<sup>108</sup> Numbeo “Groceries Index by Country 2017” (2017) [https://www.numbeo.com/cost-of-living/rankings\\_by\\_country.jsp?title=2017&displayColumn=3](https://www.numbeo.com/cost-of-living/rankings_by_country.jsp?title=2017&displayColumn=3).

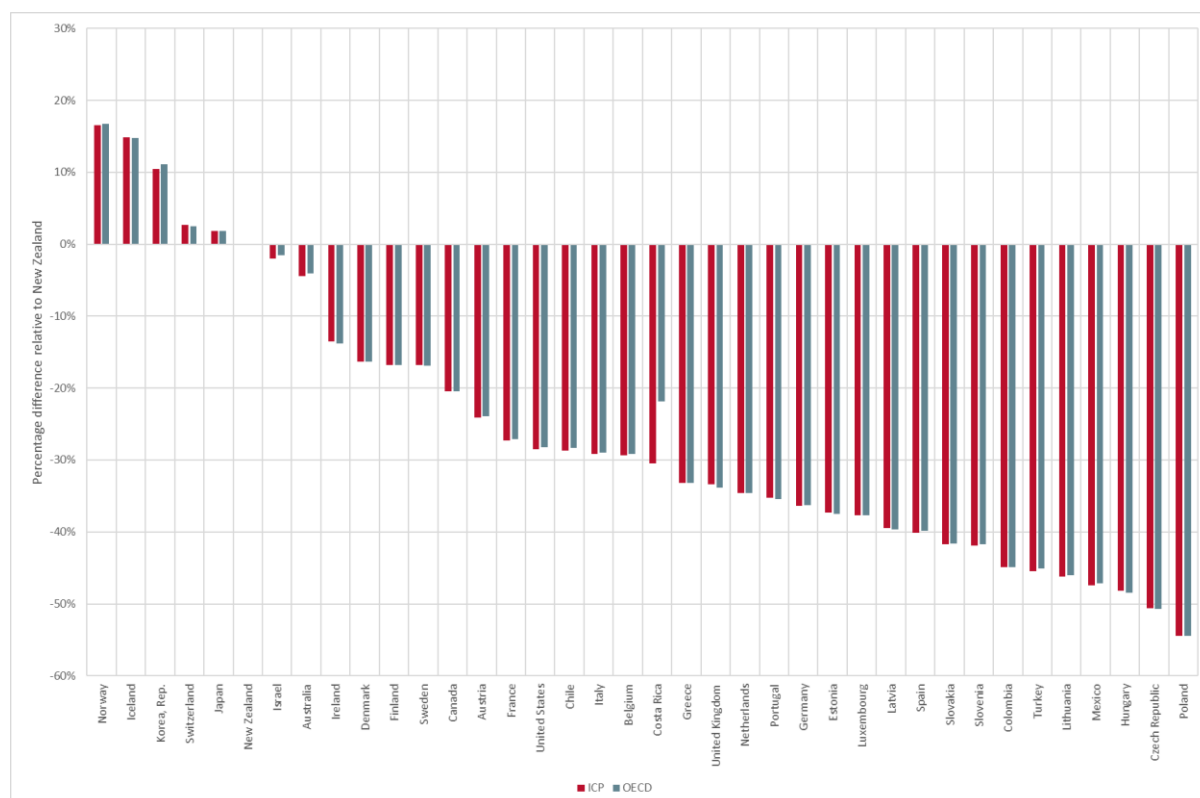
<sup>109</sup> USDA “Data on expenditures on food and alcoholic beverages in selected countries: 2013-2018” (2019) [https://www.ers.usda.gov/media/10271/2013-2018-food-spending\\_update-april-2019.xls](https://www.ers.usda.gov/media/10271/2013-2018-food-spending_update-april-2019.xls).

<sup>110</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021).



- 3.99 We also examined price levels shown by the Numbeo dataset, between 2016 and 2021, which is shown in Attachment D.
- 3.100 Although relative price levels differ between the ICP, OECD, and Numbeo, all three datasets appear to be generally consistent in whether or not OECD countries have more or less expensive grocery prices than New Zealand.

**Figure 3.6 Percentage difference in food, beverages (alcoholic and non-alcoholic) and tobacco prices compared to New Zealand (NZ = 0, market exchange rate, 2017)**



Source: Commission analysis of ICP and OECD datasets.<sup>111</sup>

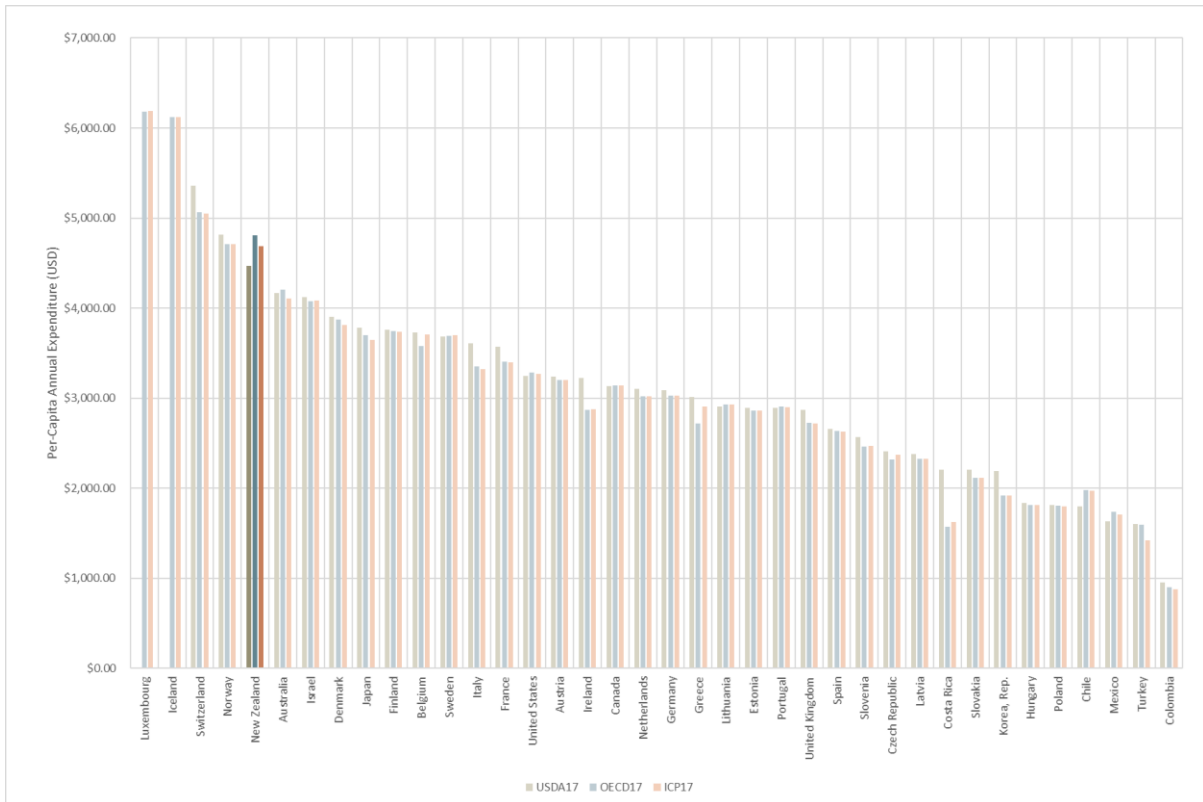
- 3.101 The ICP and OECD datasets indicate that New Zealand was the sixth and seventh most expensive grocery market in the OECD in 2017 respectively. In Figure 3.8, when alcohol and tobacco are excluded New Zealand's ranking in the ICP dataset, New Zealand's grocery price ranking slips to seventh. This suggests that while alcohol and tobacco prices may be relatively high in New Zealand, this is not a significant factor in New Zealand's overall high ranking.
- 3.102 In the Numbeo dataset between 2016 and 2021, New Zealand ranked between eighth and 11<sup>th</sup> highest out of OECD countries included. This provides some evidence that New Zealand's grocery price rankings have not changed significantly since 2017. These rankings can be found in Attachment D.

*New Zealand’s expenditure per capita on groceries also ranks highly among OECD countries*

3.103 New Zealand also ranked highly among OECD countries in terms of expenditures on grocery items using each of the OECD, ICP and USDA datasets. Regardless of the dataset used, New Zealand’s expenditure per capita on grocery products was at least the fifth highest in the OECD in 2017.

3.104 Figure 3.7 below shows per capita spending on food, beverages, and tobacco in 2017 for the OECD, ICP, and USDA datasets.

**Figure 3.7 Per capita expenditures on food, beverages (alcoholic and non-alcoholic) and tobacco (USD, 2017)**



Source: Commission analysis of ICP, OECD and USDA datasets.<sup>112</sup>

3.105 Our findings on expenditure are consistent with our findings using price-level datasets. New Zealand’s relatively high per capita spending on food potentially indicates that prices in New Zealand are high relative to other countries.

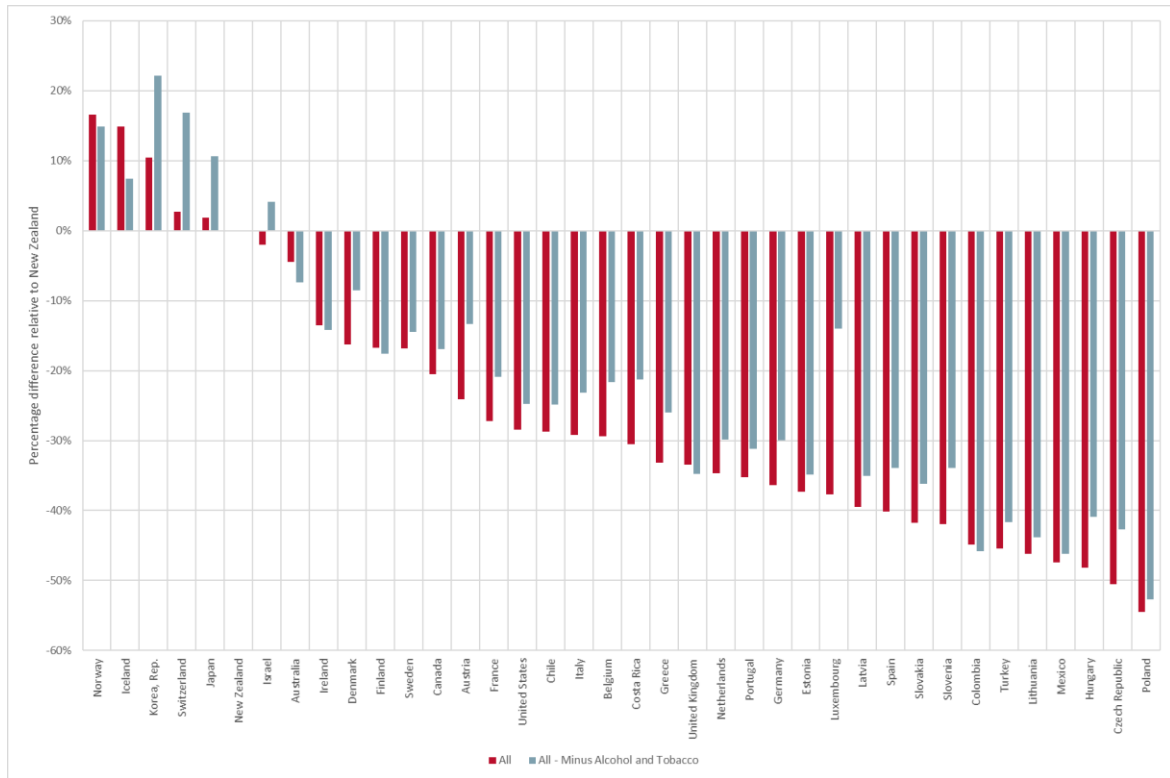
3.106 We consider that New Zealand’s ranking for grocery expenditure appears to have been consistent since 2017. In Attachment D, we show that New Zealand’s grocery expenditures relative to other countries remains relatively high even when looking at more recent datasets.

<sup>112</sup> World Bank “Databank | ICP 2017” (2020) <https://databank.worldbank.org/source/icp-2017>; [ ].

*New Zealand's grocery prices remain comparatively high when alcohol and tobacco are removed*

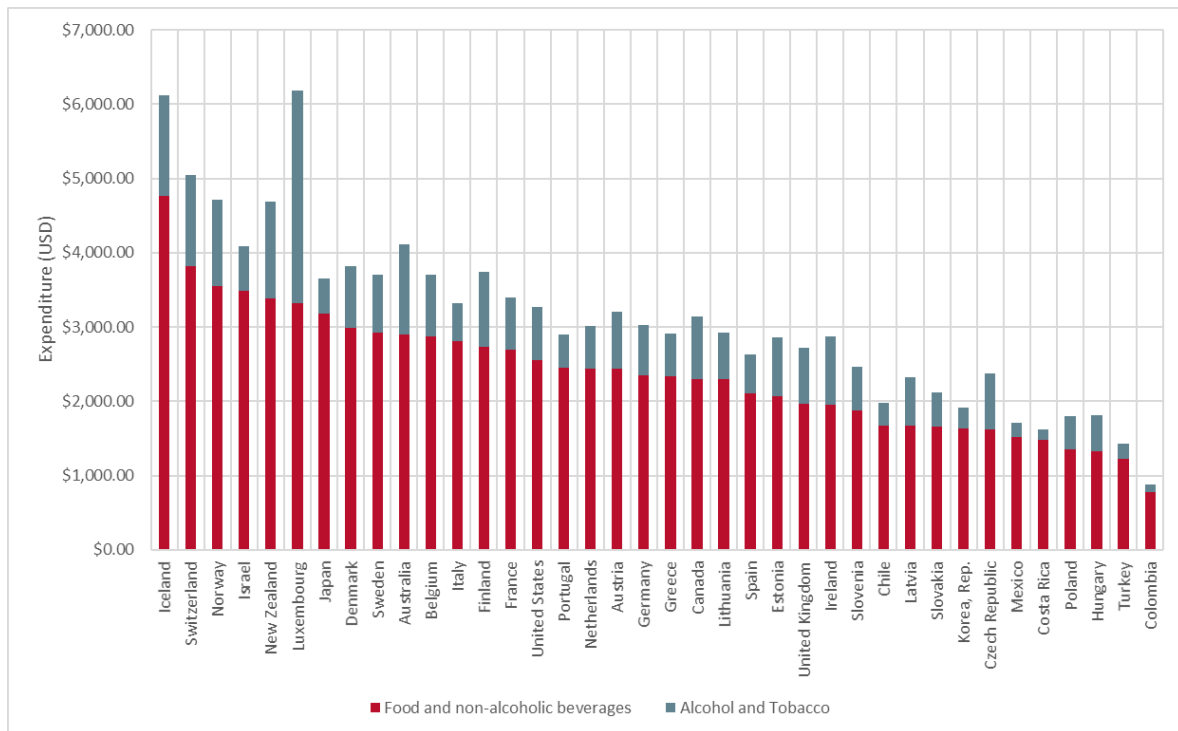
- 3.107 New Zealand grocery prices and expenditure are high in comparison to other OECD countries, even when alcohol and tobacco are removed. We considered this effect in both the ICP and OECD datasets, and found that the removal of alcohol and tobacco had similar effects in both datasets. We present data from the ICP dataset in Figure 3.8 and Figure 3.9 below, and from the OECD dataset in Attachment D.
- 3.108 When alcohol and tobacco are removed from comparisons, New Zealand has the seventh most expensive grocery prices in the OECD in both the OECD and ICP datasets. New Zealand also spends the fourth and fifth most on groceries in the OECD when alcohol and tobacco are removed, in the OECD and ICP datasets respectively.
- 3.109 Figure 3.8 below shows a price level for groceries calculated with and without alcohol and tobacco using the ICP dataset. This graph compares the price level of food and non-alcoholic beverages with the price level for food, beverages (alcoholic and non-alcoholic), and tobacco for 2017.
- 3.110 Figure 3.9 below shows per capita grocery expenditures, calculated with and without alcohol and tobacco using the ICP dataset. This graph shows the division of grocery expenditure between those two categories for 2017.

**Figure 3.8 Percentage difference in grocery prices, inclusive and exclusive of alcohol (NZ = 0, market exchange rate)**



Source: Commission analysis of ICP dataset.<sup>113</sup>

**Figure 3.9 Per capita grocery expenditures, inclusive and exclusive of alcohol and tobacco (USD, 2017)**



Source: Commission analysis of ICP dataset.<sup>114</sup>

3.111 Figure 3.9 suggests that the relatively high grocery prices in New Zealand are unlikely to be driven by higher alcohol and tobacco prices.

*Comparison to a subset of countries likely to be more similar to New Zealand*

3.112 As noted previously, there are a range of potential reasons why prices may be higher in New Zealand than in some other countries. For example, costs may vary depending on the size and scale of a country.

3.113 It is not possible to determine exactly how much of the price differences we observe can be attributed to inter-country differences in competition or any other factors. However, we compared New Zealand prices to a smaller subset of countries that we considered likely to be most comparable to New Zealand in terms of scale and size.

3.114 We selected comparators by looking for OECD countries that, on the face of it, could face similar demand and supply factors to New Zealand. The countries we selected were:

3.114.1 Australia;

3.114.2 Finland;

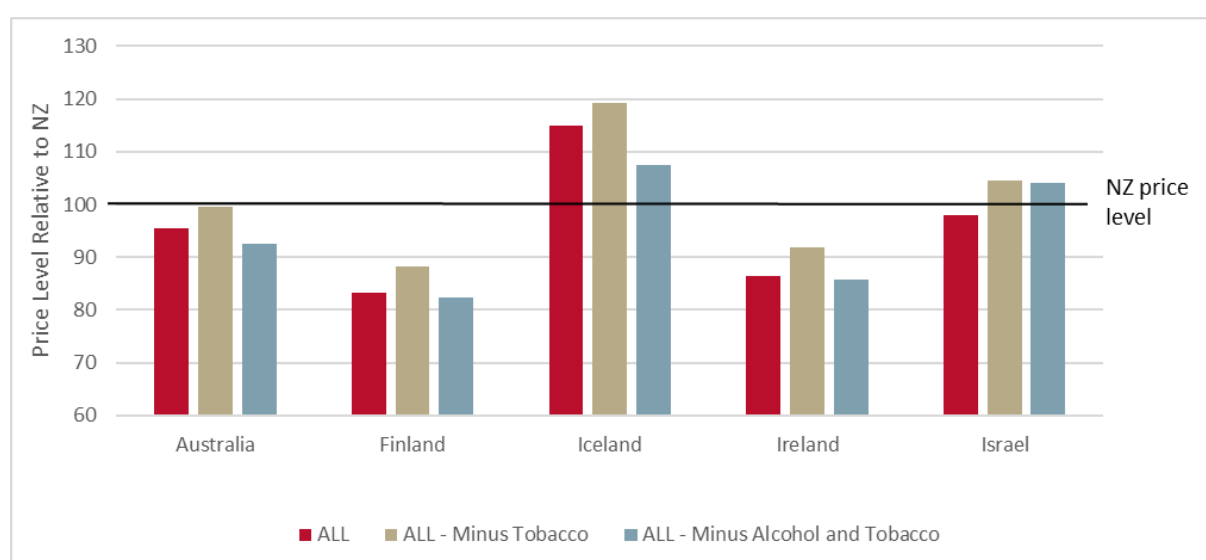
3.114.3 Iceland;

3.114.4 Ireland; and

3.114.5 Israel.

3.115 Figure 3.10 below shows a comparison of New Zealand prices with this smaller set of countries using the ICP dataset for 2017. New Zealand prices are still higher than the average for this smaller comparator group, although the result varies depending on whether alcohol and tobacco are included.

**Figure 3.10 Comparing price levels across different categories (NZ=100, tax inclusive, 2017)<sup>115</sup>**



Source: Commission analysis of ICP dataset.<sup>116</sup>

3.116 Overall, Iceland is the only country out of our set of comparators that has more expensive grocery prices in all categories. Israel has more expensive prices than New Zealand when alcohol and tobacco are removed, but not when they are included. Moreover, New Zealand appears to have more expensive grocery prices than Australia, Finland, and Ireland, regardless of which categories are excluded.

3.117 The inclusion of alcohol and tobacco appear to affect results. We also note that since 2017, there have been changes to New Zealand's taxes on tobacco, which may mean that the relative price levels that include tobacco could have changed since 2017.<sup>117</sup>

<sup>115</sup> "ALL" refers to: food, beverages (alcoholic and non-alcoholic), and tobacco.

<sup>116</sup> [ ].

<sup>117</sup> Ministry of Health "Tobacco excise tax evaluation" (2018), available at: <https://www.health.govt.nz/our-work/preventative-health-wellness/tobacco-control/smokefree-aotearoa-2025/tobacco-excise-tax-evaluation>.

- 3.118 More detail of the process we used to select comparators can be found in Attachment D.

*NERA/Woolworths NZ submission on our preliminary issues paper*

- 3.119 The NERA report submitted by Woolworths NZ also compared grocery prices internationally. The NERA report uses Economist Intelligence Unit (EIU) data for 2020 and 2019 while the most recent data included in the datasets we used is for 2017.<sup>118</sup> NERA analyses prices for the cities of Wellington and Auckland rather than New Zealand overall and compares these with cities overseas.
- 3.120 Instead of creating an average price like the agencies compiling the other datasets, NERA uses a ranking system to compare international grocery prices. First, it ranks each city by price for each product. The medians of these product rankings are then used to compare price levels for each city.
- 3.121 We understand the EIU data is collected by twice-yearly price surveys.<sup>119</sup>
- 3.122 Figure 3.11 and Figure 3.12 below show the analysis that was presented in the NERA report.<sup>120</sup> These figures show the distribution of product price rankings for each city as a box and whisker plot. They are sorted by the median ranking of product prices that a city receives.
- 3.123 Figure 3.11 shows that Auckland has a relatively inexpensive grocery market in comparison to cities that the EIU considers to be “metro” cities, while Figure 3.12 shows the same for Wellington, in comparison to cities that the EIU considers to be “non-metro” cities.

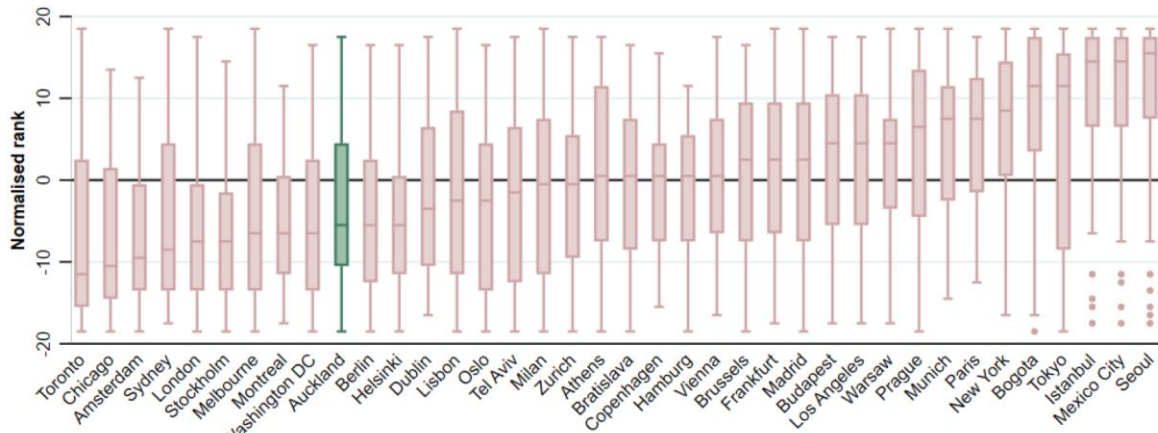
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<sup>118</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021) at [6]-[10].

<sup>119</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021) at [5].

<sup>120</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021) at [5.3] and [5.6].

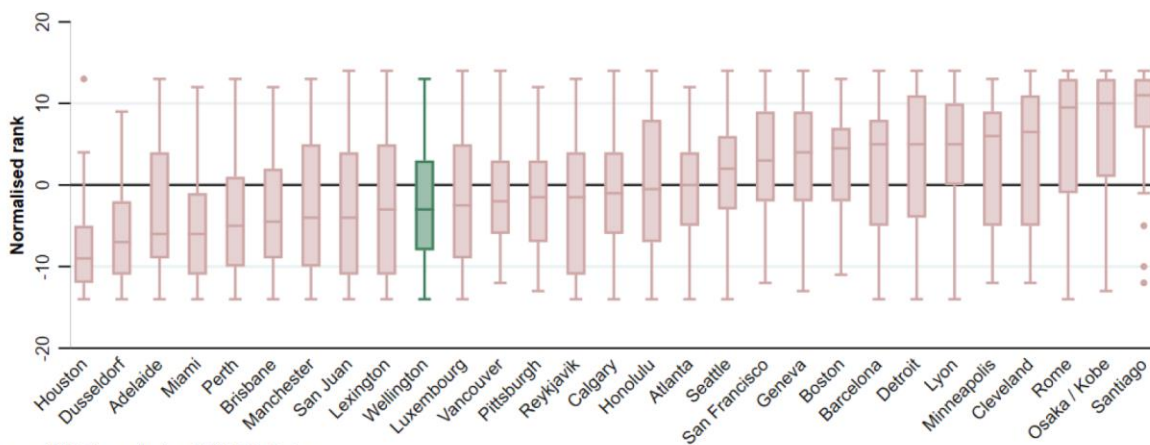
**Figure 3.11 Distribution of average product price ranks in PPP for available OECD cities  
By cities with prices collected in the metro area, 2020**



Source: NERA analysis of EIU CityData.

Source: NERA report on grocery price benchmarking.<sup>121</sup>

**Figure 3.12 Distribution of average product price ranks in PPP for available OECD cities  
By cities with prices collected in the non-metro area, 2020**



Source: NERA analysis of EIU CityData.

Source: NERA report on grocery price benchmarking.<sup>122</sup>

<sup>121</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021) at Figure 5.3.

<sup>122</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021) at Figure 5.6.



- 3.124 NERA considers it most appropriate to use a PPP to convert prices into a common currency because the supermarket and grocery store industry is non-tradeable.<sup>123</sup> While it is true that the stores themselves are not tradeable, we consider that market exchange rates are likely to be more appropriate for this analysis than PPP.<sup>124</sup> While retailing is in the non-tradeable sector, grocery products themselves are largely tradeable and PPP methods may partially eliminate the price effects (since they are themselves obtained using price indices).
- 3.125 Furthermore, it is unclear whether the ranking mechanism used by NERA is appropriate for making pricing comparisons. The ranking mechanism may limit the influence of very cheap or expensive goods that might be a large share of expenditure, meaning that the median ranking of prices may not represent consumer experiences at grocery stores. Further, consumers generally purchase a range of grocery items, not a single “median” item, so there is a strong rationale for using averages across grocery items as the appropriate measure of central tendency.
- 3.126 Given our reservations with NERA’s use of the EIU data, but noting that it was more recent than what we consider to be our most reliable data sources, we replicated NERA’s analysis using the EIU data for 2017 and 2018. We then compared the results to the analysis presented in the NERA report for 2019 and 2020.
- 3.127 For both Auckland and Wellington, the relative rankings are similar for every year from 2017 through 2020. In all years, Auckland is ranked between the fifth and 10<sup>th</sup> cheapest city out of the “metro cities” category in the EIU dataset. A similar result can be found for Wellington in the categories of non-metro cities.
- 3.128 We also conducted some sensitivity analysis to understand the potential impact of using PPP and the ranking mechanism used by NERA. We found:
- 3.128.1 using nominal exchange rates rather than PPP to convert currencies, causes an increase in the grocery price ranking of Auckland although a similar effect does not occur for Wellington; and
  - 3.128.2 we calculated mean prices for the grocery products included in NERA’s analysis. Using this method, we note an increase in the ranking of Auckland and, to an even larger extent Wellington. Attachment D contains more detail on this analysis.
- 3.129 This suggests that the differences in our and NERA’s findings are likely driven by differences in the methodology and, to a lesser extent, the datasets used.

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<sup>123</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021) at [12].

<sup>124</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper: Attachment 1 – NERA Economic Consulting, Grocery price benchmarking” (4 February 2021) at [12].

- 3.130 Our preliminary view is therefore that limited weight can be placed on the analysis in the NERA report when considering how New Zealand grocery prices compare internationally, due to the dataset not being produced by National Statistic Agencies, the use of PPP as opposed to exchange rates and the use of a ranking system by product rather than weighted average of prices.

### **Quality, range, and service outcomes**

- 3.131 When competition is working well we expect markets to deliver outcomes consistent with consumer preferences, including quality that corresponds to the prices charged, a range of products and level of customer service that best meets consumer wants and needs.
- 3.132 In their submissions in response to our preliminary issues paper, the major grocery retailers emphasised that competition occurred across all aspects of grocery retail, including quality, range and service (QRS) and that consumers were offered a large range of choices and high-quality products and service.<sup>125</sup>
- 3.133 Chapter 4 includes analysis of how supermarkets compete across a wide range of elements (including QRS) to meet diverse consumer needs, and acknowledges that we have observed competitive responses from retailers among these dimensions. Much of the innovation engaged in by the major grocery retailers targets competition on these elements and we discuss this further below.
- 3.134 Some consumers have shared their views of QRS through our consumer survey and the Ipsos report. These are insightful, if not necessarily representative of the views of the diverse range of consumers engaging with the retail grocery sector on a regular basis.
- 3.135 Some observations of QRS include:
- 3.135.1 Through our consumer survey we have heard suggestions that quality of some products (such as fresh produce) might be low in some areas and from some retailers.<sup>126</sup> However generally consumers visit specialist stores such as butchers to meet their needs for product quality.
- 3.135.2 Some sources have identified that the range of products available in store is reducing. Some respondents to our consumer survey have noticed there are fewer brands to choose from for some products, and that branded products may be discontinued if a private label alternative is introduced.<sup>127</sup>

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<sup>125</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [4]-[5]; Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 4.

<sup>126</sup> See paragraph F162 in Attachment F.

<sup>127</sup> See paragraph F165 in Attachment F.

3.135.3 The NZFGC told us that “it appears that a strategy to reduce the number of product (and consumer) choices within categories is being actively pursued with suppliers.”<sup>128</sup>

3.136 Therefore, the evidence we have considered about competition across the QRS spectrum is limited in some respects and reflects a range of differing perspectives. It is not clear whether the QRS offered to consumers differs materially from what we would expect in a workably competitive market. Nevertheless, given our conclusions about profitability, pricing, innovation and investment, we do not consider that this affects our preliminary view in relation to the effectiveness of competition in the sector.

### **Innovation and investment**

3.137 In this section we discuss investment and innovation by grocery retailers in New Zealand under the following topics:

3.137.1 the impact on consumer outcomes of innovations aimed at differentiating the retail grocery offer;

3.137.2 the effect of digital and technological advances on consumer outcomes, including the growth of online shopping and e-commerce activities in the retail grocery sector;

3.137.3 innovations aimed at improving the in-store shopping experience of consumers;

3.137.4 investments aimed at creating efficiencies through streamlining supply chain and distribution operations in the retail grocery supply chain; and

3.137.5 innovations aimed at developing private label brands and a greater variety of products for consumers (see Chapter 8).

3.138 In a workably competitive market, we would expect to see firms investing and innovating in the expectation of earning additional profits by meeting consumer demands both now and in the future. In turn, we would also expect high margins and profits to attract new entry and expansion and then be competed down to competitive levels.

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<sup>128</sup> NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [14].

- 3.139 Differences in market structure, the characteristics of innovations, and the dynamics of research and development processes lead to variations in the theoretical relationship between competition and incentives to innovate. However, while the relationship between innovation and competition is complex, in general we would expect workable competition to provide strong incentives for innovation.<sup>129</sup>
- 3.140 Evidence we have seen suggests that innovation is regarded as an important dimension of competition in the retail grocery sector, both internationally and in New Zealand. For example, the major grocery retailers submitted that they frequently monitor each other's innovations, alongside price and other non-price competition measures such as product range and customer satisfaction levels.<sup>130</sup>
- 3.141 However, while there is innovation in the grocery sector, including by major grocery retailers, it is primarily focussed on range and service rather than price and is in aggregate insufficient to explain the level of excess returns earned by the major grocery retailers over a sustained period of time.

**Innovation in the grocery sector is focussed on product and service differentiation rather than price**

- 3.142 Demand for groceries is highly differentiated. Some consumers care primarily about price, others have a stronger preference for convenience, location and other service features. In a workably competitive market, we would expect firms to compete to satisfy this diverse range of preferences. Innovation aimed at differentiating the retail grocery offer may therefore be indicative of workable competition.

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<sup>129</sup> We note that studies considering whether more competition results in greater investment by firms in innovation have presented mixed results. In some cases, the literature suggests a positive relationship (more competition, more innovation), a negative relationship (more competition, less innovation) or an inverse U-shaped relationship (low innovation levels if high/low competition, high innovation levels if medium competition). For example: Philippe Aghion, Reda Cherif and Fuad Hasanov "Competition, Innovation and Inclusive Growth" (19 March 2021) *IMF Working Paper WP21/80*, available at: <https://www.imf.org/en/Publications/WP/Issues/2021/03/19/Competition-Innovation-and-Inclusive-Growth-50269>; Øystein Moen Tord Tvedten & Andreas Wold | Len Tiu Wright (Reviewing editor) "Exploring the relationship between competition and innovation in Norwegian SMEs" (2018) *Cogent Business & Management*, 5:1, available at: <https://www.tandfonline.com/doi/full/10.1080/23311975.2018.1564167>.

<sup>130</sup> For example: Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 18; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [27]; Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 61.

- 3.143 We acknowledge that some market participants have invested and are still investing in retail grocery innovations that may benefit consumers through an expanded set of choices. For example, new entry by meal kit providers and online-only supermarkets has expanded the convenience options available to consumers. There have also been investments by grocery retailers to provide a more diversified product range, such as increasing the availability of healthy/organic products to cater for dietary preferences and providing prepared meal options for consumers.
- 3.144 In addition, the major grocery retailers have also invested in new technology to provide online grocery sales and the establishment of small format Metro stores in Auckland and Wellington.<sup>131</sup> We discuss these innovations in more detail below.
- 3.145 Our consumer research shows that many would prefer price competition rather than product and service differentiation, but food discounter type business model innovations such as offered by Aldi overseas (see Chapter 4) have not occurred in New Zealand. The pattern and impact of retail offer differentiation on consumers will depend on the extent of competition between grocery stores across the full retail offer. This issue is discussed further in Chapter 5.

### **The rate of digital innovation by some grocery retailers and/or retail banners in New Zealand appears to be lagging behind other countries**

- 3.146 Globally, innovation in food retailing has been advancing at a rapid pace in recent years. Technological advancements are changing the way in which grocery retailers have traditionally operated, while fast-moving trends related to consumer behaviour, product preference and spending motivations are leading to greater investment by grocery retailers in an effort to maintain and grow market share.<sup>132</sup>
- 3.147 Some New Zealanders are also increasingly opting to do their grocery shopping online rather than in store, taking advantage of the convenience and time saving aspects of internet shopping.<sup>133</sup> This trend is supported and enabled by increased consumer confidence in conducting transactions over the internet and better internet connectivity across large parts of the country.<sup>134</sup>

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<sup>131</sup> For example: Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 4; Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 2-3; and <https://www.stuff.co.nz/business/125796178/foodstuffs-steps-up-its-south-island-online-shopping-service>.

<sup>132</sup> For example: <https://progressivegrocer.com/2020-grocery-innovation-outlook> and <https://www.indigo9digital.com/blog/futureofretailalibaba>.

<sup>133</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 25.

<sup>134</sup> For example: <https://www.ibisworld.com/nz/industry/online-shopping/1905/> and <https://www.reseller.co.nz/article/671791/fibre-dominates-nz-broadband-first-time-fixed-wireless-slows/>.

- 3.148 Specific technological innovations cited by the major grocery retailers to improve the online shopping experience for consumers in New Zealand include:
- 3.148.1 investment in putting in place the necessary processes and infrastructure to support online retailing;<sup>135</sup>
  - 3.148.2 offering targeted promotions and offers to individual consumers (see Chapter 7); and
  - 3.148.3 smartphone apps such as myCountdown and the New World app to make it easier for consumers to place online orders, browse weekly mailers and personalised specials and create shopping lists.
- 3.149 The COVID-19 pandemic has contributed significantly towards speeding up the growth of online shopping in New Zealand (and elsewhere), including online retail grocery shopping. Some estimates show that the COVID-19 pandemic may have pushed retailers about six years ahead from where they would likely have been absent the pandemic in terms of growth in online sales.<sup>136</sup>
- 3.150 Woolworths NZ has indicated its online penetration increased from 3% total sales in FY2014 to over 12% in the current financial year to date.<sup>137</sup> More specifically, demand for Countdown's online shopping grew by 74% between April and June 2020, accounting for 11% of total sales.<sup>138</sup>

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<sup>135</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 14.

<sup>136</sup> See: <https://www.stuff.co.nz/business/122349826/online-shopping-emerges-as-the-big-winner-in-the-first-six-months-of-2020>.

<sup>137</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 18.

<sup>138</sup> See: <https://www.countdown.co.nz/news-and-media-releases/2020/september/wellington-s-first-estore-opens-to-cater-for-online-shopping-demand>.

- 3.151 To accommodate the growth of its digital sales channels Countdown opened New Zealand's first ever purpose-built and permanent eStore in Auckland in April 2020. The 8,800 sqm store includes a partially-automated micro fulfilment unit and operates 24 hours a day, seven days a week. It currently has the capacity to fulfil more than 7,500 online orders a week.<sup>139, 140</sup> Countdown has also recently opened two additional dedicated eStores in Wellington and Christchurch.<sup>141, 142</sup> We discuss investments by the major grocery retailers to build new central distribution centres aimed at increasing supply chain efficiencies below from paragraph 3.166.
- 3.152 Other supermarkets and specialist grocery retailers such as Farro Fresh, Fruit World and The Mad Butcher have also recently launched online purchasing and delivery options for consumers in Auckland. However, many other grocery retailers in areas outside Auckland currently have no online presence.
- 3.153 Technological advancements and the overall growth of online retailing in New Zealand have also had an additional positive impact in the grocery sector through facilitating recent new entry by meal kit providers and online-only grocery retailers such as The Honest Grocer and Supie.
- 3.154 Despite the impact of the COVID-19 pandemic contributing towards speeding up the growth of online grocery sales in New Zealand, it appears that online grocery sales growth and penetration is still comparatively low when compared to other countries. Figure 3.13 below shows online grocery sales as a percentage of total grocery sales in New Zealand compared to selected other countries in 2020.

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<sup>139</sup> This unit means personal shoppers can easily access packaged goods without having to walk up and down store aisles as it picks and moves the most popular grocery items to personal shoppers on a conveyor belt meaning to enhance efficiency and timeliness of orders. Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 37.

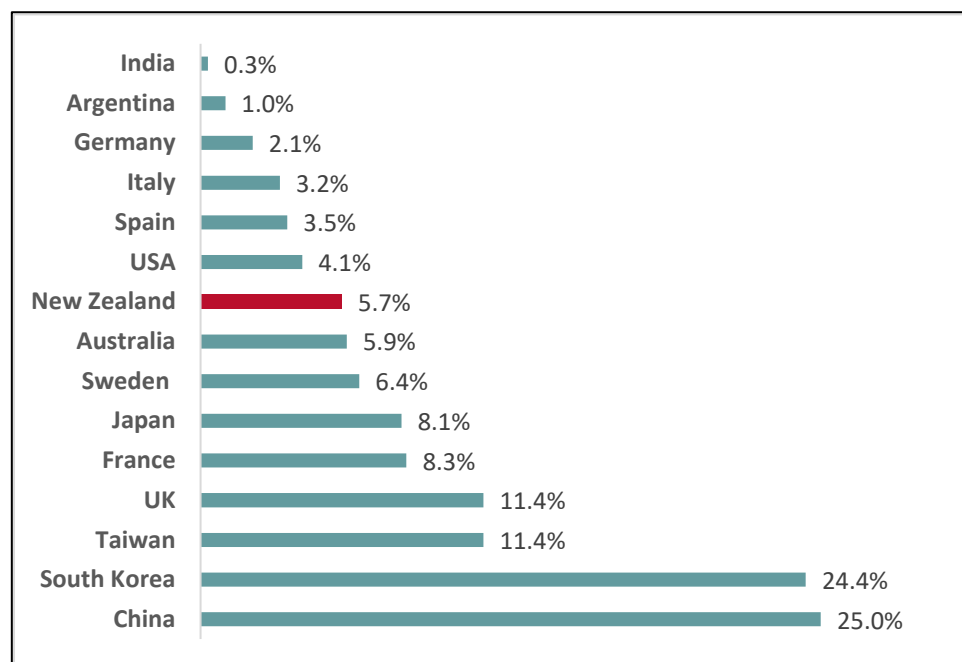
<sup>140</sup> Woolworths Group "2020 Annual Report" (2020) at [31], available at:

[https://www.woolworthsgroup.com.au/icms\\_docs/195794\\_annual-report-2020.pdf](https://www.woolworthsgroup.com.au/icms_docs/195794_annual-report-2020.pdf).

<sup>141</sup> See: <https://www.countdown.co.nz/news-and-media-releases/2020/september/wellington-s-first-estore-opens-to-cater-for-online-shopping-demand>.

<sup>142</sup> See: <https://www.countdown.co.nz/news-and-media-releases/2021/march/countdown-delivers-the-latest-online-shopping-tech-to-christchurch-shoppers>.

**Figure 3.13 Online grocery sales as a percentage of total grocery sales in selected countries (2020)**



Source: Kantar Worldpanel; NZ Post; Statistics NZ; IRI Australia.<sup>143</sup>

3.155 We have not seen any evidence that New Zealand is different from other countries in terms of demand for online grocery services. In addition, despite Countdown's relatively high levels of online sales penetration as an individual retail grocery banner, online grocery sales have been slower to grow in New Zealand as a whole as shown in Figure 3.13. Contributing to this observation:

3.155.1 Foodstuffs NI's New World stores only launched online deliveries for the first time in 2017, more than 20 years after online grocery shopping was first launched in other countries and also by Countdown in New Zealand;<sup>144</sup>

3.155.2 Foodstuffs NI's PAK'nSAVE customers currently only have a click and collect option, with no options for home delivery, while Foodstuffs NI's Four Square stores currently do not offer any online purchasing options;<sup>145</sup>

3.155.3 Foodstuffs SI only started rolling out online shopping options across its New World and PAK'nSAVE retail banners on a town-by-town basis for the first time in July 2021,<sup>146</sup> and

<sup>143</sup> [ ].

<sup>144</sup> See: <https://www.nzherald.co.nz/business/first-glimpse-of-new-world-online-shopping/27KFC5DA7WWFHVYSCKYZST4AYY/>.

<sup>145</sup> See: <https://www.paknsave.co.nz/shop/online-shopping>; <https://www.foursquare.co.nz/>.

<sup>146</sup> See: <https://insideretail.co.nz/2021/07/07/foodstuffs-south-island-launches-online-shopping-town-by-town/>.



3.155.4 online ordering options are only available at selected SuperValue and FreshChoice stores nationally.<sup>147</sup>

3.156 Despite lagging in digital innovation and penetration, Foodstuffs stores are earning persistently high excess returns (see from paragraph 3.7 above). This indicates that high profits are not acting as a reward for innovation in grocery retailing and that other offerings do not present a significant challenge to the bricks-and-mortar format stores of the major retail banners (see Chapter 5).

**The pace of innovation in bricks-and-mortar stores in New Zealand appears to be slower when compared to other countries**

3.157 While investments aimed at innovating the in-store shopping experience for consumers and changing the traditional ways of grocery retailing appear to have been undertaken, our preliminary view is that the pace and scale of innovation by some grocery retailers and/or retail banners in New Zealand may be slower than in other countries.

3.158 We are aware of many in-store innovations in the retail grocery sector in other countries that have not yet been adopted or implemented in any consistent or widespread manner across retail grocery stores in New Zealand.

3.159 For example, drive-through collection options are relatively commonly available at grocery stores in other countries and have been available for some time.<sup>148</sup> However, our understanding is that drive-through collection options are currently only available at Countdown's Rototuna store in Hamilton.<sup>149</sup>

3.160 Technological advancements such as mobile checkouts and the use of apps to enable consumers to connect to personal shoppers are available in many other countries, including Australia.<sup>150</sup>

3.161 Additional examples of in-store innovations aimed at enhancing the in-store shopping experience for consumers in other countries include:

3.161.1 investments in the use of personal shoppers and building small store formats in response to consumer demand for convenient and personalised shopping experiences;<sup>151</sup>

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<sup>147</sup> See: <https://www.supervalue.co.nz/>; <https://www.freshchoice.co.nz/>.

<sup>148</sup> For example: <https://www.tasteofhome.com/collection/grocery-delivery-pickup/>.

<sup>149</sup> See: <https://www.countdown.co.nz/news-and-media-releases/2020/may/countdown-rototuna-store-now-open-to-the-public-with-exciting-nz-first-initiatives>.

<sup>150</sup> For example: <https://insidemcg.com.au/2018/09/24/unocart-the-uber-of-grocery-delivery/>.

<sup>151</sup> For example: <https://progressivegrocer.com/small-formats-personalization-and-other-ways-make-your-stores-stand-out>.

- 3.161.2 the development of innovative in-store shopping experiences by the Hema supermarket chain in China, such as the use of barcodes on price tickets that allow consumers to scan the product barcode and instantly see the price and reviews of the item online using the store’s mobile app;<sup>152</sup>
- 3.161.3 new cashierless stores in the US and UK (Amazon Go Grocery) that uses high-tech sensors to identify what consumers pick up from the aisles, creating a checkout-free shopping option for consumers;<sup>153</sup>
- 3.161.4 the development of innovative store features to tailor the retail offer to variations in local demographics, such as Coles in Australia adding store-specific innovative features such as a living herb wall, a pick and mix bar for dog treats, and stocking a large range of vegan and vegetarian products;<sup>154</sup> and
- 3.161.5 widespread use of grocery robots at supermarket chains such as Giant and Stop & Shop in the US that alerts consumers to potential hazards such as spills and monitor shelves to alert workers to out-of-stock items and other problems related to merchandise presentation.<sup>155</sup>
- 3.162 In New Zealand the extent of innovation in bricks-and-mortar stores appears to be limited to the establishment of smaller store formats, the refurbishments of existing stores and developing new product offerings. For example, both Woolworths NZ<sup>156</sup> and Foodstuffs NI<sup>157</sup> submitted that they have invested into opening new smaller Metro format stores in recent years that mainly cater for increased consumer demand for convenience.<sup>158</sup>

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<sup>152</sup> See: <https://campbellrigg.com/news/supermarket/supermarket-design-and-innovation-inside-hema-and-loblaws-the-rise-of-the-in-store-app>.

<sup>153</sup> See: <https://www.stuff.co.nz/business/better-business/120587848/cashierless-stores-and-online-deliveries-are-the-future-of-supermarket-shopping>.

<sup>154</sup> For example: <https://www.news.com.au/finance/business/retail/coles-opens-coles-local-smallformat-store-in-st-kilda/news-story/b0206dec8cf0a5dfb0234f6a23a61aa9>.

<sup>155</sup> See: <https://www.roboticsbusinessreview.com/retail-hospitality/5-robots-grocery-stores-now/>.

<sup>156</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 24.

<sup>157</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [13.3].

<sup>158</sup> We note that the 2019 pricing data we received from the major grocery retailers show that [

]. See: Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 24 and 38.

- 3.163 In addition to establishing new smaller store formats, the major grocery retailers submitted that they have also invested in other types of in-store innovations such as new product offerings and increasing the number of self-checkout units due to changes in the shopping preferences of consumers.<sup>159</sup> However, none of these investments appear to be substantial, as they mostly relate to range and store layout changes.
- 3.164 A number of existing major retail banner stores have undergone major refurbishments in recent years, including floor space expansion, additional shelving and/or refrigeration and changing checkout configurations.<sup>160</sup>
- 3.165 We acknowledge that the apparent low levels of investment and slower pace of innovation by grocery retailers in New Zealand may also partly be driven by scale and the smaller size of the economy and population as compared to many other countries. Nevertheless, it appears that the pace and scale of development by grocery retailers in New Zealand is not consistent with what we would expect to see in a workably competitive market.

### **Consumers may not benefit from investments aimed at increasing efficiencies along the grocery supply chain**

- 3.166 As discussed earlier in this chapter, one important outcome that can be expected over the long run in a workably competitive market is that firms will tend to earn normal rates of returns and prices will reflect efficient costs. It is also expected that prices based on efficient costs and normal rates of return will lead to improved efficiency, provision of services reflecting consumer demands, sharing of the benefits of efficiency gains with consumers and limited ability to extract excessive profits.<sup>161</sup>
- 3.167 We note that in recent years the major grocery retailers have invested in improving supply chain and distribution networks aimed at reducing costs and enhancing the efficiency and resilience of the grocery supply chain in New Zealand.

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<sup>159</sup> For example: Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 2-3; Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 36-37.

<sup>160</sup> [ ];  
[ ];  
[ ].

<sup>161</sup> *Wellington International Airport Ltd and Others v Commerce Commission* [2013] NZHC 3289 at [18]-[22], available at: [https://forms.justice.govt.nz/search/Documents/pdf/jdo/53/alfresco/service/api/node/content/work space/SpacesStore/1c117dea-b8ba-491e-ba1d-d4cd30dbe522/1c117dea-b8ba-491e-ba1d-d4cd30dbe522.pdf](https://forms.justice.govt.nz/search/Documents/pdf/jdo/53/alfresco/service/api/node/content/work%20space/SpacesStore/1c117dea-b8ba-491e-ba1d-d4cd30dbe522/1c117dea-b8ba-491e-ba1d-d4cd30dbe522.pdf).

- 3.168 Woolworths NZ submitted that in addition to its investments in eStores it has also made the following investments in recent years to improve supply chain efficiencies:<sup>162</sup>
- 3.168.1 developing a new purpose-built 38,000 sqm Lower North Island distribution centre;
  - 3.168.2 partnering with Hilton Food Group to establish a new \$54 million meat processing plant in Auckland;
  - 3.168.3 partnering with Americold to underpin a \$65 million investment by Americold in expanding its temperature-controlled warehousing facility in Auckland; and
  - 3.168.4 developing a new 20,000 sqm produce distribution centre in Auckland to help service all of Countdown's North Island stores with fresh fruit and vegetables direct from local growers.
- 3.169 In 2015 Foodstuffs SI opened a new ambient distribution centre in Christchurch, adding an additional 31,587 sqm to the existing 14,000 sqm warehouse. At the time of its opening it was New Zealand's largest supermarket distribution centre, servicing all of Foodstuffs SI's retail banners in the South Island.<sup>163</sup>
- 3.170 Foodstuffs NI has also recently invested more than \$100 million to build a 77,500 sqm central distribution centre in Auckland that stocks groceries for over 150 of its stores. This investment has allowed Foodstuffs NI to centralise all of its upper North Island distribution sites.<sup>164</sup>
- 3.171 Investments aimed at improving the resilience of grocery supply chains in New Zealand were demonstrated during the COVID-19 pandemic when grocery retailers were able to continue to supply essential grocery items to New Zealanders despite the significant increase in demand at the time.
- 3.172 However, when viewed in the context of other market observations, such as the persistent high levels of profitability and pricing levels discussed above, we are not persuaded that consumers are benefitting from these cost-saving investments as would be expected in a workably competitive market.

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<sup>162</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 38.

<sup>163</sup> See: <https://www.foodstuffs-si.co.nz/about-us/news-announcements/2015/2/12/new-zealand%E2%80%99s-largest-supermarket-distribution-centre-opens-in-the-south-island>.

<sup>164</sup> See: <https://www.stuff.co.nz/business/124857669/foodstuffs-staff-move-into-building-big-as-8-rugby-fields>.

## Chapter 4 The nature of competition in the retail grocery sector

### Summary of preliminary findings

- Consumers engage in a range of different shopping missions, including: a main shop – typically at a regular interval based on the convenience of using one grocery store to get all necessities in one place; a secondary shop – to shop for specific products, typically at a specialist retailer; and/or a top-up shop – a quick shop for a small number of items, often across a range of other grocery retailers.
- Grocery retailers compete across the price, quality, range, and service spectrum to cater to these consumer needs. However, other grocery retailers tend to differentiate their retail grocery offer primarily on non-price dimensions and tend to compete mostly for smaller, secondary or top-up shopping missions.
- For most consumers, convenience and price are the key considerations that inform their choice of grocery store. However, store choice and the extent to which consumers consider other grocery retailers as alternatives to the major grocery retailers largely depends on the type of shopping mission a consumer is engaged in.
- Most consumers buy groceries for their main shop at one grocery store and they typically prefer to use one of the major grocery retailers for this main shop. Major grocery retailers are uniquely placed to offer the convenience of a main shop at a single location.
- Therefore, the major grocery retailers appear to be each other's closest competitors for consumers' main shop. Other grocery retailers do not provide a material constraint. Some estimates of market share suggest the major grocery retailers have a combined estimated share of more than 90% for consumers' main shop, and more than 80% for top-up shops.
- There are local markets as well as wider regional and national markets in the retail grocery sector. However, competition for specific shopping missions mostly occurs in local markets because consumers are generally unwilling to travel far to purchase groceries. Consumers in rural locations tend to travel further than those in urban areas.
- The local nature of grocery retailing means that the options available to consumers, in terms of product range and the variety of grocery retailers, varies depending on where they live. This is particularly so outside Auckland, including the other major urban areas such as Wellington and Christchurch. Rural consumers often have even fewer choices.
- The local nature of competition may also mean that prices are higher in areas where there are few competing retailers. However, decisions on pricing, promotion and acquisition of products by the major grocery retailers mostly take place at a national or regional (or co-operative) level. This may provide some protection from higher prices for consumers in local markets where competition is weak. Despite this, analysis of regional price differences shows that prices in the South Island and the Central and Lower North Island are higher relative to those in Auckland.

## Introduction

- 4.1 In this chapter we draw on evidence gathered during our study to identify the dimensions upon which competition is occurring in the retail grocery market. We describe consumer product and shopping preferences, the types of retailers offering groceries, and how they operate nationally and locally in different regions in New Zealand.
- 4.2 We identify the types of grocery retailers that compete with each other for the same customers by considering consumer shopping behaviour and the drivers of store choice in New Zealand. We also provide estimates of the approximate geographic size of different local markets and consider the regional variations in the options available to consumers.
- 4.3 We received a range of perspectives on the alternative options available to consumers for their main shop. The major grocery retailers are of the view that an increasing demand for convenience means that the single or main shop mission is becoming of less significance than it was in the past and that there are multiple options available to consumers for smaller, more frequent shopping missions.<sup>165</sup> However, the NZFGC told us that alternative options for consumers tend mostly to be small fringe retailers that do little to compete with the two main grocery retailers for the main household shop.<sup>166</sup>
- 4.4 We consider that the extent to which consumers consider other grocery retailers as alternatives to the major grocery retailers appears largely to depend upon the type of shopping mission a consumer is engaged in. Our consumer research indicates that most consumers buy groceries for their main shop in one location and that they typically prefer to use one of the major grocery retailers for this main shop.<sup>167</sup> Grocery retailers stocking a limited range of products are more likely to be regarded by consumers as an alternative for top-up or other smaller shopping missions.
- 4.5 We have used different methods to estimate the approximate geographic size of local markets in urban and rural areas. Overall, our findings suggest that rural consumers tend to drive further than urban consumers for grocery shopping purposes. We also find that the approximate geographic size of local markets may vary between different types of shopping missions and grocery stores.

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<sup>165</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 23; Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [11].

<sup>166</sup> NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 20.

<sup>167</sup> See: The analysis of our consumer survey (Attachment F, Figure F15); Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 8.

- 4.6 There are regional variations in the options available to consumers, both in terms of product range and the variety of grocery retailers. This is particularly so outside Auckland, including in the other major urban areas such as Wellington and Christchurch. Rural consumers typically have more limited options than urban consumers.
- 4.7 This chapter has five main sections:
- 4.7.1 our approach to analysing the nature of competition in grocery retailing;
  - 4.7.2 what are the dimensions of competition in retail grocery markets?
  - 4.7.3 consumer shopping behaviour and the drivers of store choice in New Zealand;
  - 4.7.4 the nature of local competition in grocery retailing; and
  - 4.7.5 regional variations in the grocery store options available to consumers.

### **Our approach to analysing the nature of competition in grocery retailing**

- 4.8 This section draws on a range of information sources to describe some key characteristics of consumers and grocery retailers. These characteristics provide a basis for the conclusions that follow about the dimensions upon which competition is taking place in the retail grocery sector. We use this as a basis to assess the intensity of competition between different types of grocery retailers in Chapter 5.
- 4.9 We discuss the following key characteristics below:
- 4.9.1 grocery retailers compete over a wide range of dimensions to meet diverse consumer needs;
  - 4.9.2 consumers engage in different types of shopping missions;
  - 4.9.3 there are many different types of grocery retailers in New Zealand;
  - 4.9.4 grocery retailers typically compete for consumers within small local areas; and
  - 4.9.5 there are some regional and national dimensions to competition in the retail grocery sector.

### **Grocery retailers compete over a wide range of dimensions to meet diverse consumer needs**

- 4.10 The results from our consumer survey<sup>168</sup> and the Ipsos report<sup>169</sup> suggest that for most consumers, convenience and price are the key considerations that informs their choice of grocery store. Other factors such as product range, service quality, opening hours and access to car parking also informs some consumers' choice of store.
- 4.11 The combined set of products and services offered to consumers by grocery retailers to cater to this diverse range of consumer needs is known as the retail grocery offer.
- 4.12 Grocery retailers compete for the loyalty of consumers by differentiating their retail grocery offer in a number of ways, including:
- 4.12.1 the prices of products, including regular and one-off promotions;
  - 4.12.2 loyalty programmes and non-price promotions (see Chapter 7);
  - 4.12.3 the quality of products;
  - 4.12.4 the range of available products;
  - 4.12.5 the convenience of shopping (eg, opening hours, location, etc.); and
  - 4.12.6 the quality of service and the shopping experience (eg, store layout, number and accessibility of staff to consumers, etc.).
- 4.13 Some of these factors, such as price and quality of service can usually be adjusted relatively easily by grocery retailers. However, other factors valued by some consumers such as store size, parking facilities and store layout are less easily changed in response to competition.
- 4.14 We note that competition for store locations is also an important factor relevant to consumers which is not easily changed by retailers. We discuss this further in Chapter 6 and we discuss the geographic nature of competition between grocery retailers below from paragraph 4.27.

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<sup>168</sup> See: Attachment F from paragraph F108 to paragraph F111.

<sup>169</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 8.



## Consumers engage in different types of shopping missions

- 4.15 A commonly used concept to describe a particular type of shopping trip is a shopping mission. It is generally defined by the motivational factors that drive consumers to shop, the context in which they shop and the shopping behaviours that drive the purchase decision.<sup>170</sup>
- 4.16 The concept of a shopping mission is used extensively by the major grocery retailers in New Zealand to describe the purpose of a particular shopping trip, as well as for market share monitoring and strategic decision-making purposes.<sup>171</sup> For example, Woolworths NZ described each consumer (or household) completing a range of shopping missions within any given week or month and a diverse range of factors that can drive each and every shopping mission.<sup>172</sup>
- 4.17 There are several different categories of grocery shopping missions. These range from short, often impromptu missions that have the purpose of purchasing an immediate, high need grocery item, to large-scale shopping missions.<sup>173</sup>
- 4.18 Having regard to the feedback we received in our consumer research we distinguish between three categories of shopping missions in our study:
- 4.18.1 **a main shop:** a shop typically happening weekly or at another regular interval based on the convenience of using one grocery store to get all necessities in one place;
  - 4.18.2 **a secondary shop:** a supplemental shop at a second grocery store to shop for specific products, typically at a specialist grocery retailer; and
  - 4.18.3 **a top-up shop:** a quick shop for a small number of items that can be conducted for a range of reasons across different types of grocery retailers.

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<sup>170</sup> See: [https://cdn2.hubspot.net/hub/269713/file-252232072-pdf/Understanding\\_Different\\_Shopper\\_Trip\\_Missions\\_\(Advanced\\_Shopper\\_Understanding\\_OnLine\\_Course\).pdf](https://cdn2.hubspot.net/hub/269713/file-252232072-pdf/Understanding_Different_Shopper_Trip_Missions_(Advanced_Shopper_Understanding_OnLine_Course).pdf).

<sup>171</sup> For example: [ ]; and [ ].

<sup>172</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 59.

<sup>173</sup> For example: Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [10].

- 4.19 Consumer shopping behaviour and drivers of store choice vary according to the type of shopping mission consumers engage in. The type of shopping mission a consumer is engaged in also provides an indication of the extent to which they might be willing to switch between different types of grocery retailers. For example, our expectation is that a consumer doing a main shop is unlikely to consider a store with a more limited product range as an alternative to a supermarket. This is despite the major grocery retailers suggesting that the main shop is becoming of less significance than it was in the past.<sup>174</sup>
- 4.20 The scope for consumers on a particular type of shopping mission to switch some or all of their grocery spend to a different type of grocery retailer in response to a price increase (or other deterioration in the retail grocery offer) is also relevant to our assessment of competition at the retail level in Chapter 5.

### **There are many different types of grocery retailers in New Zealand**

- 4.21 As discussed in Chapter 2, there are many grocery retailers operating across New Zealand, including supermarkets, international food stores, specialist grocery retailers, meal kit providers and online-only supermarkets. In general, we expect grocery retailers with broadly similar retail grocery offers to be each other's closest competitors as they are seeking to compete for the same group of consumers who have a preference for those offers.
- 4.22 Findings from the Ipsos study suggest that other grocery retailers are generally perceived by consumers to have limited geographic coverage and that they tend to be more expensive than the major grocery retailers for some products.<sup>175</sup>
- 4.23 While most consumers care primarily about price and convenience, others have a stronger preference for service features such as store layout and the overall shopping experience. In a workably competitive market, we would expect firms to compete to satisfy this diverse range of preferences. Differentiation on the retail grocery offer may therefore offer benefits to consumers through an expanded set of choices and increased competition between grocery retailers.
- 4.24 Our analysis shows that there are regional differences in the diversity of retail grocery options available to consumers. The greatest level of differentiation appears to be in the Auckland region, where there are several other grocery retailers operating in addition to the major grocery retailers. There are increasingly lower levels of differentiation through the rest of the country, with the lowest level of retail grocery differentiation evident in rural areas (see Figure 4.7 to Figure 4.9 and Attachment B).

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<sup>174</sup> For example: Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [11.1].

<sup>175</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 38.

- 4.25 In a workably competitive market, we would expect to see a greater level of differentiation than we see at present in other major urban areas such as Wellington and Christchurch and larger urban areas across New Zealand. The comparatively low levels of bricks-and-mortar innovations in the retail grocery sector are discussed in Chapter 3.
- 4.26 However, the success of the Aldi model in Australia<sup>176</sup> suggests that some consumers prefer less differentiation and lower prices. The impact of retail grocery offer differentiation on consumers will depend on the extent of competition between grocery stores across the full retail grocery offer. Product and service differentiation may provide a way for grocery retailers to avoid price competition, while seeking to attract consumers from one another in an effort to attract and retain a more loyal consumer base. This issue is discussed further in Chapter 5.

### **Grocery retailers typically compete for consumers located within small local areas**

- 4.27 Grocery retailers compete with each other for specific shopping missions in local markets where consumers live and work. This is because convenience is one of the key drivers of store choice for consumers.
- 4.28 Although there are some national and regional dimensions to competition between the major grocery retailers, such as pricing and the acquisition of products, competition between grocery retailers also occurs in local markets due to the generally limited distances consumers are willing to travel to purchase groceries.<sup>177</sup> This is consistent with our findings in previous merger decisions in the retail grocery sector.

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<sup>176</sup> Aldi uses a “food discounter” model to provide consumers in Australia (and elsewhere) with lower prices and less differentiation than is evident at other large supermarkets. They aim to keep costs and prices low by stocking only the most popular products, avoiding the use of discount and loyalty programmes and providing a “no-frills” model for consumers. Since first entering in 2001 it now operates more than 500 stores across Australia and are the third-biggest player in Australia’s supermarket sector. See: <https://www.abc.net.au/news/2021-01-22/aldi-changed-supermarket-shopping-in-australia-in-two-decades/13079180>.

<sup>177</sup> For example: Commerce Commission “Decision Nos. 606 & 607, Determination pursuant to the Commerce Act 1986 in the matter of applications for clearance of business acquisitions involving: Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited, and Foodstuffs South Island Limited; and (separately) Woolworths Limited and The Warehouse Group Limited” (8 June 2007) at [E18], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf); Commerce Commission “Decision No. 438, Application for clearance involving: Progressive Enterprises Limited and Woolworths (New Zealand) Limited” (13 July 2001) at [66]-[69], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/73073/438.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/73073/438.pdf).

- 4.29 The analysis of our consumer survey suggests that on average, respondents in medium (eg, Te Awamutu), large (eg, Rotorua) and major urban areas (eg, Auckland) travel less than 10 minutes to their main store. Consumers located in small urban (eg, Gore) and rural areas (eg, Haast) tend to travel longer to their main store, with consumers in rural areas travelling close to 20 minutes on average to their main store.<sup>178</sup> This finding is consistent with feedback from participants in the Ipsos study.
- 4.30 However, as we discuss in further detail below, there are some national and regional dimensions to local competition which impact on the nature and intensity of competition between grocery retailers at a local level.

**There are some regional and national dimensions to competition in the retail grocery sector**

- 4.31 Although consumers typically choose between retailers in their local area, there are also some regional and national dimensions to competition in the retail grocery sector. Decisions on pricing, promotion and acquisition of products by the major grocery retailers mostly take place at a national or regional (or co-operative) level. Competition for specific shopping missions mostly influences the store-specific range and service decisions of the major grocery retailers at a local level.
- 4.32 Some specialist grocery retailers and other supermarkets also have a wider national or regional presence through franchise agreements with individual store owners (eg, Fruit World, The Mad Butcher and Bin Inn).

*Pricing and promotion decisions by the major grocery retailers mostly take place at a national or regional level*

- 4.33 If national or regional prices are set with reference to strong competition in other areas, this may benefit consumers in markets where there is less competition which would otherwise result in them facing higher prices. However, if competition at the national level is not strong, there is a risk that all consumers may end up paying more than they likely would have in a workably competitive market.<sup>179</sup>
- 4.34 Most of the strategies relating to pricing and discounting of products are made at a national (Woolworths NZ) or at a co-operative level (Foodstuffs SI and Foodstuffs NI). This means that over time the national and island-level component of competition is likely to be a bigger driver of prices charged at major grocery retailers' stores than competition in individual local markets. This implies that the major grocery retailers are constrained most by each other and other grocery retailers with a national or significant geographic presence.

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<sup>178</sup> See: The analysis of our consumer survey (Attachment F); Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 7.

<sup>179</sup> The greater the proportion of stores a grocery retailer has with high levels of local market share, the greater its ability and incentive to raise prices or reduce levels of service, range and/or quality independently of other operators at both a national and local level. There may also be strategic reasons why grocery retailers may choose to set a uniform retail grocery offer. For example, it improves price transparency and makes it easier to monitor the competitive offering of rivals.

- 4.35 Woolworths NZ operates a national business model for its Countdown stores. This means that pricing in Countdown stores is almost entirely consistent nationwide, even though some costs (for example, distribution costs), may differ across different product categories.<sup>180</sup> The most significant product categories where this is evident are fresh products where different supply conditions and/or commercial models mean that there are price differences predominantly between the North Island and South Island.<sup>181</sup>
- 4.36 Foodstuffs NI told us that its pricing policies at a co-operative level aim to provide more consistent value to consumers across core and staple items. It also noted that pricing and promotions for fresh products, including produce and meat, operate to a different dynamic than other product categories due to their seasonality, certainty of supply and short shelf life.<sup>182</sup> There also appears to be some scope for pricing at Foodstuffs NI and Foodstuffs SI stores to vary on a store-by-store basis.<sup>183</sup>
- 4.37 Both Foodstuffs NI and Foodstuffs SI also told us that they collaborate on matters that require national consistency with the shared ownership and use of national brands, such as a national televised New World price promotion.<sup>184</sup>

*The acquisition and distribution of products by the major grocery retailers is mostly coordinated at a national or co-operative level*

- 4.38 Scale economies achieved in the acquisition of groceries at a national or co-operative level may increase barriers to entry at a local market level, thereby affecting consumers at both a local, regional and national level (see Chapter 6).

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<sup>180</sup> Woolworths NZ “Submission on the retail grocery market study preliminary issues paper” (4 February 2021) at 6.

<sup>181</sup> According to Woolworths NZ the effects of its consistent nationwide pricing at Countdown stores is that overall, [ ] of products have the same shelf price at all Countdown stores across New Zealand. Despite regional variations in fresh produce prices, [ ] of these products have the same shelf price nationwide. For packaged goods, [ ] of products have the same standard shelf price nationally and more than [ ] of promotional prices are the same nationwide. Woolworths NZ “Submission on the retail grocery market study preliminary issues paper” (4 February 2021) at 6.

<sup>182</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 34.

<sup>183</sup> Foodstuffs NI “Submission on the retail grocery market study preliminary issues paper” (4 February 2021) at 12 and 22; Foodstuffs SI “Submission on the retail grocery market study preliminary issues paper” (4 February 2021) at 14. Foodstuffs NI told us that [

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<sup>184</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 22; Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 14.

- 4.39 Woolworths NZ told us that its national business model leads to ease of doing business with its suppliers (with product decisions based on data from across all of its stores) and enables them to achieve efficiencies in their transport network and centralised marketing activities.<sup>185</sup>
- 4.40 Foodstuffs NI submitted that a significant proportion of its products are supplied directly to grocery retailers and do not go through Foodstuffs NI's central distribution centres.<sup>186</sup>
- 4.41 However, we note that Foodstuffs NI is currently implementing a new centralised buying model for its New World and Four Square stores (see Chapter 8). This means that there are some co-operative level dimensions to local competition for the procurement of products by Foodstuffs NI.

*There is some scope for the major grocery retailers to adjust product range and other dimensions of competition at a local store level*

- 4.42 As discussed above, most of the competition on pricing and the procurement of products by the major grocery retailers takes place at a national or island level. However, there is some discretion at a local store level for owner-operators and store managers to adjust their product range and other non-price dimensions of competition such as opening hours in response to local competition.
- 4.43 With regards to product range, Woolworths NZ told us that they have invested in tailoring their range and product offerings to local consumer tastes through developing new products as demand evolves (for example, increasing investment in ready-to-go meals and dedicated health food aisles).<sup>187</sup>
- 4.44 Both Foodstuffs NI and Foodstuffs SI also told us that there is scope for a member to tailor their product range, including to local consumer preferences and market conditions.<sup>188</sup>

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<sup>185</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 7.

<sup>186</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 11. Foodstuffs NI told us that direct to store represents approximately [ ] by value of all product shipped and is mostly to [ ] stores.

<sup>187</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 13.

<sup>188</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 22; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 14.

- 4.45 Specifically, Foodstuffs NI’s service offerings differ across the North Island as a result of one or a combination of the following:<sup>189</sup>
- 4.45.1 differences in local market conditions including customer needs, demographics and competition from other suppliers of retail grocery items;
  - 4.45.2 the presence of different Foodstuffs NI retail banners within different catchment areas;
  - 4.45.3 differences arising due to particular arrangements or pricing changes requested by suppliers affecting different regions;
  - 4.45.4 the nature of relevant products such as fruit or vegetables; and
  - 4.45.5 other differences arising due to the independent owner/operator model run by each co-operative.
- 4.46 Foodstuffs SI’s service offerings are determined at both the co-operative and at a store level by each member, within the framework established by their membership agreement. Specifically, there is scope for Foodstuffs SI stores to tailor their local service offerings in response to local market conditions based on the nature of demand from consumers. For example, opening hours are determined by each operator in consultation with Foodstuffs SI.<sup>190</sup>

### **What are the dimensions of competition in retail grocery markets?**

- 4.47 Grocery retailers generally provide an array of complementary services such as carparking, product range and product quality to consumers in addition to their core function of selling groceries. In order to compete for consumers located within close proximity to the store, grocery retailers differentiate their offering by combining the set of products and services offered in different ways to attract different types of consumers and shopping missions. Retail grocery offers are therefore generally aligned with consumer shopping behaviour, consumer preferences and local demographics.
- 4.48 Consumer shopping missions are a key driver of competition in the retail grocery market. We understand that the major grocery retailers tend to compete across the full price, quality, range and service (PQRS) spectrum in an effort to make their retail grocery offer attractive to consumers on many different types of shopping missions.<sup>191</sup>

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<sup>189</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 22-24. Foodstuffs NI also told us that [

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<sup>190</sup> Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 14.

<sup>191</sup> For example: [ ]; [ ].

- 4.49 However, the evidence we have gathered during our study suggests that other grocery retailers tend to compete mostly for smaller shopping missions. They do this by differentiating their retail grocery offer from the major grocery retailers on non-price dimensions of the retail grocery offer, such as product range and quality.<sup>192</sup>
- 4.50 The differentiated nature of the retail grocery offering implies that the intensity of price competition between grocery retailers in New Zealand may be relatively weak overall, even in local markets where there appears to be more retail grocery options and more competition.
- 4.51 In general, we expect there to be a link between the nature and quality of the retail grocery offer and the intensity of competition. Grocery retailers have an incentive to weaken their retail grocery offer (such as increasing prices or reducing range or quality of services) in those markets where competition is less intense to earn greater profits. This is because they face a trade-off between lost sales as a result of consumers switching to competing retailers in the same market and the additional profits that might be earned from retained sales.
- 4.52 In local markets where the intensity of competition is weaker consumers have fewer alternative options. It is therefore more likely that the additional profits earned from an increase in prices (or reduction in the quality of non-price dimensions of the retail grocery offer) will outweigh the costs associated with such a strategy in markets where competition is less intense.
- 4.53 Similarly, we expect that in markets where competition is more intense that grocery retailers will have a stronger incentive to improve their retail grocery offer in an attempt to grow or retain market share. We discuss this further in Chapter 5.
- 4.54 The incentives for grocery retailers to compete strongly on some or all of the aspects of the retail grocery offer may also be influenced by the competitive choices of competitors in the same market. For example, if a grocery retailer manages to grow its market share through improvements in its retail grocery offer at the expense of competitors in the same market, competing retailers may be incentivised to adjust and improve their retail grocery offers in response to the decline of their own market share.
- 4.55 As discussed above, many of the aspects of the retail grocery offer, such as pricing, are set uniformly across the retail banners of the major grocery retailers at a national or regional level.

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<sup>192</sup> For example: [ ];  
[ ].



- 4.56 However, as noted in the UK Competition Commission’s market investigation into the supply of groceries, the fact that many grocery retailers set a substantial proportion of their retail grocery offer nationally or regionally on a uniform basis across all their stores does not mean that the intensity of competition in local markets for grocery retailing is not important. The intensity of competition in local markets could influence the retail grocery offer in two main ways:
- 4.56.1 through affecting those dimensions of the retail grocery offer that are adjusted locally at the store level; and
  - 4.56.2 through affecting the overall level at which nationally uniform dimensions of the retail grocery offer are set.<sup>193</sup>

**Grocery retailers mostly compete for different types of shopping missions by differentiating the non-price dimensions of the retail grocery offer**

- 4.57 As discussed above, grocery retailers compete over both price and non-price dimensions of the retail grocery offer. However, our preliminary finding is that in many local markets competition for different types of shopping missions tends to focus more on differentiation of the non-price dimensions of competition than on price.
- 4.58 We understand that the major grocery retailers appreciate the importance of non-price competition dimensions in their retail grocery offers. For example, a significant emphasis is placed on growing market share through improving the quality of service, enhancing the overall shopping experience, managing stock levels, increasing product range and ensuring consistency in service levels across all stores.<sup>194</sup>
- 4.59 Feedback from industry participants suggests that most other grocery retailers do not attempt to compete with the major grocery retailers on price. Instead, these retailers strategically compete for smaller consumer shopping missions by differentiating the non-price dimensions of their respective retail grocery offers. For example, other grocery retailers have indicated that they attempt to compete for top-up shopping missions by importing a different range of products, creating unique shopping experiences or stocking better quality products.<sup>195</sup>

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<sup>193</sup> UK Competition Commission “The supply of groceries in the UK market investigation” (30 April 2008) at [6.33], available at: <https://webarchive.nationalarchives.gov.uk/20140402194746/http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/groceries-market-investigation-and-remittal/final-report-and-appendices-glossary-inquiry>.

<sup>194</sup> For example: [ ]; [ ]; [ ].

<sup>195</sup> For example: [ ]; [ ]; [ ].

- 4.60 This appears to be consistent with the submissions from Foodstuffs NI<sup>196</sup> and Foodstuffs SI<sup>197</sup> that other grocery retailers generally compete with the major grocery retailers across one or more aspects of the PQRS spectrum and that the ability of a major grocery retailer to offer the convenience of a main shop is the key differentiator from other stores.
- 4.61 The extent to which the differentiated retail grocery offer by other grocery retailers imposes some degree of competitive constraint on the major grocery retailers is discussed in Chapter 5.

**Product range and store size varies significantly between different store operators and retail grocery banners**

- 4.62 One measure of variation in the retail grocery offer across New Zealand is store size. The major grocery retailers generally have larger stores and tend to stock a significantly wider grocery product range than other types of grocery retailers. Variation in product range across stores of different sizes affects how consumers would view these stores as alternatives to each other.<sup>198</sup>
- 4.63 Data provided by the major grocery retailers and some other grocery retailers shows that the average store size of the major grocery retailers is significantly bigger than the average store size of most other grocery retailers, with the exception of the Four Square, Raeward Fresh and SuperValue retail banners for some categories of retailers. (see Figure 4.1).<sup>199</sup>

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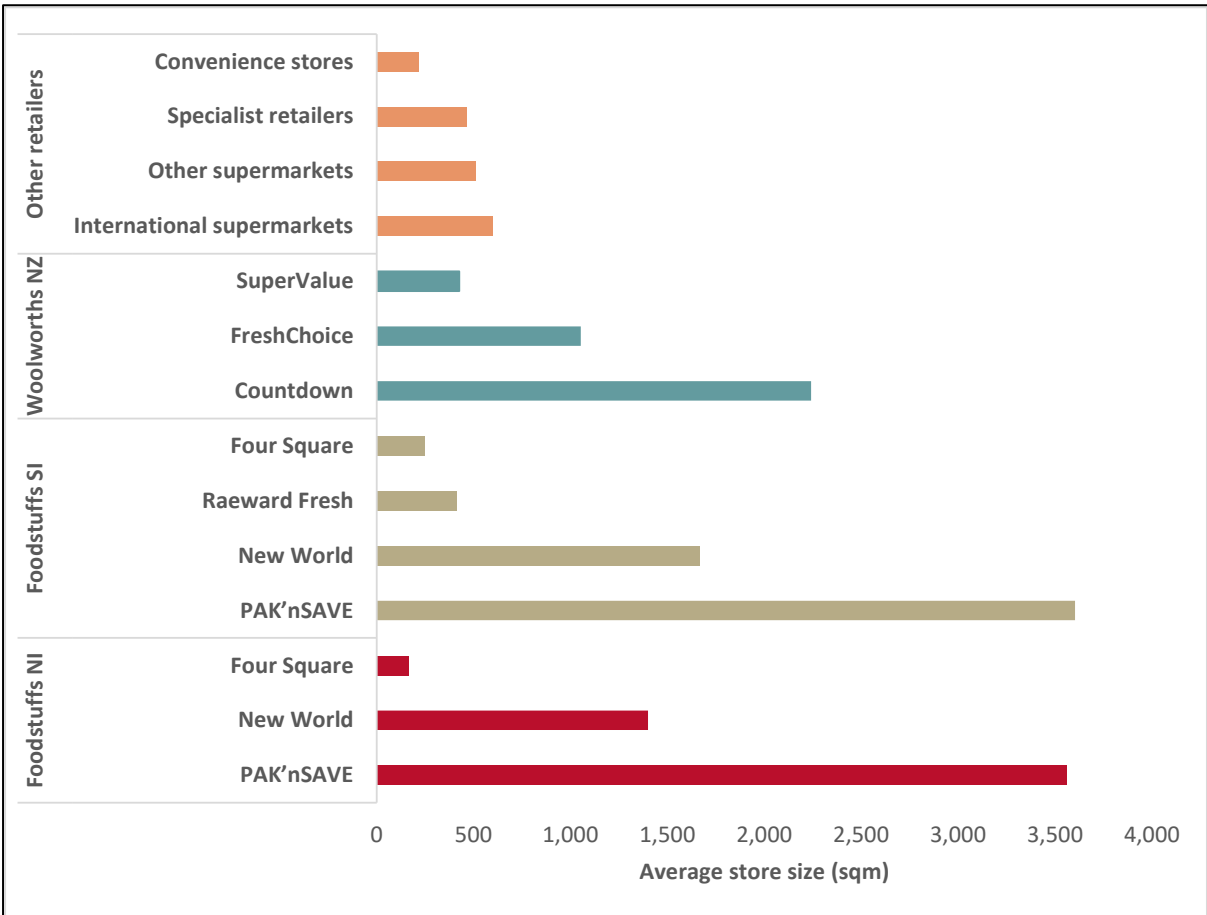
<sup>196</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 22.

<sup>197</sup> Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 8.

<sup>198</sup> UK Competition Commission “The supply of groceries in the UK market investigation” (30 April 2008) at [4.22].

<sup>199</sup> Although our list of other retailers is not comprehensive, we consider it gives a reasonable comparison of the average store size and number of products stocked at major grocery retailer stores and other grocery retailers.

**Figure 4.1 Average net store size of major grocery retailers and other grocery retailers in (square metres)**



Source: Commerce Commission analysis of data provided by industry participants.<sup>200</sup>

4.64 We acknowledge that store size is not a perfect approximation of product range and the number of Stock Keeping Units (SKUs) available at a grocery store. However, our analysis of information provided by grocery retailers on the average number of SKUs stocked by each retail banner shows that, on average, smaller grocery retailers stock between 38% to 85% fewer SKUs than New World, Countdown and PAK'nSAVE.<sup>201</sup>

**Consumer shopping behaviour and the drivers of store choice in New Zealand**

4.65 The factors that motivate and influence consumers to choose where they purchase their groceries from are known as the drivers of store choice. The evidence suggests that there are multiple drivers of store choice in New Zealand and that these vary by demographics, type of shopping mission and geography.

4.66 Some of the key drivers of store choice include factors such as price, convenience, location and consumer perceptions of and familiarity with grocery store brands.

<sup>200</sup> [ ].  
<sup>201</sup> [ ].

- 4.67 The retail grocery offers of grocery retailers are generally aligned with consumer shopping behaviour and local demographics. This means that consumers are more likely to switch to a grocery store with a similar retail grocery offer if there is a decline in the quality of their current retail grocery offer.
- 4.68 However, some characteristics of consumer shopping behaviour limit the extent to which consumers will switch stores in response to a decline in the retail grocery offer of their current store and/or brand. For example, consumers who are time-poor and have a strong preference for one-stop shopping at one of the major grocery retailer brands are less likely to switch to other grocery retailers with a limited product range.

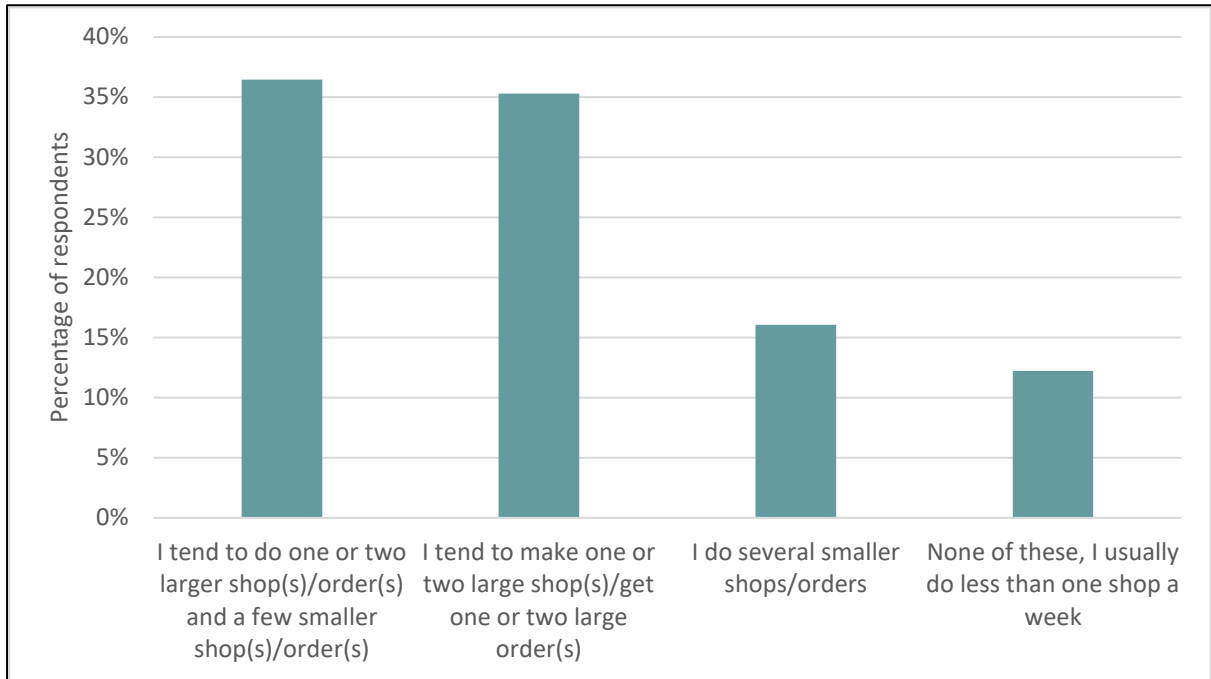
**Most consumers tend to do at least one large shop each week**

- 4.69 As discussed above, the major grocery retailers suggest that increasing demand for convenience by consumers is leading to significant changes in shopping behaviour.<sup>202</sup>
- 4.70 To better understand the shopping patterns of consumers we gathered information from respondents to our consumer survey on the typical size of their shopping trips each week.
- 4.71 72% of respondents to our consumer survey tend to do at least one or two larger shops each week, and about half of those supplement these with a few smaller top-up shops. A further 12% of respondents usually do less than one shop a week. The remaining 16% of respondents either rely on several smaller shops each week or they usually do less than one shop a week (see Figure 4.2).

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<sup>202</sup> For example: Woolworths NZ “Submission on the retail grocery market study preliminary issues paper” (4 February 2021) at 23; Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 2.

**Figure 4.2 Percentage of respondents who engage in different types of shopping missions**



Source: Commerce Commission analysis of responses to our consumer survey.<sup>203</sup>

- 4.72 The COVID-19 pandemic has had an impact on the shopping frequency and behaviour by consumers in New Zealand. The major grocery retailers suggest that as a result of the COVID-19 pandemic consumers tend to make less frequent grocery shopping trips and stock up in bulk on more items.<sup>204</sup> It is unclear whether this trend will continue in future.
- 4.73 However, we note that an increased prevalence of larger and less frequent shops is likely to place other grocery retailers that are unable to compete for consumers on a main shopping mission at a competitive disadvantage to the major grocery retailers. We discuss this in more detail below.

<sup>203</sup>

[ ].

<sup>204</sup>

For example: Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 10; Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 18.

### The key drivers of store choice vary between different types of shopping missions

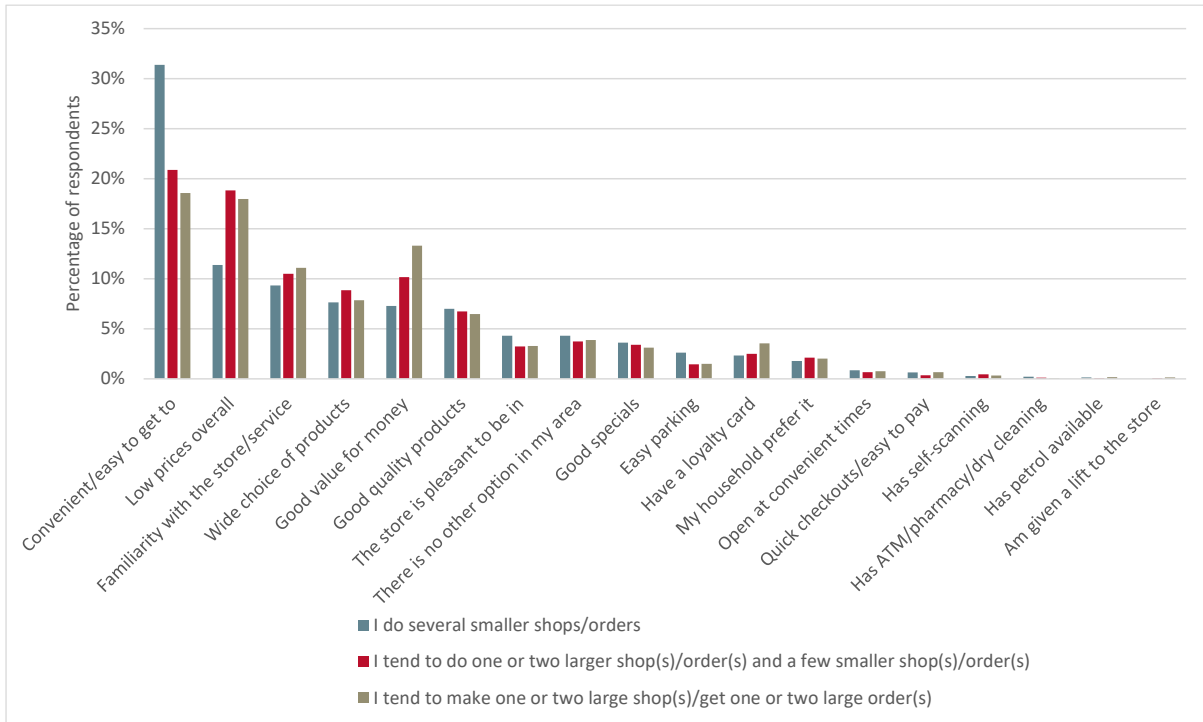
- 4.74 Grocery retailers choose to emphasise different dimensions of the retail grocery offer depending on the type of shopping mission a consumer is engaged on. Evidence suggests that the major grocery retailers do extensive research to understand how their retail grocery offer matches consumers' needs so that they can maximise store attractiveness and fulfil every different type of shopping mission.<sup>205</sup>
- 4.75 Given that the retail grocery offer is aligned with consumer shopping behaviour, our expectation is that the drivers of store choice will also vary depending on the type of shopping mission a consumer is engaged in.
- 4.76 Woolworths NZ told us that each consumer (or household) has a range of shopping missions within any given week or month that they need to fulfil. For some shopping missions such as top-up shops, convenience will be most important, while for other shopping missions, quality, range or price might be more important.<sup>206</sup>
- 4.77 Our analysis of our consumer survey suggests that consumers who tend to do several smaller shops a week value convenience and ease of access relatively more than consumers who tend to do at least one or two larger shops a week. It also appears that consumers who tend to do one or two larger shops a week are relatively more price sensitive than consumers who engage in more frequent shopping trips (see Figure 4.3).

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<sup>205</sup> For example: [ ]; [ ];

<sup>206</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [59].

**Figure 4.3 Respondents’ key reason for choice of main store by type of shopping trip**



Source: Commerce Commission analysis of responses to our consumer survey.<sup>207</sup>

- 4.78 Participants in the Ipsos study reported different forms of shopping missions that they engaged in each week. These included a main shop, a secondary smaller shop, and the occasional top-up shop. Each of these different types of shopping missions prioritised different drivers for store selection.<sup>208</sup>
- 4.79 The Ipsos study found that shopping routines and store selection by participants was mainly driven by a sense of convenience, ie, proximity and a need for routine and familiarity. The study also found that specific store choice can also be influenced by a range of secondary factors, including store atmosphere, quality and value, and the range of products available. Some participants also had a scheduled, much smaller secondary shop to allow them to take advantage of the perceived quality of one retailer and the pricing of another.<sup>209</sup>
- 4.80 We note that this finding is consistent with our analysis of the responses to our consumer survey as discussed above.

<sup>207</sup>

[ ].

<sup>208</sup>

Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 7.

<sup>209</sup>

Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 8-9.

- 4.81 Our preliminary finding is that the key drivers of store choice vary to some degree between different types of shopping missions. Although convenience is the key driver of store choice across all types of shopping missions, price appears to be a relatively more important consideration for consumers doing a larger shop.

**Many consumers prefer to use a major grocery retailer for their main shop**

- 4.82 Supermarkets attract consumers because they provide them with convenient one-stop shopping for a wide range of grocery products, either online or in a bricks-and-mortar store. The availability of a wide range of products reduces the time and costs of shopping, whether shopping in store or online.<sup>210</sup> It also provides supermarkets with a competitive advantage for consumers' main shop over other grocery retailers with a smaller range of products.<sup>211</sup>
- 4.83 The major grocery retailers are of the view that the traditional retail grocery channels are becoming less important as consumers move towards convenience-based shopping alternatives. For example, Woolworths NZ told us that there is a significant and growing range of retailers and other suppliers of food and grocery products in New Zealand that compete directly and successfully with "traditional supermarket" grocery retailers.<sup>212</sup>
- 4.84 This is consistent with Foodstuffs NI's view that changes in the shopping preferences of consumers are increasing the intensity of competition faced by traditional supermarkets. They are of the view that there is a wide range of options for consumers across different product categories and shopping missions and that full-service grocery retailers face material competitive constraint across all product categories.<sup>213</sup>

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<sup>210</sup> An additional attraction for consumers who use supermarkets is that a main shop allows consumers to purchase groceries at a much lower total transaction cost than would be the case if the same groceries were purchased at a range of specialist stores. Transaction costs include payment fees, transportation costs, search costs and the value the consumer places on their time when shopping for groceries. Commerce Commission "Decision Nos. 606 & 607, Determination pursuant to the Commerce Act 1986 in the matter of applications for clearance of business acquisitions involving: Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited, and Foodstuffs South Island Limited; and (separately) Woolworths Limited and The Warehouse Group Limited" (8 June 2007) at [122], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf).

<sup>211</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 2.

<sup>212</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 28.

<sup>213</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 2-3.



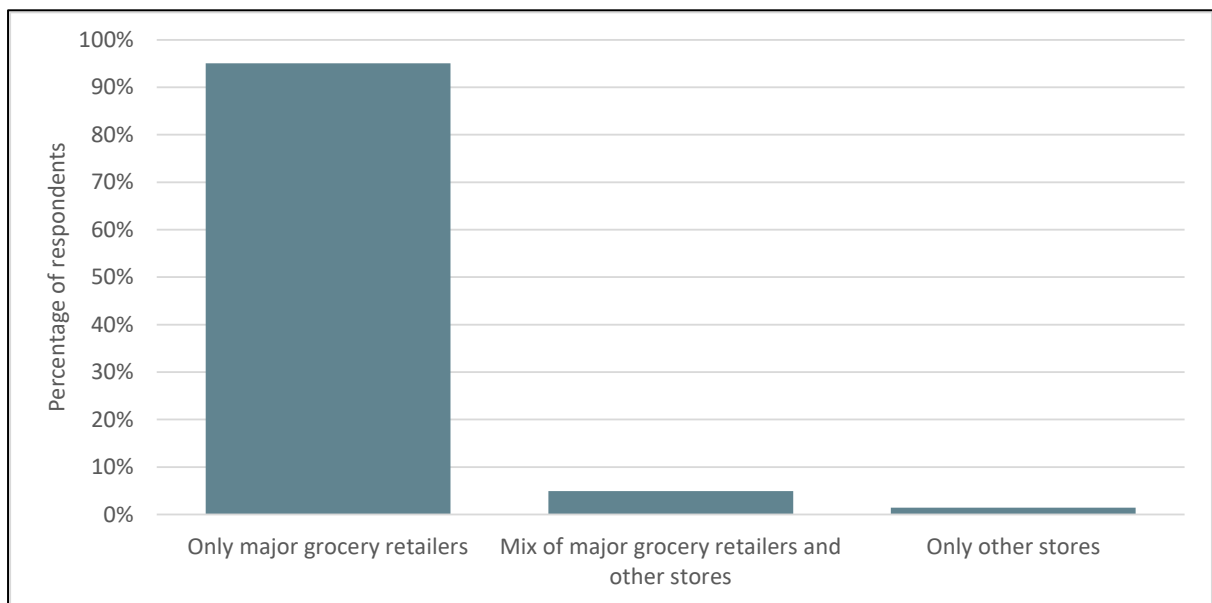
4.85 Despite submissions from the major grocery retailers<sup>214</sup> on the decline of the main shopping mission and the competitive advantage of the one-stop shop format, evidence from our consumer research suggests that most consumers prefer to buy groceries for their main shop at one grocery store and typically from one of the major grocery retailers.<sup>215</sup> We discuss this further below.

*Consumer research suggests that consumers view the major grocery retailers as each other's closest competitors for consumers' main shop*

4.86 Evidence from our consumer research suggests that consumers view the major grocery retailers as each other's closest alternatives for purposes of doing a main shop.

4.87 Figure 4.4 below shows that 95% of respondents to our consumer survey reported one of the major grocery retailers as their main store.<sup>216</sup> This seems to confirm that consumers view the major grocery retailers as each other's closest competitors for a main shop.

**Figure 4.4 Main store choice by respondents to our consumer survey (%)**



Source: Commerce Commission analysis of responses to our consumer survey.<sup>217</sup>

<sup>214</sup> For example: Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 2.

<sup>215</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 7.

<sup>216</sup> 'Main store' was defined as 'the store you spend most at, or do most of your grocery shopping with'.

<sup>217</sup> [ ].

- 4.88 Many participants in the Ipsos study described using specialist grocery retailers and other grocery retailers for top-up shops or supplemental to their main grocery shop. However, time and a desire to do a ‘one-stop shop’ hindered these other grocery retailers from being used for a main shop.<sup>218</sup> This finding is consistent with our analysis of the responses to our consumer survey.
- 4.89 Some of the reasons provided by participants indicated that they prefer doing their main shop at a one-stop shop in order to avoid having to visit multiple locations. The major grocery retailers were viewed as best positioned for this purpose as they have a wider selection of products in one location.<sup>219</sup>
- 4.90 The Ipsos study also found that the major grocery retailers are the most popular destination for consumers’ main shop. Participants indicated that they are typically viewed as being most convenient and overall considered less expensive for many product categories when compared to other grocery retailers.<sup>220</sup>
- 4.91 The results from our consumer research therefore suggest that there is a core group of consumers that prefers one-stop shopping at supermarkets which offer a wide range and options for doing a main shop.

*Market share estimates of different shopping missions confirms that the major grocery retailers are each other’s closest competitors for consumers’ main shop*

- 4.92 Market share estimates of different types of shopping missions by retail banner show that the major grocery retailers have a combined estimated share of more than 90% for consumers’ main shop.<sup>221</sup>
- 4.93 We acknowledge that these estimates may vary between different local markets depending on alternative options available to consumers for their main shop.
- 4.94 However, these market share estimates appear to confirm that the major grocery retailers are each other’s closest competitors for consumers’ main shop and that other grocery retailers do not provide a material competitive constraint on the major grocery retailers for consumers’ main shop.
- 4.95 We discuss the extent and intensity of competition between the major grocery retailers for consumers’ main shop in Chapter 5.

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<sup>218</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 8.

<sup>219</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 36.

<sup>220</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 8.

<sup>221</sup> [ ].

### **The extent to which other grocery retailers compete with the major grocery retailers depend on the type of shopping mission a consumer is engaged in**

- 4.96 We agree with the submission by Foodstuffs SI that a retailer with a broader offering, albeit with one or two omissions such as fresh vegetables/dairy, offers more general competition to the major grocery retailers. This is particularly so for those consumers whose mission is not a main shop. This means that competition between the major grocery retailers and other grocery retailers is likely to be closer where consumers are engaged in shops other than a main shop.<sup>222</sup>
- 4.97 However, market share estimates of different types of shopping missions by retail banner show that the major grocery retailers have a combined estimated share of more than 80% for top-up shops.<sup>223</sup>
- 4.98 Although this may vary in different local markets, we are of the view that this provides evidence that the major grocery retailers still have some key advantages over other grocery retailers when competing for smaller top-up shopping missions.
- 4.99 The implications our findings have for the strength of competition between the major grocery retailers and other grocery retailers is discussed in more detail in Chapter 5.

### **The nature of local competition in grocery retailing**

- 4.100 The major grocery retailers are likely to face a greater level of constraint from each other and other grocery retailers with a national (or significant geographic) presence. However, grocery retailers also compete with each other for specific shopping missions in local markets where consumers live and work. Store location is a key driver of store choice due to the generally limited distances consumers are willing to travel to purchase groceries.
- 4.101 There is not a one sized estimation of the approximate geographic size of local markets that applies to all local areas across New Zealand. It is difficult to precisely estimate a delineation of the size of geographic markets as it may vary according to local factors such as topography and the distribution of the population relative to the stores in the area. In some local markets competition may therefore occur over a shorter or longer distance than our estimates indicate. This is consistent with Woolworths NZ's view that there is no clear-cut answer as to how far consumers will travel for groceries, given the diverse range of factors that can drive each and every shopping mission.<sup>224</sup>
- 4.102 We discuss the range of factors which will influence how far consumers are willing to travel for grocery shopping purposes below.

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<sup>222</sup> Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 14-15.

<sup>223</sup> [ ].

<sup>224</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 59.

### **The approximate geographic size of local markets may vary between different types of retailers and shopping missions**

- 4.103 Research suggests that the importance of distance decreases according to how much the consumer feels they will achieve, or plans to achieve, by visiting a particular store.<sup>225</sup>
- 4.104 This means that a consumer who plans to spend a large percentage of their household budget in a particular store is likely to be less influenced by the distance to the store than a consumer who plans to spend only a small percentage of their household budget at the same store.<sup>226</sup> Consumers may therefore be willing to travel further to shop at their main store than they would be willing to travel for convenience or top-up shopping purposes.
- 4.105 This is consistent with submissions from Foodstuffs NI and Woolworths NZ that consumers are likely to be willing to travel further to larger stores. Specifically, Foodstuffs NI told us that the distance any particular consumer will drive to a store depends on a range of factors, including the nature of the shopping mission and the size and type of store, as consumers ordinarily drive further to larger stores such as PAK'nSAVE.<sup>227</sup> Woolworths NZ also told us that Costco is seen as a “destination shop” and that they have seen analysis from Australia suggesting that Costco stores have in-person catchment areas of approximately 25 km.<sup>228</sup>
- 4.106 Feedback from other grocery retailers confirms that they tend to compete for consumers located within relatively small local areas, which is consistent with our view that consumers mainly use these retailers for the purposes of smaller or top-up shopping missions. For example, some of these retailers have indicated that they consider catchment areas to range from just a few blocks from the location of the store to approximately 10 minutes’ driving distance.<sup>229</sup>
- 4.107 However, depending on the alternative options available to consumers in local markets and/or regions they may be willing to travel further to stores that could be regarded as destination stores (eg, international food stores).

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<sup>225</sup> Hansen et al. “How the Measurement of Store Choice Behaviour Moderates the Relationship between Distance and Store Choice Behaviour” (2013) at 3-4, available at: <https://core.ac.uk/download/pdf/50684972.pdf>.

<sup>226</sup> NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 31.

<sup>227</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 24.

<sup>228</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 27.

<sup>229</sup> For example: [ ];  
[ ].

### The approximate geographic size of local markets varies depending on urban or rural store locations

- 4.108 We have estimated the approximate geographic size of local markets separately for urban and rural areas. This is because there are regional variations in the options available to consumers, both in terms of product range and the diversity of grocery stores. Rural consumers also tend to drive further than urban consumers for grocery shopping purposes. We discuss regional variations in the options available to consumers below from paragraph 4.120.
- 4.109 This is consistent with Foodstuffs SI's submission that the distance that consumers are willing to travel to purchase groceries is catchment dependent based on the nature and unique attributes of the community. In their view a catchment area would generally be up to a 15 km radius. However, for a rural store its catchment area will depend on the store's location and its proximity to surrounding urban areas.<sup>230</sup>
- 4.110 In previous investigations we used a five km radius around each grocery store as a starting point to estimate the approximate geographic size of local markets.<sup>231</sup>
- 4.111 However, for the purposes of our study we have chosen to use drive time to estimate the approximate geographic size of local markets in urban and rural areas. We agree with Foodstuffs NI that as a rule of thumb, the traditional five to 10 km radius around a particular grocery retailer used in the New Zealand context is of limited value.<sup>232</sup> This is because distance-based measures may not provide an accurate picture of how consumers can access a particular site and the alternative options available to them in the area close to where they live or work.

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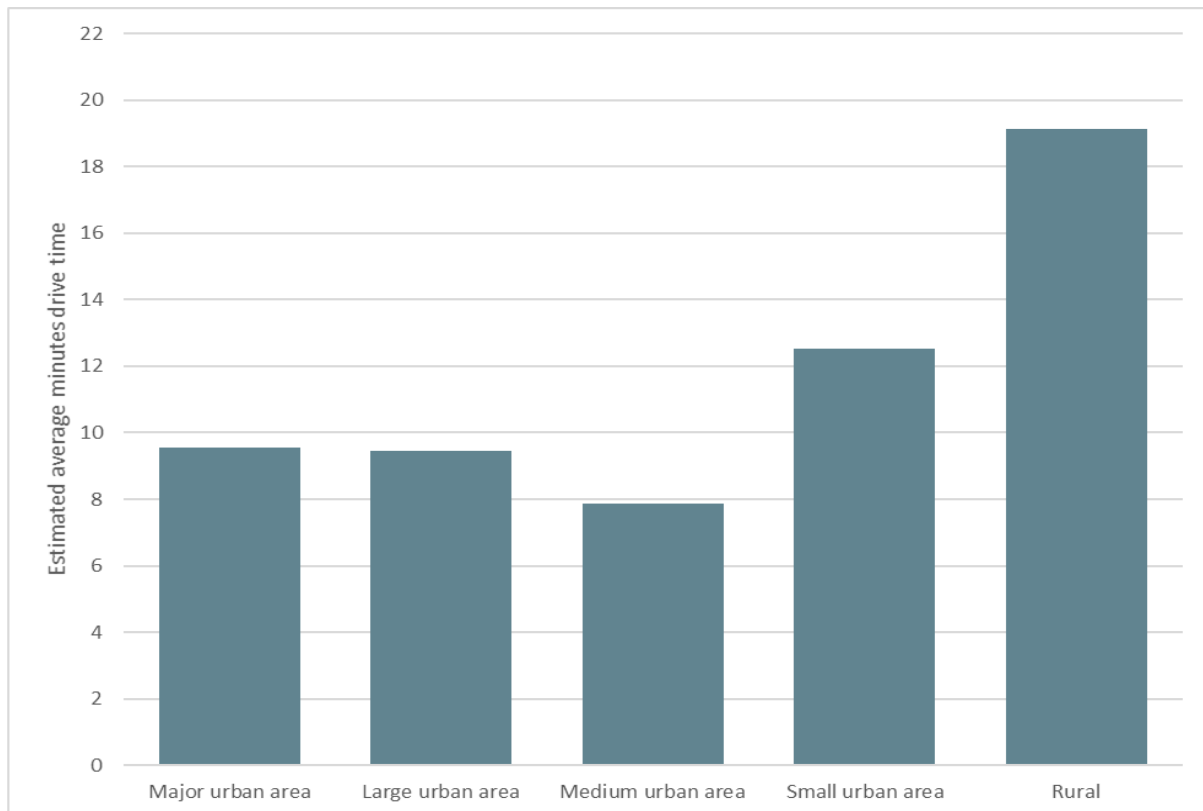
<sup>230</sup> Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 15.

<sup>231</sup> For example: Commerce Commission "Decision Nos. 606 & 607, Determination pursuant to the Commerce Act 1986 in the matter of applications for clearance of business acquisitions involving: Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited, and Foodstuffs South Island Limited; and (separately) Woolworths Limited and The Warehouse Group Limited" (8 June 2007) at [E18], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf); Commerce Commission "Decision No. 438, Application for clearance involving: Progressive Enterprises Limited and Woolworths (NZ) Limited" (13 July 2001) at [66]-[69], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/73073/438.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0020/73073/438.pdf).

<sup>232</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 24.

4.112 Our analysis of the responses to our consumer survey shows that, on average, respondents in medium (eg, Te Awamutu), large (eg, Rotorua) and major (eg, Auckland) urban areas travel less than 10 minutes to their main store. Consumers located in small urban (eg, Gore) and rural areas (eg, Haast) tend to travel longer to their main store, with consumers in rural areas travelling close to 20 minutes on average to their main store (see Figure 4.5). This is not an unexpected finding, as consumers living in rural areas may be more likely to make less frequent and longer journeys to stock up on products in bulk.<sup>233</sup>

**Figure 4.5 Estimated average drive time to main store**

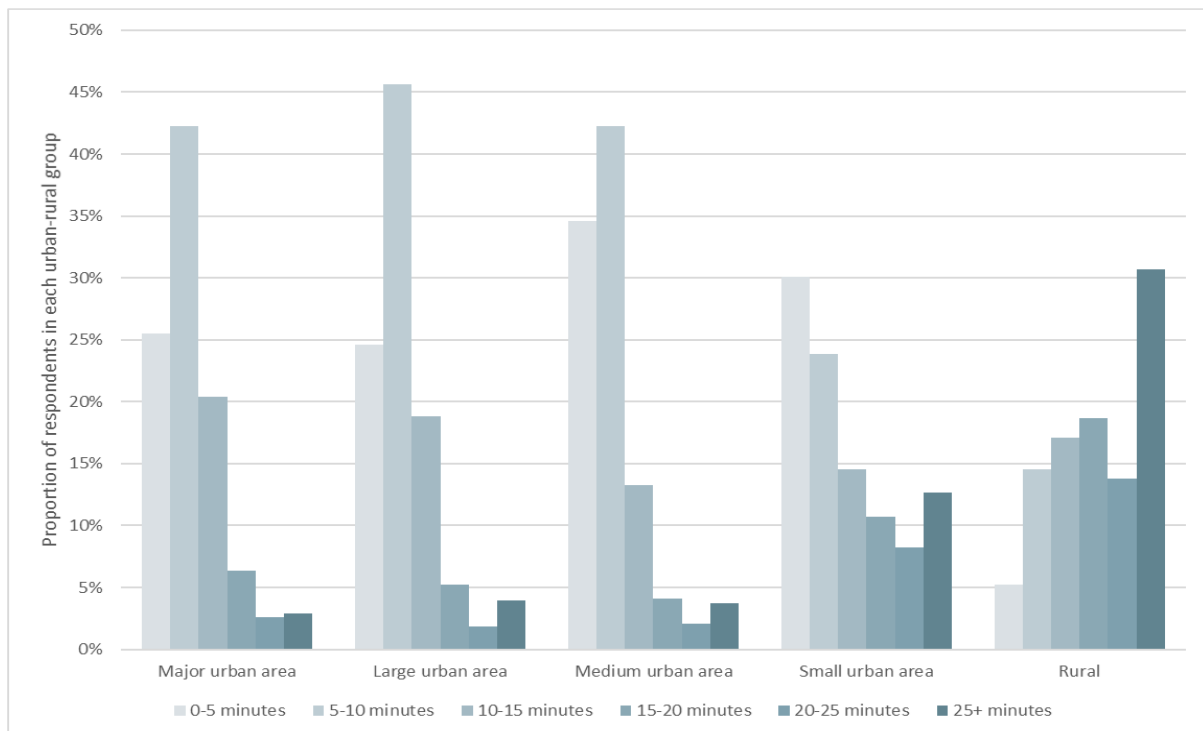


Source: Commerce Commission analysis of responses to our consumer survey.<sup>234</sup>

4.113 Our analysis also shows that more than 60% of urban respondents travel less than 10 minutes to their main store. However, in comparison less than 20% of rural respondents indicated that they travel less than 10 minutes to their main store, while approximately 30% of rural respondents stated that they have to travel more than 25 minutes to their main store (see Figure 4.6).

<sup>233</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 59.

<sup>234</sup> [ ].

**Figure 4.6** How long it usually takes respondents to travel to their main store

Source: Commerce Commission analysis of responses to our consumer survey.<sup>235</sup>

- 4.114 Most of the participants in the Ipsos study reported that they travel less than 7 km for grocery shopping purposes and that they did not need to travel far to access alternative stores. However, rural participants reported often having to travel further (up to 40 minutes) for their main shop and therefore needed to plan larger shops more carefully.<sup>236</sup> This finding is consistent with our analysis of the responses to our consumer survey.
- 4.115 Business cases of the major grocery retailers also confirm that urban catchment areas tend to be smaller than for those of stores located in rural areas.
- 4.116 Estimates of urban catchment areas for Countdown and New World stores range from 1 km to 10 km.<sup>237</sup> PAK'nSAVE stores tend to have a slightly wider catchment area of up to 15 km.<sup>238</sup> This is consistent with Foodstuffs NI's submission that consumers are generally willing to drive further to larger stores and PAK'nSAVE.<sup>239</sup>

<sup>235</sup> [redacted].

<sup>236</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 26-27.

<sup>237</sup> For example: [redacted];

[redacted].

<sup>238</sup> [redacted].

<sup>239</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 24.

- 4.117 However, estimates of catchment areas for Countdown and New World stores in rural locations tend to be wider than those in urban areas, generally ranging between 3 km and 40 km.<sup>240</sup>
- 4.118 Frontier Economics used two different measures of competition in local markets to estimate the approximate geographic size of local markets in urban and rural areas for the major grocery retailers.<sup>241</sup> The results of the first method using a weighted market share approach indicate that the approximate geographic size of local markets in rural areas vary between 5 to 20 minutes' drive time. Estimations of the approximate geographic size of local markets in urban areas range between 10 to 20 minutes' drive time.<sup>242</sup>
- 4.119 The second method uses a dummy variable for proximity of each store to the major grocery retailers as the measure of competition. Using this method, the results indicate that the approximate geographic size of local markets in both urban and rural areas vary between 5 to 20 minutes' drive time.<sup>243</sup>

### **Regional variations in the grocery store options available to consumers**

- 4.120 In this section we discuss the analysis we undertook to assess regional variations across New Zealand in prices and the variety of grocery store options available to consumers.
- 4.121 Our analysis of the location of major grocery retail banners and other grocery retailers shows that consumers in rural areas typically have less choice and variety of retail grocery options than consumers located in urban areas. Analysis done by Frontier Economics also shows that prices relative to Auckland are higher in the South Island and the Central and Lower North Island.

### **Consumers in rural areas tend to have less choice than those located in urban areas**

- 4.122 The geographic location of stores in different local markets and/or regions of itself does not provide us with any information of the extent and intensity of competition between the major grocery retailers and other grocery retailers. However, the locations of grocery stores provide a useful overview of the different retail grocery options available to consumers and how it may affect consumer shopping behaviour.

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<sup>240</sup> For example: [ ];  
[ ]

<sup>241</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector - Report for the Commerce Commission" (15 July 2021) at 28.

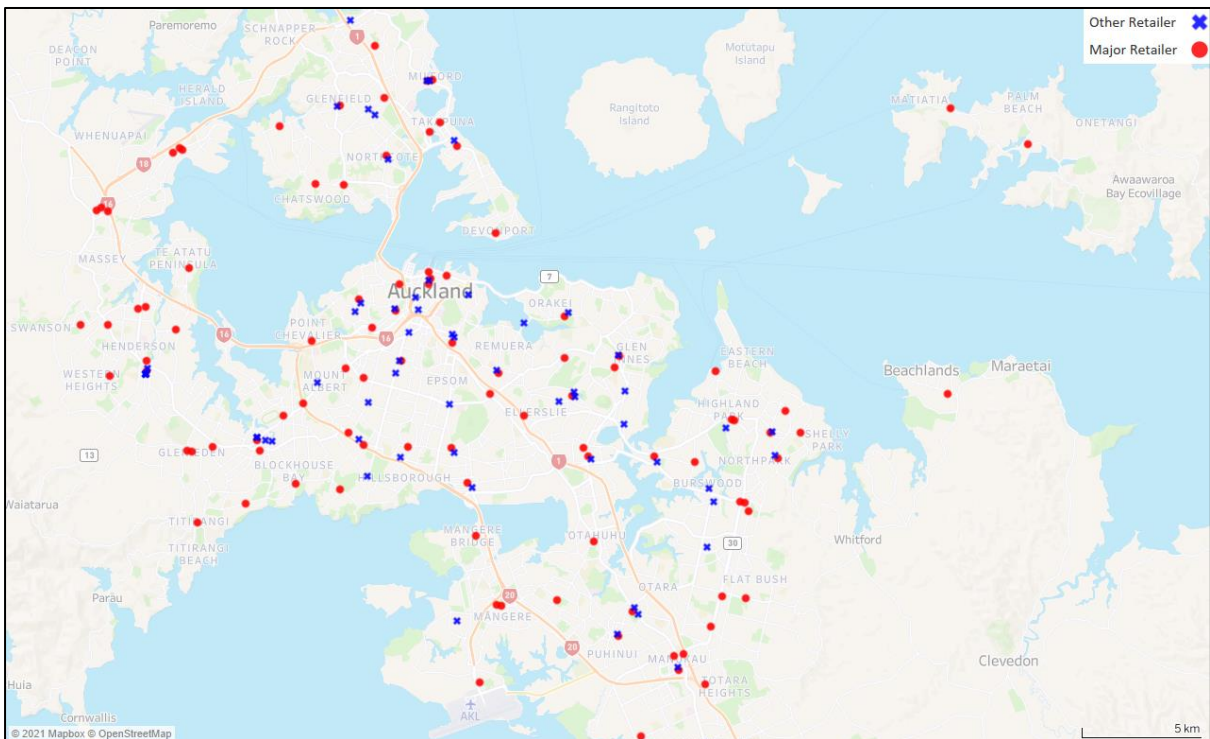
<sup>242</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector - Report for the Commerce Commission" (15 July 2021) at 28-29.

<sup>243</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector - Report for the Commerce Commission" (15 July 2021) at 30-31.



- 4.123 As shown in Figure 4.7 to Figure 4.9 below, consumers in rural areas typically have less variety and choice available to them compared to urban consumers. Consumers in the Auckland region also appear to have comparatively greater variety in grocery shopping options available to them than consumers located in other urban areas or rural areas.<sup>244</sup>
- 4.124 We have not attempted to show the locations of every store across New Zealand that might sell one or more grocery products. Rather, our analysis includes the locations of categories of grocery retailers that sell a wider range of products (such as international food stores and other supermarkets), as they are most likely to provide an alternative option to some consumers for their main shop.

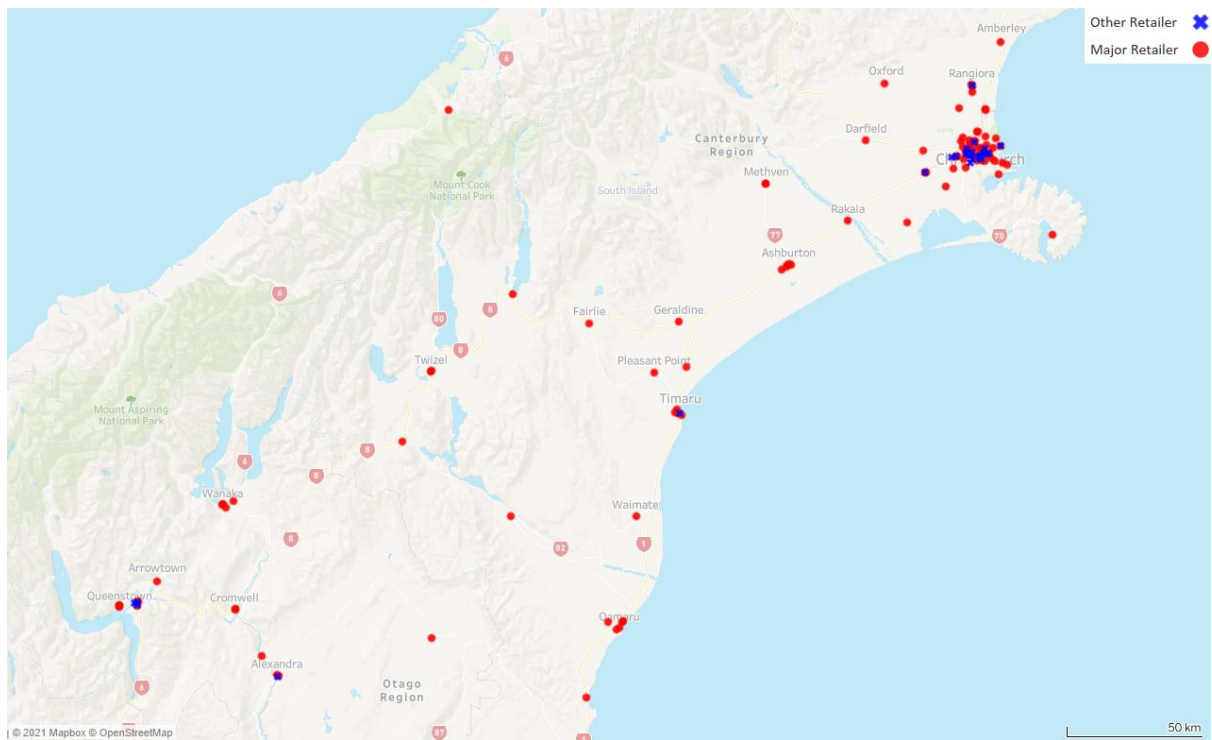
**Figure 4.7 Grocery store locations in Auckland**



Source: Commerce Commission analysis of information provided by grocery retailers.<sup>245</sup>

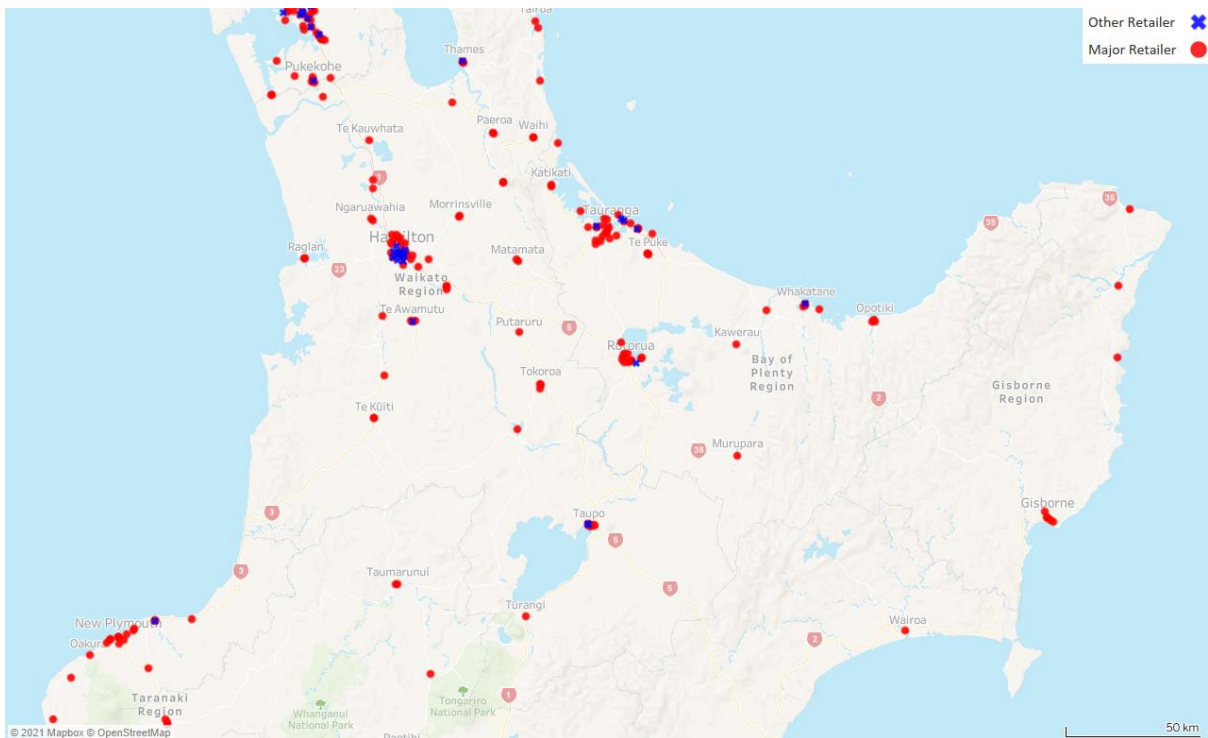
244 See Attachment B for additional maps of other regions across New Zealand.  
 245 [ ]; [ ].

**Figure 4.8 Grocery store locations in the central South Island**



Source: Commerce Commission analysis information provided by grocery retailers.<sup>246</sup>

**Figure 4.9 Grocery store locations in the central North Island**



Source: Commerce Commission analysis of information provided by grocery retailers.<sup>247</sup>

### There is some evidence of small regional price differences between the major grocery retailers

- 4.125 In general, we would expect to see variation in prices between different regions due to differences in factors such as transport costs and market structures.
- 4.126 However, pricing and promotion decisions by the major grocery retailers mostly take place at a national or regional level (see paragraphs 4.34 to 4.36). This means that there may not be significant variation in pricing within the major grocery retail banners in different local markets and/or regions. This is consistent with analysis by Frontier Economics on the variation in pricing across stores of the major grocery retail banners.<sup>248</sup>

<sup>247</sup> [ ]; [ ].

<sup>248</sup> Analysis by Frontier Economics shows that with the exception of [ ], pricing at the stores of the other major grocery retail banners typically lie within [ ] percent of each other. Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 24.

- 4.127 Estimates by Frontier Economics of the average price differences within each retail banner show that there are mostly only small differences in average prices between the North Island and South Island.<sup>249</sup>
- 4.128 In order to assess potential regional price variations in more detail Frontier Economics used two different methods to analyse whether there are any material inter-regional differences in prices charged by the major grocery retailers across New Zealand. The differences in the results between the two methods reflect differences in the availability of major grocery retail banners in different regions. Table 4.1 below provides a summary of the findings of Frontier Economics.
- 4.129 Method 1 reflects inter-regional variation within major grocery retail banners and provides estimates of the average differences in prices across regions within major grocery retail banners relative to Auckland. Price indices were developed for each retail banner and a price index number was then estimated for each store within the retail banner. The results of this method provide estimates of the average differences in prices across regions within major grocery retail banners.
- 4.130 Method 2 shows inter-regional price variation in prices based on a national index across all the major grocery retail banners. It provides estimates of the combined effect of different prices across regions within major grocery retail banners and the different availability of these banners in each region.
- 4.131 Store price indices were estimated by comparing all stores to a base store. After this store-revenue weighted averages of the price indices of the stores in each region were calculated. The weighting ensures that the results also reflect how much money consumers spend in each store and retail banner in each region.

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<sup>249</sup> Analysis by Frontier Economics shows that for all major grocery retail banners except [ ] there are only small differences in average prices between the North Island and South Island. On average, [ ] stores are [ ] cheaper in the South Island than in the North Island. Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 18.

**Table 4.1 Regional price differences relative to Auckland**

	Region	Method 1 Retail banner-specific indices	Method 2 National index
<b>Upper North Island</b>	Auckland	0.0%	0.0%
	Bay of Plenty	-0.6%	0.5%
	Northland	-0.6%	3.0%
	Waikato	-0.4%	1.7%
<b>Central and Lower North Island</b>	Gisborne	-1.1%	1.2%
	Hawke's Bay	1.5%	1.4%
	Manawatu-Whanganui	1.3%	2.1%
	Taranaki	1.3%	2.2%
	Wellington	1.1%	1.4%
<b>South Island</b>	Canterbury	-0.7%	1.7%
	Marlborough	-0.5%	1.9%
	Nelson	-0.7%	2.8%
	Otago	-1.3%	3.3%
	Southland	-1.5%	3.1%
	Tasman	-1.6%	1.9%
	West Coast	-1.9%	4.8%

Source: Table 9, Frontier report.<sup>250</sup>

- 4.132 Overall, the results from Method 1 show that average prices across regions within major grocery retail banners are lower in regions outside Auckland, with the exception of the Lower North Island. However, this method does not account for the fact that there may be material differences in average prices across regions resulting from the concentration of particular major grocery retail banners in certain regions.<sup>251</sup>

<sup>250</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 20.

<sup>251</sup> For example, analysis by Frontier Economics on the number of stores by major grocery retail banner and type of area shows that rural areas tend to be services only by [ ] stores. Additional analysis by Frontier Economics also shows that [ ] stores tend to be substantially [ ] than other major grocery retail banners for most products other than tobacco. Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 17 and 19.

- 4.133 Method 2 accounts for this by estimating the combined effect of different prices across regions within major grocery retail banners and the different availability of major grocery retail banners in each region. We are therefore of the view that Method 2 provides a more accurate reflection of inter-regional differences in prices and how this may affect consumer outcomes in different regions across New Zealand.
- 4.134 The results from Method 2 in Table 4.1 above shows prices relative to Auckland are generally higher in the South Island and the Central and Lower North Island. The West Coast is the most expensive when compared with other regions relative to Auckland when using the national index to account for differences in the availability of major grocery retail banners in different regions.<sup>252</sup> This is not an unexpected finding given differences in transport costs between rural areas such as the West Coast and other regions across the country.

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<sup>252</sup> Analysis by Frontier Economics indicates that [ ] stores tend to be the [ ] stores for products other than tobacco and that rural areas tend [ ]. Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 19.

## Chapter 5 Competition at the retail level

### Summary of preliminary findings

- In Chapter 4 we noted our preliminary view that most consumers buy groceries for their main shop at one grocery store and they typically prefer to use one of the major grocery retailers for this main shop. Major grocery retailers are uniquely placed to offer the convenience of a main shop at a single location and appear to be each other's closest competitors for consumers' main shop. Other grocery retailers do not provide a material constraint.
- In this chapter we further discuss the level of competition between major grocery retailers, and between major grocery retailers and other grocery retailers.
- Although the fringe of other grocery retailers provides options for some consumers in local markets for secondary or top-up shopping missions, they generally do not compete with the major grocery retailers for consumers' main shop. Neither do retail offerings like meal kits provide a substitute for supermarket shopping, either alone, or when combined with retail offerings by other grocery retailers.
- New small-scale entry is viable. However, new entry by other grocery retailers appears to have limited impact on the major grocery retailers. It is unlikely that any new grocery retailer with a similar retail offer to the major grocery retailers will, under current market circumstances, enter at the scale required for effective competition for consumers' main shop.
- Our analysis suggests that other grocery retailers monitor the prices of similar products stocked by the major grocery retailers, but it is rare for the major grocery retailers to monitor and respond to the retail offerings of other grocery retailers.
- Our preliminary view is that competition between the major grocery retailers is also not effective. Major grocery retailers differentiate their retail banners in ways that appear to limit competition between them, particularly on price.
- Further, analysis shows that local market concentration has little or no effect on price competition between the major grocery retailers and there is also little variation in the market shares of the major grocery retailers' retail banners over time. This suggests that price competition between the major grocery retailers is less than we would expect to see in a workably competitive market.
- Our study did not disclose any evidence that the major grocery retailers are accommodating each other's strategies. However, some features of the retail grocery sector suggest it is vulnerable to tacit coordination, such as common relationships with the same suppliers.

## Introduction

- 5.1 This chapter discusses the intensity of competition between different types of grocery retailers and examine how the structure of local grocery markets affects price competition between the major grocery retailers. We also provide an estimate of market shares in the retail grocery sector and consider whether grocery retailers are accommodating each other's strategies.
- 5.2 We received a range of perspectives on the intensity of competition in the retail grocery sector. The major grocery retailers consider that the retail grocery sector in New Zealand is intensely competitive and a wide range of different types of grocery retailers provide a strong competitive constraint to the traditional one-stop shop, especially for smaller shopping missions.<sup>253</sup> They also consider that accommodating behaviour is neither occurring nor likely to occur in the retail grocery sector.<sup>254</sup>
- 5.3 However, the NZFGC and Consumer NZ both consider the constraint provided by other grocery retailers to be limited and the risk of accommodating behaviour to be a concern.<sup>255</sup>
- 5.4 In Chapter 4 we noted our preliminary view that other grocery retailers do not constrain the major grocery retailers to a significant extent in any local market(s), either individually or in aggregate.
- 5.5 In addition, in a workably competitive market, we would expect to see a much higher degree of price competition and to see this result in more significant variation in market shares. However, the evidence suggests that market shares are stable over time and that there is active management of price differentials between their respective retail banners by each major grocery retailer.
- 5.6 This chapter has five main sections:
- 5.6.1 our approach to analysing competition at the retail level;
  - 5.6.2 what is the extent to which other grocery retailers compete with the major grocery retailers?
  - 5.6.3 how intense is the level of competition between the major grocery retailers?

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<sup>253</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 11-28; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 1; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 4-5.

<sup>254</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 25-26; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 17; Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 60-61.

<sup>255</sup> NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 20 and 32; Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 4-6.



- 5.6.4 how does the structure of local grocery markets affect price competition between the major grocery retailers?
- 5.6.5 are grocery retailers accommodating each other's behaviour?

### **Our approach to analysing competition at the retail level**

- 5.7 This section describes the economic concepts we have used to assess the intensity of competition between the major grocery retailers and other grocery retailers. These concepts provide a basis for the conclusions that follow about the structure of the retail grocery market and the conduct within it.
- 5.8 Our approach to assessing retail competition considers the following topics:
  - 5.8.1 there are several factors that determine the extent of competition between different types of grocery retailers;
  - 5.8.2 grocery retailers are likely to face weaker competitive constraints in concentrated markets with barriers to entry and retail grocery offer differentiation;
  - 5.8.3 the intensity of competition between grocery retailers may differ at a national, regional and local level;
  - 5.8.4 the future competitive environment in grocery retailing is likely to remain relatively stable; and
  - 5.8.5 firms can reach an understanding to accommodate each other's behaviour without an explicit agreement.

### **There are several factors that determine the extent of competition between different types of grocery retailers**

- 5.9 As discussed in Chapter 4, there are many different types of grocery retailers in New Zealand. Each of these retailers competes over one or more aspects of the PQRS spectrum, such as location, price and product range. The extent of competition between grocery retailers varies both by retail banner and geography.
- 5.10 Competitive intensity is defined as the extent to which firms exert competitive pressure on each other. The degree of differentiation in a market can play an important role in determining the competitive intensity between firms. Differentiation of the retail grocery offer can benefit consumers if their preferences are better met by the choices available. However, differentiation can weaken price competition by limiting the number of firms directly competing with each other.

- 5.11 The importance placed by many consumers on non-price dimensions of competition provides grocery retailers with an opportunity to differentiate their retail grocery offer and to influence consumers' decisions about where to shop. The evidence we have gathered during our study suggests that differentiation on non-price dimensions of the retail grocery offer tends to be a more common feature in the grocery retailing market than price competition.
- 5.12 Competitive constraints may also be weakened if grocery retailers do not have a strong incentive to compete. For example, if they can benefit from increased prices by accommodating each other's price rises rather than competing strongly to constrain them. Competitive constraints in the market may be further weakened to the extent that consumers are not willing and/or able to switch from one retail banner to another.
- 5.13 We note that there are also other factors that influence competitive intensity between firms, including costs, market concentration, the rate of market growth and switching costs.

**Grocery retailers are likely to face weaker competitive constraints in concentrated markets with barriers to entry and retail grocery offer differentiation**

- 5.14 Market concentration measures are indicators of the structure of a market. Measures of concentration calculate the extent to which market shares are concentrated between firms competing in the same market and are indicators of potential market power and competitive intensity.<sup>256</sup> Most models of competition predict that a potential change in market structure, for example, the number of firms competing in the market, will have consequences for competition and market prices.<sup>257</sup> Specifically, higher concentration, or fewer firms in a market, is usually associated with weaker competition and higher prices particularly when there are also barriers to entry and expansion.
- 5.15 The relationship between the concentration or structure of the market and intensity of competition can be somewhat ambiguous. For example, greater concentration might indicate a decline in competition, but might also demonstrate that competition is effective and that more efficient firms are able to gain market share.<sup>258</sup> Further, the differentiated nature of the retail grocery offering implies that the intensity of competition between grocery retailers in New Zealand may be weaker than in more homogenous markets, even in instances where there appears to be fewer retail grocery options and more competitors.

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<sup>256</sup> See: <https://www.oecd.org/daf/competition/market-concentration.htm#:~:text=Market%20concentration%20measures%20the%20extent,for%20the%20intensity%20of%20competition>. Some of the more commonly used market concentration measures include the Herfindahl-Hirschman Index (HHI) and the Concentration Ratio (CR).

<sup>257</sup> P Davis and E Garcés "Quantitative Techniques for Competition and Antitrust Analysis" *Princeton University Press, Princeton and Oxford* (2010) at 230.

<sup>258</sup> OECD "Summary of Discussion of the Hearing on Market Concentration (2018)" *DAF/COMP/M(2018)1/ANN6/FINAL* (12 November 2019) at 2, available at: [https://one.oecd.org/document/DAF/COMP/M\(2018\)1/ANN6/FINAL/en/pdf](https://one.oecd.org/document/DAF/COMP/M(2018)1/ANN6/FINAL/en/pdf).

- 5.16 However, in general we expect that grocery retailers will face weaker competitive constraints in markets with fewer retail grocery options where there are barriers to entry and expansion. Weak competition in retail grocery markets may harm local consumers in the short term and consumers in general in the longer term. This may be evidenced through higher prices, as well as lower levels of service and a reduction in quality and other non-price aspects of the retail grocery offer.
- 5.17 We have assessed the extent to which grocery retailers adjust dimensions of their retail grocery offer at the store level in response to local competitive conditions and market structures. We discuss the results of the analysis by Frontier Economics to assess the effect of local market structures on prices below from paragraph 5.118.

### **The intensity of competition between grocery retailers differs at a national, regional and local level**

- 5.18 As discussed in Chapter 4, some of the decisions affecting local competition are made at a national or regional level by the major grocery retailers. These include pricing and promotional policies, as well as the acquisition of groceries.
- 5.19 At most, other grocery retailers tend to compete with the major grocery retailers only over some aspects of the retail grocery offer. This competition tends to occur in some local markets for consumers on smaller shopping missions. However, these other grocery retailers generally do not operate nationally and are therefore unable to constrain the major grocery retailers at a national level.
- 5.20 Some of the other grocery retailers have multiple stores in some regional areas such as Auckland that allow them to purchase groceries from suppliers in bulk. However, they also operate at a much smaller scale than the major grocery retailers. This means that they are unlikely to be cost competitive for most products. Nevertheless, they may provide some competition for smaller shopping missions in local markets where they operate.
- 5.21 It appears that the aggregated effect of competition by other grocery retailers in local markets is not sufficient to competitively constrain the major grocery retailers at a national or regional level. We discuss this further below paragraph 5.39.

### **The future competitive environment in the grocery retailing market is likely to remain relatively stable**

- 5.22 In general, we expect incumbent firms to have less incentive to compete vigorously in markets where the competitive environment is relatively stable and unlikely to be disrupted by external factors, such as new entry or fluctuations in demand.
- 5.23 There are several factors that contribute toward a stable outlook for the grocery retailing market.

- 5.24 First, the existence of barriers to entry and expansion means that it is unlikely that any new competitors with similar retail grocery offers to the major grocery retailers will enter at the scale required to directly challenge them and compete for the main shop of consumers (see Chapter 6).
- 5.25 Second, the cost advantages of the major grocery retailers in the acquisition of groceries limits the ability of small grocery retailers to compete directly with the major grocery retailers on price (see Chapter 6).
- 5.26 Third, the grocery retailing market has relatively stable and predictable demand when compared with other industries, even though it is subject to shifts in taste and market shocks such as the COVID-19 pandemic. Grocery purchases are necessary and frequent. In the absence of the threat of disruption by new entry or expansion, stable demand will tend to lead to stable market shares because grocery retailers have weaker incentives to compete vigorously and risk triggering a price war that may ultimately only serve to reduce industry profitability.
- 5.27 We discuss the stability of market shares in the retail grocery market further below from paragraph 5.74.

#### **Firms can accommodate each other's behaviour without an explicit agreement**

- 5.28 A firm in a workably competitive market will find it hard to raise prices in order to increase profits. This is because of the risk that consumers will respond by switching to cheaper rivals and the firm will lose market share.<sup>259</sup> Tacit coordination refers to a situation where firms recognise they can reach a more profitable outcome if they accommodate each other's price increases rather than undercut them.<sup>260</sup>
- 5.29 Firms in concentrated oligopoly or duopoly markets are interdependent in the sense that each firm's actions affects the other firms, and each firm will consider its rivals' likely reactions when deciding its own competitive strategy. Firms will rationally take account of their rivals' potential actions and reactions when setting prices or making other decisions about their product or service offerings.
- 5.30 In certain situations, firms in oligopolistic or duopoly markets may be able to coordinate their actions to achieve and sustain higher than competitive prices and profits.
- 5.31 Accommodating behaviour or tacit coordination, such as price leadership-price following behaviour, does not necessarily require an explicit agreement or express coordination between competing firms.<sup>261</sup>

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<sup>259</sup> Price increases that occur due to an increase in the marginal costs of all firms is consistent with competition.

<sup>260</sup> Commerce Commission "Mergers and acquisitions guidelines" (July 2019) at [3.85].

<sup>261</sup> Commerce Act 1986, s 30.

- 5.32 Tacit coordination can cause economic harm, as discussed further below, but is not unlawful. Explicit coordination may be both harmful and unlawful, and may breach cartel laws. We have not seen evidence of explicit coordination in our study to date.
- 5.33 Tacit coordination can develop instead where firms are able to reduce uncertainty by repeatedly observing each other's actions and reactions so that they each learn how the others will respond and, for example, that one firm's price rises will be matched by others rather than competed away through inter-firm rivalry. In this report we variously use the terms accommodating behaviour, price leadership and tacit coordination to refer to this type of conduct.
- 5.34 When firms engage in accommodating behaviour this can result in higher than competitive prices being charged, or a decline in other non-price aspects of competition. When this occurs, prices above competitive levels can generate higher than normal industry profits, to the detriment of consumers and efficiency.
- 5.35 However, accommodating behaviour of this nature is not an inevitable outcome of oligopoly market structures. Two conditions must hold for it to occur.<sup>262</sup>
- 5.35.1 Firms must be able to reach similar views<sup>263</sup> on how they can maintain or increase industry profits. For example, firms may reach similar views that changes in the leader's price should be followed rather than competed away.<sup>264</sup>
- 5.35.2 Firms must be able to detect and punish cheating, so that the potential individual profit gains from a firm's cheating are outweighed by the costs of punishment.<sup>265</sup>
- 5.36 We note that even if these conditions are met, tacit coordination may not be sustainable if it can be disrupted by the entry of other firms or the countervailing actions of consumers.

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<sup>262</sup> We note that the major grocery retailers compete at different levels of the supply chain, for different locations and products. The vulnerability of the retail grocery market to tacit coordination may differ to some extent in each market throughout the country where they compete.

<sup>263</sup> As outlined above, this may occur with or without an agreement between the firms.

<sup>264</sup> Firms that follow a leader's price changes will increase their own prices in response to the leader's prices rises and lower their prices, but not undercut the leader's, in response to the leader's price reductions.

<sup>265</sup> Punishment may take the form of a period of aggressive market behaviour by a rival (or rivals) to retaliate against a firm deviating from the accommodating behaviour. For example, the rival could set prices low (or increase quantity) which would reduce the profits of the deviating firm. The threat of punishment deters firms from accommodating behaviour. For example: M Motta "Competition Policy: Theory and Practice" *Cambridge University Press, Cambridge* (2004) at 139.

- 5.37 In addition to the price leader-follower behaviour described above, we also note that tacit and explicit coordination can be achieved based on indirect communication through a common upstream supplier or downstream consumer. These are known as “hub-and-spoke arrangements”. The “hub” facilitates the coordination between the “spokes” without direct contacts between the spokes. Tacit coordination occurs by each spoke communicating with the hub, and the hub sharing information it has learned from one spoke with the other spokes.<sup>266</sup>
- 5.38 Most grocery retailers have many common suppliers that they interact with on a frequent basis as part of the category management process. Communication by one retailer with its supplier, and by that supplier with a competing retailer, may lead to tacit coordination if it enables them to get a sense of the conduct of competitors. We discuss this further below from paragraph 5.150.

### **What is the extent to which other grocery retailers compete with the major grocery retailers?**

- 5.39 In this section we assess the extent of the aggregate competitive constraint imposed on the major grocery retailers by other grocery retailers.
- 5.40 Providing consumers with an alternative retail grocery offering to the major grocery retailers by and of itself may not be indicative of strong competition in the market. In a workably competitive market, we would expect to see an incentive for the major grocery retailers to adjust their retail grocery offer and lower profit margins in response to the threat of losing a material portion of consumers to other grocery retailers.
- 5.41 T&G Fresh told us that supermarkets hold considerable market share compared to other grocery retailers who may be more specialised and offer limited products.<sup>267</sup>
- 5.42 In contrast, the major grocery retailers consider that the retail grocery market is highly competitive and that they face significant competitive constraints from a wide range of other grocery retailers. For example, Woolworths NZ told us that they face a diverse competitive landscape, including:<sup>268</sup>
- 5.42.1 other supermarkets;
  - 5.42.2 specialist grocery retailers;

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<sup>266</sup> We note that while this indirect communication may be supplemented with some direct communication between the spokes, the primary avenue for communication is through the hub. See, for example, in the context of explicit coordination rather than tacit coordination: Joseph E. Harrington, Jr. “How Do Hub-and-Spoke Cartels Operate? Lessons from Nine Case Studies” (2018), available at: [https://joeharrington5201922.github.io/pdf/Harrington\\_Hub%20and%20Spoke%20Collusion\\_18.08.24.pdf](https://joeharrington5201922.github.io/pdf/Harrington_Hub%20and%20Spoke%20Collusion_18.08.24.pdf).

<sup>267</sup> T&G Fresh “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 3.

<sup>268</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 13-16.

- 5.42.3 convenience stores;
  - 5.42.4 general merchandise retailers;
  - 5.42.5 liquor stores;
  - 5.42.6 health and beauty retailers and pharmacies;
  - 5.42.7 specialist pet retailers;
  - 5.42.8 online grocery specialists and online platforms;
  - 5.42.9 hardware retailers;
  - 5.42.10 trade specialists that have developed consumer offerings;
  - 5.42.11 ready-to-eat delivery and meal kit providers; and
  - 5.42.12 food and beverage service providers.
- 5.43 Woolworths NZ also told us that the intensity of competition in the market and the willingness of New Zealanders to shop around between grocery retailers means that they need to have multiple different competitive initiatives to stay relevant to their customers to avoid significant loss of sales to Foodstuffs and other grocery retailers.<sup>269</sup>
- 5.44 In the sections below we complement some of our conclusions in Chapter 4 and assess the extent to which other grocery retailers compete with the major grocery retailers for consumers' main shop. We also consider whether there is any evidence that the major grocery retailers adjust their prices or other non-price dimensions of their retail grocery offer in response to competition by other grocery retailers.

**Different types of grocery retailers may exercise asymmetric competitive constraints on each other**

- 5.45 The retail grocery market is differentiated and grocery retailers compete over a wide range of dimensions in the retail grocery offer (see Chapter 4). The differentiated nature of the retail grocery market means that larger grocery stores may constrain the price of smaller stores while the reverse may not be true. We refer to this as asymmetric competitive constraints.

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<sup>269</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 12-13.

- 5.46 Our study appears to confirm the existence of asymmetric competitive constraints between other grocery retailers and the major grocery retailers. Most of these other grocery retailers told us they monitor prices of similar products stocked at the major grocery retailer banners located in close proximity to their own stores and that they make price adjustments accordingly in order to ensure that their prices are competitive.<sup>270</sup>
- 5.47 Although we have seen some evidence of ad hoc price comparisons done by the major grocery retailers of prices charged at other grocery retailers,<sup>271</sup> we have seen little evidence to suggest that these comparisons are done on an ongoing and consistent basis, or that the major grocery retailers adjust their prices in response to such monitoring.
- 5.48 We have also seen some evidence of the major grocery retailers adjusting their product range in some local markets to compete with the likes of international food stores.<sup>272</sup> However, we have not seen any consistent evidence of them adjusting their product and service offerings in response to competition from other grocery retailers.
- 5.49 In contrast, the major grocery retailers do monitor both price and non-price dimensions of competition of each other's competing retail banners on an ongoing and frequent basis. We have also seen evidence that they adjust and improve their retail grocery offers in response to changes in the competitive offering of other major grocery retailer banners (see paragraphs 5.103 to 5.106 below).
- 5.50 Frontier Economics also assessed the extent to which other grocery retailers located in close proximity to the major grocery retailers have any effect on the prices set by the major grocery retailer banners. They found that there is little evidence that other grocery retailers have an effect on the prices set by the major grocery retailers.<sup>273</sup>

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<sup>270</sup> For example: [ ]; [ ].

<sup>271</sup> For example: [ ].

<sup>272</sup> [ ].

<sup>273</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 30-31.



### **Other grocery retailers generally do not compete for consumers engaged in a main shop mission**

- 5.51 We acknowledge submissions from the major grocery retailers that New Zealanders actively cross shop across a variety of different types of retailers. For example, Woolworths NZ told us that Nielsen Homescan data shows that in a given month, more than half of New Zealanders will shop at specialists and non-supermarkets for retail grocery products. Additional analysis shows that some consumers will visit other food and grocery retailers on the same shopping trip. Woolworths NZ submitted that this means that these other grocery retailers compete closely with traditional supermarket retailers.<sup>274</sup>
- 5.52 However, in Chapter 4 we discussed our research into consumer shopping preferences and concluded that most consumers buy groceries for their main shop at one grocery store and they typically prefer to use one of the major grocery retailers for this main shop. Major grocery retailers are uniquely placed to offer the convenience of a main shop at a single location and this presents them with a competitive advantage.
- 5.53 In general, the dimensions of the retail grocery offer that are important to consumers on a main shopping mission such as price and range are usually not strong parts of the retail grocery offer of other grocery retailers. The ability of other grocery retailers, meal kit providers and food box operators to constrain the major grocery retailers across the full retail grocery offer is limited. As a result, our preliminary view, noted in Chapter 4 is that the major grocery retailers appear to be each other's closest competitors for consumers' main shop and other grocery retailers, and any observable cross shopping, do not provide a material constraint on the major grocery retailers.

### **Other grocery retailers tend to strategically differentiate their retail grocery offers from the major grocery retailers**

- 5.54 In Chapter 4 we also concluded that other grocery retailers tend to differentiate their retail grocery offer primarily on non-price dimensions as well as tending to compete mostly for smaller, secondary or top-up shopping missions.
- 5.55 The differentiated nature of the retail grocery market means that the retail grocery offers of different types of grocery retailers are imperfect substitutes and that consumer preferences will depend not only on price but also on non-price dimensions of the retail grocery offering. Grocery retailers with similar product offerings on both price and non-price dimensions of the retail grocery offer will therefore be each other's closest competitors.

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<sup>274</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 16.

- 5.56 Other grocery retailers told us that they tend to focus on the non-price dimensions of their retail grocery offer, such as product range and quality rather than attempting to compete strongly on price. This is mainly because they cannot match the major grocery retailers’ cost and scale advantages (see Chapter 6) and therefore cannot compete directly with the major grocery retailers on price across the full range of products stocked at the major grocery retailer banners.
- 5.57 We note that in instances where other grocery retailers do compete with the major grocery retailers on price they tend to focus on particular products or subsets of consumers, such as those products stocked at international food stores or consumers who are willing to buy bulk goods.<sup>275</sup>
- 5.58 Some examples of differentiation on non-price dimensions of the retail grocery offer by other grocery retailers include:
- 5.58.1 some specialist grocery retailers told us that they differentiate their retail grocery offering from the major grocery retailers by stocking a different range of fresh produce and meat products;<sup>276</sup>
  - 5.58.2 we were told that some convenience stores change their product range to cater for take-away food options and consumers on impulsive shopping missions;<sup>277</sup> and
  - 5.58.3 some other supermarkets told us that they create a unique shopping experience for consumers by stocking a different range of fresh foods and imported goods in comparison to the product range available at the major grocery retailers.<sup>278</sup>
- 5.59 We acknowledge that there are benefits to consumers from having more choice in local markets to satisfy diverse needs and preferences. However, the differentiation between the retail grocery offer of the major grocery retailers and those of other grocery retailers weakens potential competition between them as they tend to compete for consumers on different types of shopping missions.
- 5.60 This means that there is limited incentive for the major grocery retailers to adjust their retail grocery offering in response to competition from other grocery retailers. This is because there is a low risk that a material portion of consumers will switch to other grocery retailers in response to an increase in price (or decline in other non-price aspects of competition) of their respective retail grocery offers relative to those of other grocery retailers.

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<sup>275</sup> [ ];  
[ ].

<sup>276</sup> [ ]; [ ].

<sup>277</sup> [ ];  
[ ].

<sup>278</sup> [ ]; [ ].

## Meal kit providers and food box operators provide an additional convenience option for consumers

- 5.61 Increased demand from consumers for convenience in the form of home delivery options has led to significant growth of meal kit providers and food box operators in New Zealand in recent years, albeit from a low base. The COVID-19 pandemic has also contributed to the growth in the number of consumers using these services.
- 5.62 The major grocery retailers told us that meal kit providers such as My Food Bag and HelloFresh have grown significantly in recent years and that they operate as direct competitors to traditional grocery retailers by reducing the need for main shops.<sup>279</sup> In response the major grocery retailers have expanded their ready-to-eat and quick-to-prepare in-store offerings in response to the competition provided by meal kit providers. For example, Woolworths NZ told us that there is an increasing offering of convenience initiatives and "ready-to-eat" options within large format grocery stores, and they have implemented other initiatives such as layout changes to bring read-to-eat food closer to the front of the store.<sup>280</sup>
- 5.63 However, the NZFGC<sup>281</sup> and Consumer NZ<sup>282</sup> suggest that meal kits are unlikely to place a significant competitive constraint on the major grocery retailers, as they tend to be targeted at a specific consumer segment, which would generally include less price sensitive consumers.
- 5.64 A meal kit provider told us that although they compete to some extent with the major grocery retailers on food consumption expenditure, their direct competitors are other meal kit providers.<sup>283</sup> Similarly, a food box operator told us that although they view anyone selling similar products as a competitor (including the major grocery retailers), they compete closely with meal kit providers for the same wallet spend.<sup>284</sup>

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<sup>279</sup> For example: Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 6; Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 2-3. Woolworths NZ told us that there has been a significant uptake of meal kit providers and that this channel is estimated to be worth over [ ] and growing at more than [ ] per annum in New Zealand.

<sup>280</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 23.

<sup>281</sup> NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 21.

<sup>282</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 4.

<sup>283</sup> [ ].

<sup>284</sup> [ ].

- 5.65 Some participants in the Ipsos study mentioned exploring alternatives such as food boxes and meal kit deliveries. However, while many participants noted having tried a meal kit or food box delivery service in the past, only a handful were regular users. A lot of the uptake of food boxes and meal kits reported by participants related to aggressive pricing promotions, variety, choice and convenient solutions.<sup>285</sup>
- 5.66 Further, the overall financial commitment required to regularly subscribe to meal kit providers and food boxes and the fact that they do not fully remove the need for some grocery shopping, means that participants in the Ipsos study were less likely to switch all their spending to meal kits or adopt these as a long-term alternative.<sup>286</sup>
- 5.67 The overall benefits of these services for participants were time saved on meal planning and preparation, as well as new variety and portion control. However, many found meal kits to be more costly than a typical grocery order and often time consuming to prepare. Those who had used them felt that it had not stopped them from doing a regular grocery shop, as other meals and non-food grocery items still need to be purchased.<sup>287</sup>
- 5.68 Our preliminary view is that there may be a degree of competition between meal kit providers, food box operators and the major grocery retailers for consumers that value convenience. However, we are of the view that meal kit providers tend to provide a differentiated service to that offered to consumers by the major grocery retailers. This means that meal kits are generally not considered a substitute for supermarket shopping as consumers still need to do a regular grocery shop for essential items. We are also of the preliminary view that meal kit providers and food box operators may not provide a viable alternative option for all consumers, particularly for those who are more price sensitive.

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<sup>285</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 40.

<sup>286</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 40.

<sup>287</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 40. We note that participants in the Ipsos study indicated that meal kits and food boxes were seen to have more competition than grocery retailers due to the number of available brands and the aggressive promotional behaviour. Participants felt that price and choice was available in this segment of the market as it was viewed as less ‘structured’ than the supermarkets.

- 5.69 Although meal kit providers have grown significantly in recent years, their combined share of the total retail grocery market remains small.<sup>288</sup> Further, as discussed in Chapter 3, the slow growth of online grocery sales in New Zealand implies that online competitors such as meal kit providers are unlikely to provide significantly more competition to the major grocery retailers in the foreseeable future.

**Evidence provided by the major grocery retailers suggest that they face weak competition from other grocery retailers in most local markets**

- 5.70 As discussed above, if there were strong competition between the major grocery retailers and other grocery retailers, we would expect to see the major grocery retailers adjusting their retail grocery offer in response to competition from these other grocery retailers.
- 5.71 We have seen little evidence of other grocery retailers featuring in any strategic considerations by the major grocery retailers.
- 5.72 Business cases considering the potential establishment of new stores by the major grocery retailers generally only assess competition by existing major grocery retailer banners within the relevant catchment area. Although there are some references to other types of grocery retailers such as bakeries, international food stores and petrol stations within the relevant catchment area, the assessment of existing competition in these business cases tends to focus mainly on the proximity of competing major grocery retailers to the proposed site of a new major grocery retail store.<sup>289</sup>
- 5.73 This seems to indicate that other grocery retailers generally do not compete strongly with the major grocery retailers on any aspects of their retail grocery offer, either individually in local markets or in aggregate at a national or regional level.

**The combined market shares of the major grocery retailers is persistently high and stable over time**

- 5.74 In this section we provide estimates of market shares in the retail grocery sector. Although we have not formally defined a market as part of our study, we refer to these estimations as market shares for purposes of our analysis in this section.
- 5.75 These estimates contribute to our assessment of competition in the retail grocery market in a number of ways.
- 5.76 First, the stores included in the major grocery retailers' estimates of market shares can provide evidence of the extent to which they consider other grocery retailers as competitors.

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<sup>288</sup> We estimate that meal kit providers currently account for less than 2% of the total retail grocery market. This is based on the submission from Woolworths NZ that the channel accounts for approximately [ ] and data from Statistics New Zealand on the total size of the retail grocery sector (\$22 billion).

<sup>289</sup> For example: [ ].

- 5.77 Second, a high market share held over a long period of time is one indication of market power.<sup>290</sup> Enduring market power may indicate that competition is not working well for the long-term benefit of consumers.
- 5.78 However, we note that high market shares alone do not necessarily mean a firm has market power. Therefore, we also consider other relevant factors in our study to assess potential market power of the major grocery retailers such as the intensity of existing competition and conditions of entry and expansion (see Chapter 6).
- 5.79 Third, changes in market shares over time is one measure of the intensity of competition between grocery retailers. In a workably competitive market, we would expect to see variation of market shares over time as grocery retailers compete to win and retain customers.<sup>291</sup> However, stable market shares may indicate that grocery retailers are not aggressively competing for customers.
- 5.80 We have used the following sources of information to estimate market shares of grocery retailers in New Zealand:
- 5.80.1 evidence provided by the major grocery retailers relating to their estimates of market shares;
  - 5.80.2 our own estimates based on sales revenue information received from industry participants and data from Statistics New Zealand; and
  - 5.80.3 an estimate of market shares in the retail grocery sector by Canstar.<sup>292</sup>

*The major grocery retailers measure market shares in different ways*

- 5.81 The major grocery retailers monitor and estimate market shares of their own retail banners and competing major grocery retailer banners on a frequent and consistent basis.<sup>293</sup> There are some differences between the way major grocery retailers estimate market shares.<sup>294</sup>

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<sup>290</sup> We note that high market shares by and of itself do not necessarily mean a firm has market power.

<sup>291</sup> Absent any other factors such as demand or supply shocks that may result in greater variation of market shares.

<sup>292</sup> Available at: <https://www.stuff.co.nz/business/industries/122947384/nz-supermarkets--the-illusion-of-choice-when-there-are-just-two-big-players>.

<sup>293</sup> For example: [ ]; [ ].

<sup>294</sup> Some of the main differences include: [

].

*Market share estimates provided by the major grocery retailers show that their combined shares are high*

- 5.82 We reviewed a sample of market share estimates provided by the major grocery retailers to analyse shares for the period January 2015 to January 2020 at both a national and regional level.<sup>295</sup>
- 5.83 Table 5.1 shows the minimum estimated combined market shares separately for each of the major grocery retailers in the North Island, South Island and at the national level. It shows that the major grocery retailers have a high estimated combined share based on their own calculations and across a range of different data sources.
- 5.84 We note that estimates shown in Table 5.1 come from a range of data sources, relate to different points in time and are measured over different periods of time. In addition, we do not have full visibility of the methodologies used by the major grocery retailers to estimate their respective market shares. There are also some inconsistencies with regards to the other grocery retailers included in their respective estimations.<sup>296</sup> Given these differences, we present market share estimates using a 10% range.

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<sup>295</sup> We did not include market share estimates in our sample after January 2020 to ensure that our analysis is not affected by impact of the COVID-19 pandemic.

<sup>296</sup> There are some instances where  
[  
example: [ ]. There are also some instances where ]. For  
[  
]. For example: [ ].

**Table 5.1 Minimum combined market shares of the major grocery retailers (January 2015 to January 2020, Moving Annual Total)<sup>297</sup>**

National						
	Jan 2015	Jan 2016	Jan 2017	Jan 2018	Jan 2019	Jan 2020
Foodstuffs	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Woolworths NZ	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
<b>Minimum combined market shares</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>90-100%</b>	<b>80-90%</b>	<b>80-90%</b>
North Island						
	Jan 2015	Jan 2016	Jan 2017	Jan 2018	Jan 2019	Jan 2020
Foodstuffs NI	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Woolworths NZ	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
<b>Minimum combined market shares</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>
South Island						
	Jan 2015	Jan 2016	Jan 2017	Jan 2018	Jan 2019	Jan 2020
Foodstuffs SI	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Woolworths NZ	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
<b>Minimum combined market shares</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>	<b>80-90%</b>

Source: Market share estimates based on information provided by the major grocery retailers.<sup>298</sup>

- 5.85 We also tested the major grocery retailers' estimates at the national level against an independent estimate by Canstar and our own estimates based on sales revenue data provided by industry participants and (secondly) on a combination of that information with Stats New Zealand data.

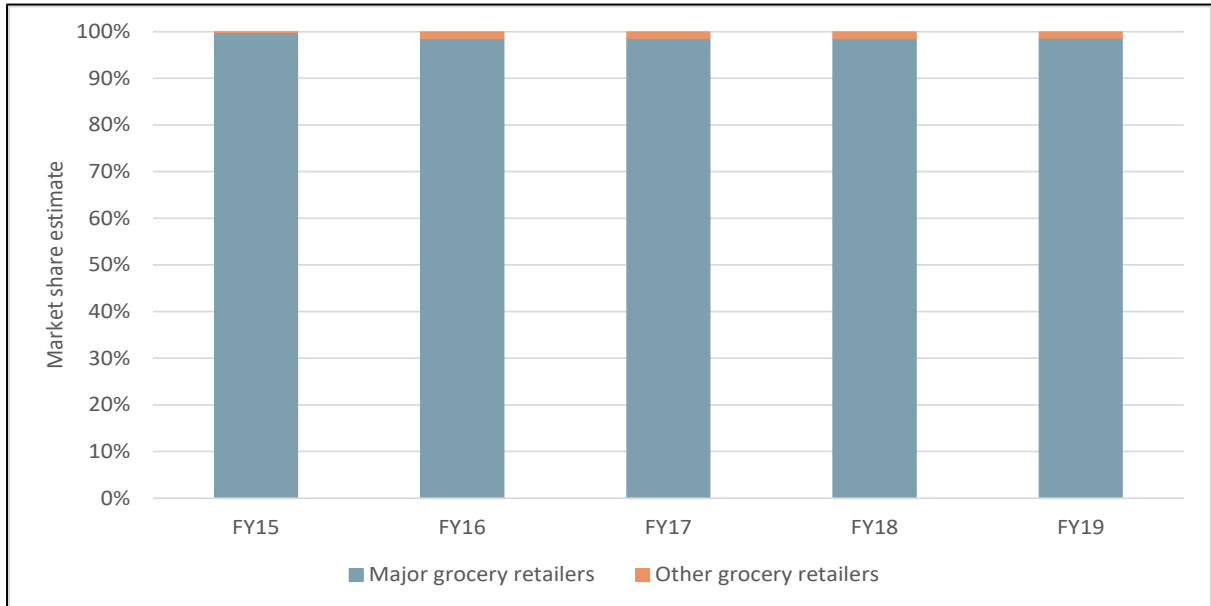
<sup>297</sup> The minimum combined market shares is the sum of the smallest estimates for each major grocery retailer's estimated market share in the sample of market share estimates provided by the major grocery retailers. Given the differences in estimation methodologies used by the major grocery retailers we use a 10% range to estimate the combined market share of the major grocery retailers.

<sup>298</sup> The analysis in Table 5.1 is based on a sample of market share estimates provided by the major grocery retailers for the period January 2015 to January 2020 at both a national and regional level.



- 5.86 For purposes of our first estimate we use sales revenue data sourced from financial and management accounts of the major grocery retailers and a sample of other grocery retailers to estimate market shares for each grocery retailer as a proportion of the total sales revenue (see Figure 5.1 below).<sup>299</sup>

**Figure 5.1 Market share estimates using sales revenue as a proportion of total sales revenue**



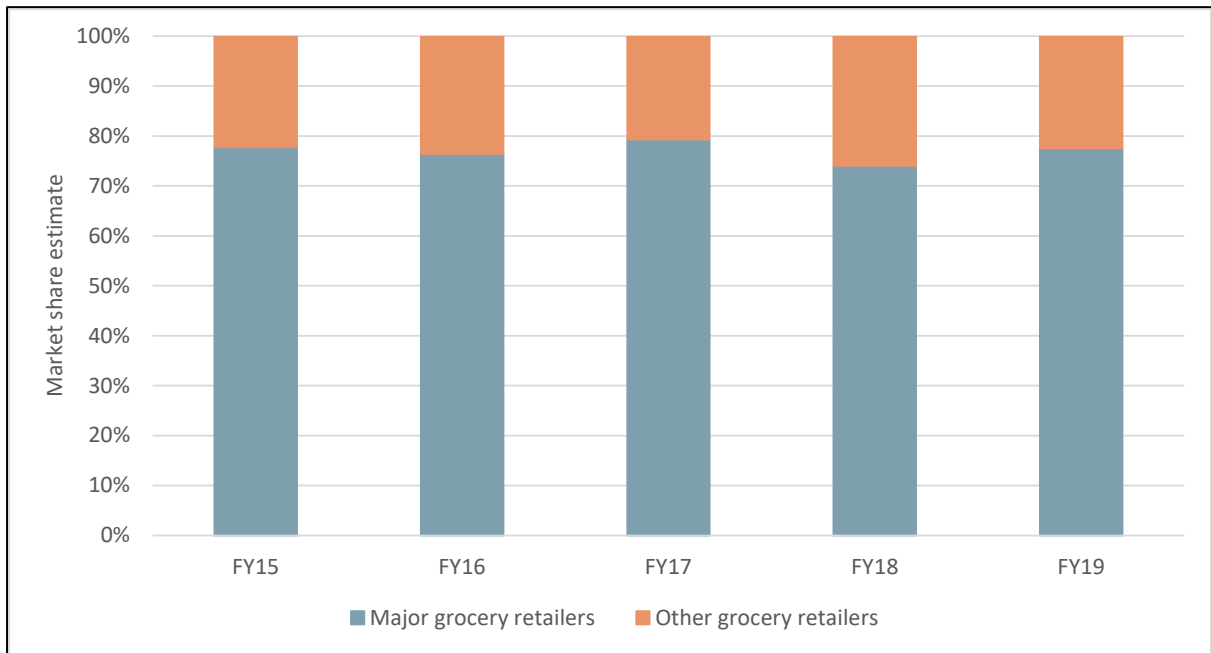
Source: Commerce Commission analysis of sales revenue provided by industry participants.<sup>300</sup>

- 5.87 Our second estimate uses data obtained from Statistics New Zealand on the total size of the groceries and supermarkets sector in New Zealand to estimate market shares in the retail grocery market (see Figure 5.2 below).
- 5.88 We note that our market share estimates in Figure 5.2 are slightly lower than the estimates of the major grocery retailers (see Table 5.1). This is because Statistics New Zealand include a wider range of smaller competitors in their calculations of the total size of the retail grocery sector than those included in the estimations of the major grocery retailers.<sup>301</sup>

<sup>299</sup> Financial data analysed for market share used the same sample of other grocery retailers as used for our margin analysis in Chapter 3.

<sup>300</sup> [ ].

<sup>301</sup> We note that the data obtained from Statistics New Zealand's Retail Trade Survey includes other supermarkets, convenience stores and international food stores, but excludes specialist grocery retailers.

**Figure 5.2 Market share estimates using sales revenue and Statistics NZ data**

Source: Commerce Commission analysis of sales revenue provided by industry participants and Statistics New Zealand data.<sup>302</sup>

- 5.89 Our estimates of the market shares of the major grocery retailers from FY15 to FY19 range between 90% to 100% in our first estimate and from 70% to 80% in our second estimate. These estimates span Canstar’s estimates of a combined market share of 85% in 2020.
- 5.90 We note that when the major grocery retailers include other grocery retailers in their own estimates their combined estimated market share is still high, ranging between 75% and 95%.<sup>303</sup>
- 5.91 We also find that there is little variation in market shares over time. This is consistent across all the different estimations discussed above (see Table 5.1 and Figure 5.1 to Figure 5.2). We are of the view that this provides further evidence that other grocery retailers do not compete strongly with the major grocery retailers.
- 5.92 Despite the multiple ways market shares can be measured, the combined market shares of the major grocery retailers appear to be high. We found that most estimates ranged from 80% to 90% and the lowest estimates of their combined market share were from 70% to 80%. We are of the view that this provides further evidence that the major grocery retailers are each other’s closest competitors.

<sup>302</sup> [ ].

<sup>303</sup> Estimates by [ ] for the North Island show that the major grocery retailers have a combined estimated market share ranging between [ ]. Different estimates by [ ] indicate that the major grocery retailers have a combined estimated market share ranging from [ ] at a national level. For example: [ ]; [ ].

- 5.93 Different estimates all show that market shares are stable over time. This suggests that the major grocery retailers are not competing closely with each other. In a workably competitive market, we would expect to see greater variation in market shares as firms compete for each other's customers.

### **How intense is the level of competition between the major grocery retailers?**

- 5.94 In this section we assess the intensity of competition between the major grocery retailers. This is important because we consider that the major grocery retailers do not compete closely with other grocery retailers.
- 5.95 The strength of competition between the major grocery retailers is therefore a key driver of the prices, quality and range of grocery products available to New Zealand consumers. In competition terms we refer to this type of market structure as a duopoly with a fringe of other grocery retailers.<sup>304</sup>

### **The major grocery retailers are each other's closest competitors**

- 5.96 As discussed in Chapter 4, the major grocery retailers provide similar retail grocery offers and are each other's closest competitors for consumers' main shop. This is confirmed by evidence we have seen of strategic considerations by the major grocery retailers, the Ipsos study and our consumer survey (see Attachment F). We discuss each of these below.

#### *What can we tell about the intensity of competition between the major grocery retailers from the consumer survey?*

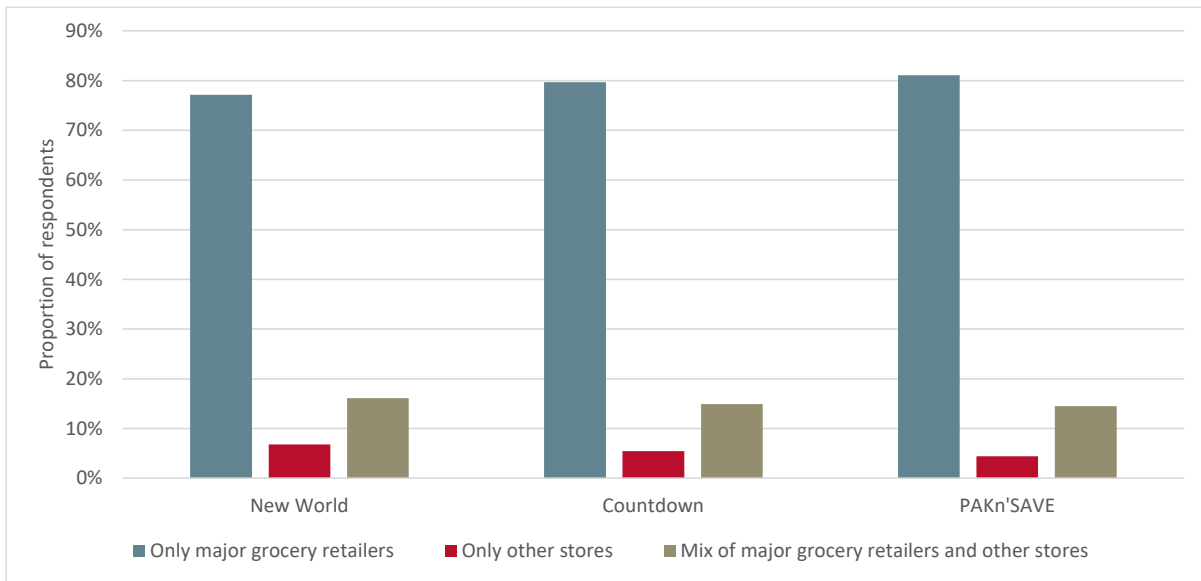
- 5.97 Our consumer survey contributes to our understanding of the closeness of competition between the major grocery retailers as it reveals consumers' views on the degree of substitutability between them.
- 5.98 Specifically, we asked respondents what their main store<sup>305</sup> was, and where they would shop if their main store(s) closed for the foreseeable future. The purpose of these questions was to test which stores respondents viewed as the closest substitutes to their main store.<sup>306</sup>
- 5.99 In Chapter 4 we noted that 95% of survey respondents reported one of the major grocery retailers as their main stores (see Figure 4.4). Figure 5.3 below shows that over 77% of respondents would switch their shopping to another of the major grocery retailers' stores if they reported their main store as Countdown, New World or PAK'nSAVE. This indicates that the consumers who responded to our consumer survey generally viewed the major grocery retailers as a closer alternative than other grocery retailers.

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<sup>304</sup> Whilst there are two separate Foodstuffs co-operatives, there are two major grocery retailers operating stores under national brands on each island.

<sup>305</sup> 'Main store' was defined as 'the store you spend most at, or do most of your grocery shopping with'.

<sup>306</sup> We gave respondents the option to choose up to 12 types of stores, modified to account for their main store. See paragraph F113 in Attachment F for further discussion on this question in our consumer survey.

**Figure 5.3 Types of stores that respondents would visit if their main store(s) closed<sup>307</sup>**

Source: Commerce Commission analysis of responses to our consumer survey.<sup>308</sup>

- 5.100 We note that although respondents to our consumer survey viewed the major grocery retailers as each other's closest alternatives, we cannot necessarily infer that the major grocery retailers are each other's closest competitors from the survey analysis alone. The survey also does not provide any evidence about what consumers would actually do if confronted with their main store closing. This may be different to what they told us they would do in response to a hypothetical store closure scenario.
- 5.101 In addition, our survey asked where respondents would shop if their main store closed for the foreseeable future, but it did not ask respondents how they would respond to a change in retail grocery offering. This is relevant as consumers' responses to a change in offering may influence how closely the major grocery retailers may compete.
- 5.102 We have therefore also considered additional evidence about the closeness of competition between the major grocery retailers such as market share estimates and evidence from the Ipsos study.

<sup>307</sup> We asked respondents which stores they would visit if their main store closed for the foreseeable future. Figure F21 in Attachment F shows where respondent would shop by store type. The sample size ranges from 3,700 for New World customers to 4,775 for Countdown customers.

<sup>308</sup> [ ].

*The major grocery retailers adjust their competitive strategies in response to frequent monitoring of each other's retail grocery offers*

- 5.103 The major grocery retailers regularly monitor the prices, product and service offerings of competitors in order to remain competitive. For example, Foodstuffs NI told us that it monitors Countdown's prices and also those of other competitors by reviewing websites of New Zealand and Australian grocery retailers to ensure that its prices are competitive.<sup>309</sup>
- 5.104 We have seen evidence that the major grocery retailers adjust their competitive strategies in response to frequent monitoring of each other's retail grocery offers.<sup>310</sup>
- 5.105 We have seen a number of examples of frequent adjustments to the competitive strategies of the major grocery retailers in response to changes in each other's retail grocery offer. Some of the more common examples include:
- 5.105.1 adjustments in product range to compete for specific demographics in local markets;<sup>311</sup>
  - 5.105.2 improving online delivery services through improvements in the ease of website navigation and timeliness of deliveries;<sup>312</sup> and
  - 5.105.3 strategies around ensuring that stock availability and range improves so that consumers will become more loyal and avoid supplementing their shop at another competing grocery retailer.<sup>313</sup>
- 5.106 We have seen evidence that even in instances where market share monitoring by the major grocery retailers include those of other grocery retailers, the combined estimated market share of other grocery retailers is persistently low (see from paragraphs 5.74 to 5.93 above). This is consistent with our view that other grocery retailers do not compete closely with the major grocery retailers.

**The major grocery retailers appear to be strategically differentiating their retail grocery offers from each other**

- 5.107 The impact of retail grocery offer differentiation on consumers will depend on the extent of competition between grocery stores across the full retail grocery offer. For example, consumers will have different preferences and some might prefer lower prices and less differentiation on product range and quality.

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<sup>309</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 26.

<sup>310</sup> The competitive parameters monitored on a frequent basis include [

[ ]]. For example: [ ]; [ ];

<sup>311</sup> For example: [ ].

<sup>312</sup> For example: [ ].

<sup>313</sup> For example: [ ].

- 5.108 Consumer perceptions of differentiation by the major grocery retailer banners may affect the intensity of competition between the major grocery retailers. This is because the perception consumers have of a retail banner and its retail grocery offer may influence purchasing and switching behaviour.
- 5.109 For example, some participants in the Ipsos study were of the view that each of the major grocery retailers had chosen to focus on different parts of the market and that they did not directly compete on their main brand promises or for the same demographics. Participants also described a trade-off between quality, range of available products and the in-store experience between the major grocery retailer banners.<sup>314</sup>
- 5.110 Although we consider the major grocery retailers are each other's closest competitors, evidence we have seen shows that they attempt to position themselves differently in the market by differentiating their retail grocery offer on both price and non-price dimensions of the retail grocery offer.<sup>315</sup> This appears to be done mainly with the aim of attracting a more loyal and exclusive customer base.<sup>316</sup>
- 5.111 We have also seen some evidence that the major grocery retailers actively manage specified price differentials between their respective retail banners retail banners, as we now discuss.

**Competition between the major grocery retailers is less than we expect to see in a workably competitive market**

- 5.112 In a workably competitive market, we would expect to see a higher degree of pricing competition. This would ordinarily result in variation in market shares over time.
- 5.113 However, evidence shows that the major grocery retailers<sup>317</sup> monitor price levels for specific products with the aim of maintaining specified price differentials between the different major grocery retailer banners.<sup>318</sup>
- 5.114 The active management of price differentials may provide a way for the major grocery retailers to avoid direct price competition while still seeking to attract consumers from one another through differentiation on non-price aspects of the retail grocery offer. We discuss this further in paragraphs 5.154 to 5.157 below.

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<sup>314</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 33.

<sup>315</sup> Of the three major grocery retailer banners, it appears that [

].

<sup>316</sup> For example: [ ]; [ ];

[ ].

<sup>317</sup> [ ].

<sup>318</sup> For example: [ ]; [ ].

- 5.115 Our preliminary view is that price competition between the major grocery retailers is considerably less than we would expect to see in a workably competitive market.

### **How does the structure of local grocery markets affect price competition between the major grocery retailers?**

- 5.116 In general, we expect that grocery retailers will face weaker competitive constraints in concentrated local markets where there are barriers to entry and expansion. We also expect that higher market concentration will lead to worse consumer outcomes than in markets with lower levels of market concentration (see paragraphs 5.14 to 5.17 above).
- 5.117 In this section we discuss the quantitative analysis conducted by Frontier Economics to examine how the structure of local grocery markets affects prices. We also consider the scope for increased competition from new entry and expansion by existing grocery retailers.

### **Local market concentration appears to have little or no effect on price competition between the major grocery retailers**

- 5.118 Frontier Economics tested whether there is a relationship between concentration and prices in local grocery markets. These tests were conducted by comparing the way in which variations in concentration across local grocery markets are related to variations in prices.<sup>319</sup> They also controlled for various other factors that may influence variations in prices, such as retail banner and demographics.<sup>320</sup>
- 5.119 For the purposes of conducting the tests Frontier Economics defined separate geographic markets around each of the 694 stores in the sample (the focal stores). The market for each focal store included all those stores which exercise a constraint on the prices, range or quality of service of the focal store.<sup>321</sup> We used the results of this estimation of the approximate geographic size of local grocery markets in our discussion of local geographic markets in Chapter 4.
- 5.120 Two different methods were used to measure market concentration levels for each of the 694 focal stores. The first measure was the focal store's share of local market revenue of the major grocery retailer group to which the focal store belongs, where these shares were weighted to account for the distance of competing stores to the focal store. The second measure was the proximity of the closest store of each of the six major grocery retailer banners to the focal store.<sup>322</sup>

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<sup>319</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 17.

<sup>320</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 25-26.

<sup>321</sup> The focal store is defined as the store around which a market is defined in each local grocery market. An underlying assumption of this analysis that the constraint of a competitor is likely to be greatest for stores located close to the focal store and that the constraint decreases for stores located further from the focal store.

<sup>322</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 23-24.

- 5.121 Separate tests were conducted for each of the different major grocery retailer banners. The results of the tests vary somewhat, depending on the measure of market concentration. In models with weighted revenue share as the concentration variable, Frontier Economics found that increased concentration in local markets tends to be associated with higher prices in the cases of Four Square, New World and SuperValue.<sup>323</sup> However, no consistent effects were found for the other major grocery retailer banners.
- 5.122 In models using proximity to the major grocery retailer banners as the concentration measure, Frontier Economics found that Four Square stores tend to have lower prices when a FreshChoice or SuperValue store is located nearby. Countdown, FreshChoice and SuperValue stores tends to have lower prices when a New World store is located nearby, by around 1%. However, no consistent effects were found for the other major grocery retailer banners.<sup>324</sup>
- 5.123 The results also show that proximity of the focal store to other stores of the same major grocery retailer tends to increase prices for certain pairs of stores, but not for others. In particular, prices at Four Square stores tend to be higher if a PAK'nSAVE store is nearby. Similarly, prices at SuperValue stores tend to be higher when a Countdown or FreshChoice store is nearby.<sup>325</sup>
- 5.124 Frontier Economics also found little evidence that the proximity of other grocery retailers, such as specialist grocery retailers, international food stores and other supermarkets has an effect on the prices set by the major grocery retailers in local markets.<sup>326</sup>
- 5.125 Overall, the analysis by Frontier Economics suggest that local market concentration appears to have little or no effect on price competition between the major grocery retailers. This is consistent with our preliminary finding that price competition between the major grocery retailers is less than we would expect in a workably competitive market.
- 5.126 The finding that local market concentration appears to have little or no effect on price competition between grocery retailers also appears to confirm that the aggregated effect of competition by other grocery retailers in local markets is not sufficient to increase the intensity of competition at either a local, regional or national level (see paragraph 5.21 above).

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<sup>323</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 29-30.

<sup>324</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 31-32.

<sup>325</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 33.

<sup>326</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 33-34.



**The extent of the impact of new entry, exit or rebranded entry on prices appear to vary depending on region and local market characteristics**

- 5.127 In general, we would expect grocery prices to increase in a local market if a retailer that was previously a strong competitor exits that market (an exit event) and for grocery prices to fall if a retailer that is expected to be a strong competitor enters a local market (an entry event). The expected impact of a rebranding of an existing store is less clear and might depend on the specific brand change that occurred.
- 5.128 Frontier Economics used a sample of 32 events when stores entered, exited, changed location or rebranded during the period 1 April 2016 to 31 March 2019 to assess whether these events had an economically significant impact on the prices charged by competing stores within the same local markets.
- 5.129 The sample included 14 entry events, six exit events, six store replacement events, three store rebranding events and three store consolidation or temporary closure events. Although the analysis mostly focussed on events associated with the PAK'nSAVE, New World and Countdown retail banners, two of the events related to new store openings by Farro Fresh in Auckland.
- 5.130 The impacts of these entry, exit or rebranding events on prices in the relevant local market were assessed by looking at the prices of neighbouring major grocery retailers for the 12 months prior to and following the event.<sup>327</sup> Frontier Economics used prices of control stores in neighbouring markets to account for the possibility that prices of competing stores may have changed around the time of the event for reasons other than the event, such as cost increases or general inflation.<sup>328</sup>
- 5.131 Frontier Economics found that there was no systematic relationship between the entry, exit or rebranding of a store and the prices charged by close competitor store in the 12 months after the event.<sup>329</sup> This is consistent with their finding that local market concentration levels appear to have little or no effect on price competition between most of the major grocery retailer banners (see paragraphs 5.118 to 5.126 above).

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<sup>327</sup> Frontier Economics acknowledged that its analysis may not pick up all the competitive effects of entry because the analysis is limited to a period of time. All studies have limitations, and we consider it likely that, to the extent that entry affects price competition, at least some of this effect would be observed in the period studied.

<sup>328</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 35.

<sup>329</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 7.

- 5.132 The lack of evidence that entry by two new Farro Fresh stores in Auckland constrained the pricing of the major grocery retailers in close proximity to these new openings seems to support the view that there is little evidence that other grocery retailers have an effect on the prices set by the major grocery retailers (see paragraph 5.50 above).<sup>330</sup>

**There appears to be little scope for increased competition from new entry and expansion**

- 5.133 Given our preliminary view that existing competition between grocery retailers is weak we assessed whether there is the potential for competition to be strengthened by entry or expansion.
- 5.134 There have been a number of smaller scale entrants (or entrants with differentiated product offerings) into the sector. However, small-scale entry, while viable, is likely to have limited effect on the behaviour of the major grocery retailers. Although entry by other grocery retailers can increase choice for consumers, it is unlikely to materially impact the major grocery retailers and significantly improve competition for consumers' main shop.
- 5.135 As discussed in Chapter 6, we are of the view that, absent some unforeseen entry to the market or market intervention, it is unlikely that new entry at scale will occur in the foreseeable future for a number of reasons. There are several barriers to large-scale entry including access to sites and access to competitively priced wholesale supply.
- 5.136 The likelihood of expansion by existing retailers to constrain the major grocery retailers for consumers' main shop is also discussed further in Chapter 6.

**Are grocery retailers accommodating each other's behaviour?**

- 5.137 As noted above, our view is that the New Zealand retail grocery market can best be described as a duopoly with a fringe of other grocery retailers. In such markets, the duopolists may be able to coordinate their behaviour to sustain higher prices and profitability than would otherwise be attainable, to the detriment of consumers and efficiency.
- 5.138 In this section we assess whether the evidence suggests that the major grocery retailers are accommodating each other's behaviour.
- 5.139 Accommodating behaviour is more likely to occur when a market has features that make this easier, such as:<sup>331</sup>

- 5.139.1 homogeneous products;

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<sup>330</sup> Frontier Economics "Econometric analysis of the New Zealand Retail Grocery Sector – Report for the Commerce Commission" (15 July 2021) at 37.

<sup>331</sup> Commerce Commission "Mergers and acquisitions guidelines" (July 2019) at [3.89].

- 5.139.2 a small number of competitors and an absence of a particularly vigorous competitor or strong competition from outside the coordinating firms;
  - 5.139.3 repeated interactions between firms through, for example, contact in other markets, or at industry organisations or meetings;
  - 5.139.4 firms of similar size and cost structures;
  - 5.139.5 little innovation, stable demand and a lack of supply shocks/volatility;
  - 5.139.6 firms that can readily observe each other's prices or volumes;
  - 5.139.7 small frequent transactions; and
  - 5.139.8 firms interrelated through association or cross-partial ownership.
- 5.140 Conversely, other features of a market can make it more difficult for accommodation to occur or make it less complete. Those features include:
- 5.140.1 a high degree of differentiation and innovation in market offerings;
  - 5.140.2 firms operating in a number of locations, with different price setters in each of those locations;
  - 5.140.3 a prevalence of discounts and non-price promotions; and
  - 5.140.4 the presence of one or more vigorous competitors who may disrupt tacit coordination or make tacit coordination less effective.

**Some features of the grocery retailing market may make it vulnerable to accommodating behaviour between the major grocery retailers**

- 5.141 A strategy by competitors to accommodate each other's behaviour may not always be sustainable, as individual firms have an incentive to undercut competitors so as to increase sales and earn additional profits.
- 5.142 However, we are of the view that the retail grocery market has some features which make it vulnerable to sustainable accommodating behaviour and may reduce the need for price competition between the major grocery retailers, such as:
  - 5.142.1 the small number of competitors at both a national and regional level;
  - 5.142.2 repeated interaction over a long period of time;
  - 5.142.3 frequent interaction with common suppliers on promotional schedules and other supply conditions;
  - 5.142.4 the limited scope for new entry and expansion;
  - 5.142.5 weak investment and innovation; and

- 5.142.6 the considerable degree of price transparency in the market.
- 5.143 Our estimates of market shares in the retail grocery sector show that the market is highly concentrated and that there is little variation in shares over time. The relatively stable environment of the retail grocery sector also facilitates monitoring of rivals' behaviour.<sup>332</sup>
- 5.144 For tacit coordination to be successful, other competitive constraints in the retail grocery market must be relatively weak so that the actions of potential new entrants and consumers are unlikely to be successful in disrupting any attempts by the major grocery retailers to accommodate each other's behaviour.<sup>333</sup>
- 5.145 As discussed in paragraphs 5.70 to 5.73, the major grocery retailers face weak competition from existing grocery retailers and potential disruptors such as meal kit providers. This means that they are unlikely to be successful in disrupting any attempts by the major grocery retailers to accommodate each other's behaviour.
- 5.146 Although there have been a number of smaller scale entrants (or entrants with differentiated product offerings) into the sector, small-scale entry is likely to have limited effect on the behaviour of the major grocery retailers.
- 5.147 There is also a considerable degree of price transparency in the market given the national and regional pricing policies of the major grocery retailers and the ready availability of data through website monitoring and third-party data collectors such as Nielsen and IRI. As discussed in paragraphs 5.103 to 5.106 above, the major grocery retailers frequently monitor the prices of many of each other's products. Flat nationwide pricing irrespective of delivery costs could also be viewed as supporting price transparency by eliminating a source of local cost variation.
- 5.148 In markets such as this where competitors have high visibility of each other's retail grocery offerings, and face little risk of disruption by competitors or entrants a strategy to accommodate each other's behaviour may be more sustainable as firms will be able to rapidly detect and punish any efforts by competitors to undercut each other, thus reducing the incentive to do so.<sup>334</sup>

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<sup>332</sup> An unstable market makes it more difficult for firms to determine whether a price adjustment reflects the new situation, or is instead partly due to a deviation from the coordination strategy.

<sup>333</sup> Low barriers to entry, a strong competitive fringe of grocery retailers and countervailing buyer power may all serve to disrupt any attempts by the major grocery retailers to accommodate each other's behaviour.

<sup>334</sup> Punishment may take the form of a period of aggressive market behaviour by a rival (or rivals) to retaliate against a firm deviating from the accommodating behaviour. For example, the rival could set prices low (or increase quantity) which would reduce the profits of the deviating firm. The threat of punishment deters firms from deviating from accommodating behaviour. For example: M Motta *Competition Policy: Theory and Practice* (Cambridge University Press, Cambridge, 2004) at 139.

5.149 We also acknowledge that some features of the retail grocery market may hinder accommodating behaviour, such as:

5.149.1 the high degree of product and brand differentiation (see paragraphs 5.107 to 5.111 above);

5.149.2 the large number of products sold by the major grocery retailers;

5.149.3 a prevalence of discounts and non-price promotions, although there may be some visibility of competitors' likely discounting and promotional arrangements through common suppliers (see Chapter 7).

**There is a potential risk that communications between the major grocery retailers and common suppliers may be used to avoid promotional clashes**

5.150 The major grocery retailers share a common set of suppliers and interact frequently with those suppliers on promotional schedules and other supply conditions. This raises the potential for these common suppliers to act as a 'hub' that facilitates tacit coordination between grocery retailers (the 'spokes') by indirectly exchanging information between retailers without the need for direct communication between them.

5.151 We have seen no evidence of any direct communications between any grocery retailers through common suppliers with the aim of influencing each other's retail grocery offers. We are also not aware of any evidence that the major grocery retailers have advance communication on the promotional schedules of competitors.

5.152 However, we have seen some evidence of grocery retailers seeking information from suppliers about prices, discounts and promotions of their rivals.<sup>335</sup> We have also seen some evidence that promotional clashes are avoided for some products (see Attachment E).

5.153 Given that there are only two major grocery retailers it is likely to be relatively easy for a retailer to monitor promotional clashes and to put pressure on common suppliers to assist to avoid these.

**The maintenance of price differentials between retail banners may have similar effects as market sharing arrangements**

5.154 A market sharing cartel is an agreement between competitors to divide the market (or markets) among themselves by agreeing not to compete for each other's customers, or not to enter or expand into a competitor's market.<sup>336</sup>

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<sup>335</sup> For example: [ ];

<sup>336</sup> For example:

[https://www.compcomm.hk/en/media/reports\\_publications/files/CCMarketingSharing\\_2021\\_EN.pdf](https://www.compcomm.hk/en/media/reports_publications/files/CCMarketingSharing_2021_EN.pdf).

- 5.155 As discussed in paragraphs 5.113 to 5.115 above, evidence we have seen shows that the major grocery retailers are actively managing price differentials between their respective retail banners for specific product categories.
- 5.156 Although we have seen no evidence of any direct communication between the major grocery retailers to maintain these price differentials between their respective retail banners, there is a potential risk that they may have similar effects as market sharing arrangements in the sense that they allow the major grocery retailers to avoid direct competition on price for specific groups of consumers.
- 5.157 This may be particularly harmful to consumers who find it time consuming and difficult to compare prices between grocery retailers and are less likely to switch even if there is weak competition on price.

**We found no evidence of leader-follower pricing behaviour in the retail grocery sector**

- 5.158 We have analysed pricing data provided by the major grocery retailers to assess whether there is any evidence of leader-follower type pricing behaviour in the retail grocery sector (see Attachment E).
- 5.159 This analysis found no clear pattern of high correlations of price changes across any of the geographic clusters used for the purposes of analysing price correlations across stores. We therefore conclude that we have found no evidence of leader-follower type pricing across the stores in the geographic clusters used for purposes of this analysis.
- 5.160 In summary, we have not seen evidence of cartel conduct that may breach the Commerce Act. However, we have observed conduct that may, given the features of the market discussed above, be conducive to accommodating behaviour which does not breach the Commerce Act but could impact competition. These are:
- 5.160.1 frequent communications between the major grocery retailers and common suppliers; and
- 5.160.2 the maintenance of price differentials between the major grocery retailer banners.
- 5.161 However, we have not identified a mechanism, such as leader-follower behaviour that may facilitate accommodating behaviour.

## Chapter 6 Conditions of entry and expansion

### Summary of preliminary findings

- There have been a number of smaller scale entrants and/or entrants with differentiated product offerings into the retail grocery sector, and we are aware of the planned entry of Costco. However, we do not consider we can rely, under current competitive conditions, on entry or expansion being sufficient to materially enhance competition for the provision of a main shop in the foreseeable future.
- Large-scale entry to the retail grocery sector may be hindered by the size of the NZ economy and its population profile which restricts the number of places a supermarket can be profitably operated.
- The availability of land for new entrants and existing firms is reduced by difficulties in getting planning permission to develop potential sites and conduct by the major grocery retailers relating to property, including how they use restrictive covenants on land and exclusivity covenants in leases to prevent other supermarkets operating.
- The absence of wholesale options for a full range of groceries means that independent grocery retailers and new entrants are unlikely to be able to buy sufficient products cheaply enough to compete with the major grocery retailers for the provision of a main shop offering.
- We are aware of situations where suppliers may refuse to supply new grocery retailers where they are concerned that the retail prices being offered are too low. In some cases, the refusal to supply may have occurred after concerns were raised by another grocery retailer the supplier trades with.

### Introduction

- 6.1 In this chapter we consider longer-run competitive dynamics by assessing how the features of the retail grocery sector affect the ability of retailers to enter the sector and expand their operations. We draw preliminary conclusions in relation to a wide range of factors, including the nature of the sector and relevant regulations, and the conduct of current retailers.
- 6.2 The threat of entry by new firms, and the potential for existing firms to readily expand, can significantly constrain the behaviour of existing firms, even when they do not face significant constraint from existing competitors. Conditions of entry and expansion can therefore limit the number of competitors in a market and the threat of further competition.

- 6.3 We raised questions on entry and expansion conditions in our preliminary issues paper and received a number of responses on these issues:
- 6.3.1 Foodstuffs NI and Foodstuffs SI submitted that for traditional bricks-and-mortar full-service network of supermarket offerings “competing on all aspects of PQRS, then there are a number of factors that affect entry and expansion including the need for scale (for supply relationships), the availability of sites for big-box retail, regulatory hurdles and infrastructure (particularly in relation to temperature-controlled products).” They also submitted that “[a]t the other end of the spectrum if the offering is online only (competing on one or more of the QRS aspects of the spectrum) then the factors affecting entry and expansion by other retailers are very different with only some form of consolidation and network distribution available. Such an offering [sic] could acquire products from a range of sources including importing some products and, in the absence of scale, acquiring others from wholesalers and existing supermarkets until it obtained sufficient scale to deal with major suppliers. In essence entry simply requires a commitment of capital (a very different proposition to the property, regulatory and infrastructure issues faced by a traditional supermarket).”<sup>337</sup>
- 6.3.2 Woolworths NZ noted that “[s]mall format convenience and/or speciality bricks-and-mortar grocery offerings have lower build, fit-out and leasing costs than large format stores”, and “our view is that there are no material barriers to servicing [online] demand, as evidenced by the proliferation of online marketplaces and start-ups selling meal kits, food boxes, ready-to-eat food delivery, and D2C offerings. Such businesses do not need a bricks-and-mortar presence or their own logistics network to service customers, and can operate using third-party logistics providers from “dark stores” (warehouses) without the need to find a prominent retail site or incur the costs of fitting-out a retail location.” It also submitted that “while larger format bricks-and-mortar offerings will incur higher up-front build, fit-out and leasing costs, there are numerous examples of big-box retailers in New Zealand (including retailers that have expanded their footprint over the last 10 years) that demonstrate that entry/expansion in large format retailing is readily achievable (for example, Costco, The Warehouse, Kmart, Mitre 10 and Bunnings).”<sup>338</sup>

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<sup>337</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 26-27. Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 17-18.

<sup>338</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 61-62.



- 6.3.3 Other submitters indicated that there appear to be some conditions making it more difficult to enter and expand. Examples provided include factors limiting access to suitable sites (eg, land banking) and limited access to independent wholesale and/or distribution options.<sup>339</sup>
- 6.4 Our study has identified that a number of factors are likely to be preventing or slowing entry and expansion into the grocery sector.
- 6.5 The remaining sections in this chapter cover:
  - 6.5.1 our approach to analysing conditions of entry and expansion;
  - 6.5.2 recent entry and prospect of imminent entry;
  - 6.5.3 impact of New Zealand’s size and geography on entry and expansion;
  - 6.5.4 site availability and development;
  - 6.5.5 cost advantages available to the major grocery retailers;
  - 6.5.6 access to wholesale;
  - 6.5.7 conduct by suppliers and retailers which could potentially affect product sourcing;
  - 6.5.8 alcohol licensing laws; and
  - 6.5.9 loyalty programmes.

### **Our approach to analysing conditions of entry and expansion**

- 6.6 This section sets out the framework for our discussion of conditions of entry and expansion in the rest of the chapter. It explains:
  - 6.6.1 the starting point for our discussion of entry and expansion conditions;
  - 6.6.2 what we mean by conditions of entry and expansion;
  - 6.6.3 the significance of conditions of entry and expansion to competition;
  - 6.6.4 the types of businesses in the grocery sector in relation to which we intend to assess conditions of entry and expansion; and
  - 6.6.5 sources of information we have gathered and reviewed.

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<sup>339</sup> For example: NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [135]-[137]; The Warehouse Group “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 3-4; Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [34]-[37].

## The starting point for our discussion of entry and expansion conditions

6.7 We considered the conditions of entry and expansion by retail grocery chains into the New Zealand grocery sector in 2007 when Foodstuffs (Foodstuffs Auckland, Foodstuffs Wellington, and Foodstuffs SI) and Woolworths NZ each separately applied for clearance to acquire The Warehouse Group.<sup>340</sup> Our decision to decline clearance was appealed to the Courts.

6.8 In the subsequent appeal, *Commerce Commission v Woolworths Limited And Ors*, the Court of Appeal stated:<sup>341</sup>

[the Commission] also concluded, uncontroversially, that there were high barriers to entry into the relevant markets (for reasons associated with access to suitable sites, requirements for resource consents and economies of scale) and that there is no likely new entrant into the relevant markets other than the Warehouse.

6.9 It also stated that:<sup>342</sup>

We consider that the Commission was right to give weight to the theoretical concerns raised by a 3:2 merger in markets such as these, characterised by high barriers to entry. ...Other potential entrants are not obvious and barriers to entry are high.

6.10 We have not relied on this previous finding in our assessments of entry and expansion conditions for our study, instead seeking to understand the range of entry and expansion conditions relevant to the sector today. However, as set out in detail below, we note that many of the preliminary findings at this stage of our study are consistent with those found previously.

## What we mean by conditions of entry and expansion

6.11 We do not intend to use the term ‘barriers to entry’ in this report but will instead use the term ‘conditions of entry and expansion’, which is related to, but broader than, the economic concept of ‘barriers to entry’.

6.12 We have not adopted a specific definition of barriers to entry for this study. Instead we have taken an expansive approach to the factors that we consider might affect conditions of entry and expansion. There are two key reasons for this:

6.12.1 A market study is a study of “any factors that may affect competition for the supply or acquisition of goods or services”.<sup>343</sup> Its scope is likely to be broad.

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<sup>340</sup> Commerce Commission “Decision Nos. 606 & 607, Determination pursuant to the Commerce Act 1986 in the matter of applications for clearance of business acquisitions involving: Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited, and Foodstuffs South Island Limited; and (separately) Woolworths Limited and The Warehouse Group Limited” (8 June 2007), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf).

<sup>341</sup> *The Commerce Commission v Woolworths Limited And Ors* [2008] NZCA 276, at [166].

<sup>342</sup> *The Commerce Commission v Woolworths Limited And Ors* [2008] NZCA 276, at [200].

<sup>343</sup> Section 48 of the Act.

- 6.12.2 It is consistent with the approach adopted by the Courts in *Commerce Commission v New Zealand Bus* and *Air New Zealand v Commerce Commission*. In those cases, the Courts emphasised that the question of whether conditions in a market qualify as a barrier to entry, however defined, is less important than considering whether those conditions have the potential to prevent, impede or slow entry and expansion.<sup>344</sup>
- 6.13 We have considered the following types of entry and expansion as part of our analysis:
- 6.13.1 a new entrant entering the market;
  - 6.13.2 an existing competitor expanding its current grocery offering (eg, in terms of store network or product range);
  - 6.13.3 expansion by an existing firm operating in a different sector (eg, general merchandise) into the grocery sector; and
  - 6.13.4 expansion by an existing firm operating in the grocery sector into a different part of the supply chain (eg, expanding from wholesale to retail).
- 6.14 Conditions of entry and expansion can take a variety of forms, but generally fall within three categories.<sup>345</sup> While we do not explicitly use these categories to frame our discussion throughout this chapter, we briefly outline them below as they provide a helpful starting point for this discussion:
- 6.14.1 Structural conditions are associated with the technologies, resources or inputs a firm would need to enter or expand. This may include factors such as the significance of economies of scale, scope or density. For example, the geographic location and relatively small size of the New Zealand market could potentially limit the scope for entry and expansion if there are significant economies of scale, scope and/or density.
  - 6.14.2 Regulatory conditions include resource management or other planning consent requirements, licensing requirements for a business or product, and regulations governing standards and quality. For example, the resource consent process for obtaining permission to build grocery stores could affect the ability for grocery retailers, either existing or new, to open new stores.

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<sup>344</sup> *Commerce Commission v New Zealand Bus Ltd* (2006) 11 TCLR 679 (HC) at [147]-[155], citing Dennis Carlton “Why Barriers To Entry are Barriers to Understanding” (2004) 94 *American Economics Review* 466, and *Air New Zealand v Commerce Commission (No 6)* (2004) 11 TCLR 347 (HC) at [102]. This approach was confirmed by the Court of Appeal in *New Zealand Bus Ltd v Commerce Commission* [2007] NZCA 502 at [252].

<sup>345</sup> Commerce Commission “Mergers and acquisitions Guidelines” (July 2019) at [3.109]-[3.111].

- 6.14.3 Strategic conditions arise where incumbent firms take actions to discourage prospective entrants or expansion. For example, existing retailers may seek to restrict potential competitors' access to suitable land for grocery retailing.

### **The significance of conditions of entry and expansion to competition**

- 6.15 As the Court stated in *Re Queensland Co-op Milling Association Limited*:<sup>346</sup>

Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of the entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct.

- 6.16 The threat of firms entering or expanding can be crucial to achieving competitive outcomes. However, the costs and risks associated with entry and expansion, can reduce the viability of doing so, limiting the number of competing suppliers in the market.
- 6.17 If entry and expansion are difficult or prohibited, then less competitive offerings (eg, higher prices, lower quality) are more likely to persist in the longer term, to the detriment of New Zealand consumers.

### **Conditions of entry and expansion and different business types**

#### *Assessing conditions of entry and expansion at different levels of the supply chain*

- 6.18 The terms of reference directs us to any factors that may affect competition for the supply or acquisition of groceries by retailers including a focus on 'the structure of the grocery industry at the wholesale and retail levels'. In this chapter we consider the conditions for entry and expansion at the retail level (or what conditions are relevant to changing the structure of the industry at the retail level). In considering this we also consider the relevance of the wholesale level of the sector.
- 6.19 Access to competitively priced products (for example via wholesale) is a key factor for retail entry and expansion, and factors preventing wholesale competition may have a flow-on impact of reducing the viability of retail entry. This chapter therefore also includes a discussion of wholesale conditions of entry and expansion.

#### *Assessing conditions of entry and expansion for different business models*

- 6.20 As discussed in Chapter 2, there are a range of retailers operating in the grocery sector. Some conditions of entry and expansion we discuss in this chapter may impact grocery retailers consistently regardless of their business model. For example, import regulations may impact grocery retailers' ability to enter or expand in much the same way regardless of their business model.

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<sup>346</sup> *Re Queensland Co-Op Milling Association Limited and Defiance Holdings Limited (QCMA)* (1976) ATPR 40-012 at [246].

- 6.21 Other conditions of entry and expansion may impact grocery retailers to differing degrees or not at all. For example, the availability of land suitable for store development may:
- 6.21.1 significantly impact the ability of supermarket operators (eg, major grocery retailers and potential large-scale supermarket entrants) to enter and expand;
  - 6.21.2 have a less significant impact on other supermarkets or international food stores which operate smaller stores (and would therefore require smaller sites); or
  - 6.21.3 not be relevant to online-only supermarkets or meal kit providers.
- 6.22 As discussed in Chapter 4, most consumers appear to prefer to conduct a main shop to buy most of their groceries (we note 95% of respondents to our consumer survey reported only major grocery retailers as their main store(s)).<sup>347</sup>
- 6.23 We are considering the conditions of entry and expansion into the retail grocery sector broadly, recognising that there are diverse customer preferences and therefore a range of offerings provided by grocery retailers. We have particularly focussed on entry and expansion conditions relating to the ability of new entrants or existing firms to compete with the major grocery retailers for the provision of a main shop. In our view this ability will be critical to increasing the level of competition.

### Recent entry and prospect of imminent entry

- 6.24 In a market with a small number of competitors, incumbent firms may still be constrained by the threat of entry. In this section, we consider the extent to which recent entry and expansion into the grocery sector and the prospect of future large-scale entry and expansion of supermarkets are likely to constrain incumbent firms. For our purposes, large-scale entry and expansion refers to entry and expansion at a sufficient scale to impose a regional or nationwide constraint on major grocery retailers, which could include entry and expansion by a number of different firms or regional/national entry and expansion by a single firm.
- 6.25 As discussed in Chapter 3, we consider that the profitability of the major grocery retailers appears to be higher than we would expect if competition was working well. If competition was working well, we would expect entry and/or expansion by other supermarket operators to compete for these profits. However:
- 6.25.1 we are not aware of specific plans for future large-scale entry or expansion by a supermarket operator into the retail grocery sector;<sup>348</sup> and

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<sup>347</sup> 'Main store' was defined as "the store you spend most at, or do most of your grocery shopping with".

<sup>348</sup> [ ]; [ ].

- 6.25.2 as discussed in Chapter 2, there have not been any instances of large-scale entry by a supermarket operator into the retail grocery sector in the last decade.
- 6.26 The lack of recent and prospective large-scale entry by a supermarket operator despite the high profitability of the major grocery retailers may indicate that conditions of entry and expansion limit the scope for competition to work effectively.
- 6.27 However, there continues to be some entry and expansion in the sector, including:<sup>349</sup>
  - 6.27.1 likely future entry of Costco, which has confirmed that it intends to open a store in Auckland in 2022.<sup>350</sup> It has been speculated that Costco appears to be actively looking for store sites in Christchurch and Wellington,<sup>351</sup>
  - 6.27.2 entry of meal kit providers such as Hello Fresh and My Food Bag;
  - 6.27.3 entry of Chemist Warehouse;
  - 6.27.4 expansion of foodservice wholesalers (eg, Bidfood, Service Foods) into online retail grocery during lockdown;<sup>352</sup>
  - 6.27.5 launch of online-only supermarkets (eg, The Honest Grocer, Supie); and
  - 6.27.6 planned expansion by other grocery retailers.<sup>353</sup>
- 6.28 Woolworths NZ submitted that it considers the entry of a variety of new and expanding entrants adopting a variety of different business models (as described in paragraph 6.27) demonstrates that there are no material barriers to entry or expansion by retail grocery competitors.<sup>354</sup>

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<sup>349</sup> For example, we have recently become aware that Four Candles Food Market may be a new entrant into the sector. It has advertised for positions at one store in Auckland, which is a possible indication that it may not be entering on a scale sufficient to significantly constrain the major grocery retailers. We currently do not have sufficient information to comment further on the potential impact of its entry.

<sup>350</sup> Costco’s website states “Costco Auckland warehouse, opening 2022” (as of 5 July 2021) <https://www.costco.co.nz/>.

<sup>351</sup> Melanie Carroll “Costco delays its New Zealand launch, but is actively looking for additional sites” (29 October 2020) <https://www.stuff.co.nz/business/industries/123230944/costco-delays-its-new-zealand-launch-but-is-actively-looking-for-additional-sites>.

<sup>352</sup> [ ];  
[ ].

<sup>353</sup> [ ];  
[ ]; [ ]; [ ];

<sup>354</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 62.

- 6.29 The entry events discussed in paragraphs 6.27.2 to 6.27.6 have and may further increase the choices offered to consumers. However, we do not consider that they will significantly increase the effectiveness of competition for a main shop offering or competitive outcomes for consumers' main shop.
- 6.29.1 As discussed in Chapter 4, our view is that major grocery retailers are likely to compete most closely with retailers that offer consumers the ability to conduct a main shop. We therefore do not consider that the observed entry in the sector by retailers which do not compete for the provision of a main shop (eg, by meal kit providers and Chemist Warehouse) necessarily means that competition is working well, or that there are no conditions preventing significant further entry or expansion of supermarkets offering a main shop.
- 6.29.2 As discussed in Chapter 4 other grocery retailers (such as other supermarkets) largely tend to provide differentiated offerings from the major grocery retailers. We do not consider further expansion by these retailers is likely to provide a significantly greater constraint on major grocery retailers.
- 6.29.3 Online entrants have the potential to compete for the provision of a main shop. However, as discussed in Chapter 3, the relatively low penetration and growth of online grocery sales in New Zealand indicates that online-only offerings are unlikely to provide significantly more competition to the major grocery retailers in the foreseeable future.
- 6.30 We consider that Costco's entry is likely to impose some constraint on the major grocery retailers.<sup>355</sup> However:
- 6.30.1 its limited store network at this stage (with one confirmed store and speculation over two potential additional stores) means that it is unlikely to significantly constrain the major grocery retailers except in isolated catchment areas;
- 6.30.2 Costco provides a differentiated offering from the major grocery retailers which may be more likely to appeal to consumers with a certain level of disposable income as it charges a membership fee and sells products in larger package sizes;<sup>356</sup> and
- 6.30.3 Costco's reasonably unique business model means that its entry is not evidence that conditions are conducive to a pattern of entry or expansion sufficient to constrain the major grocery retailers.

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<sup>355</sup> [ ];

<sup>356</sup> [ ].

## Impact of New Zealand's size and geography on entry and expansion

- 6.31 In our preliminary issues paper, we asked for feedback on the extent to which the size and geography of New Zealand affect the possibility of entry and expansion.
- 6.32 Development of new stores in the retail grocery sector requires capital expenditure (eg, land costs, building costs, store fit-out) from a prospective new entrant or expanding firm. In order for entry and expansion to be viable, there needs to be a customer base of sufficient size to enable new stores to earn enough return to justify investment.
- 6.33 Population density is therefore likely to be relevant to entry and expansion as it affects the size of customer bases which stores would have access to in their catchment area. Areas with high population density would be more likely to give a prospective store access to a suitably sized customer base. Low population density may be a factor impacting on the viability of entry and expansion as it reduces the likelihood that the customer base in a catchment area would be of a sufficient size to justify investment in a new store.
- 6.34 This is supported by stakeholders (including Foodstuffs SI) generally indicating through submissions on our preliminary issues paper and statements at meetings that New Zealand's small population and/or low population density are factors which reduce potential returns on investment for a grocery store (noting Foodstuffs SI indicated this was particularly the case for a full-service supermarket) and/or make it difficult to achieve sufficient scale to compete effectively.<sup>357</sup>
- 6.35 By contrast, Foodstuffs NI submitted that:<sup>358</sup>
- 6.35.1 New Zealand's size and geography is materially less relevant to entry and expansion than has previously been the case given the range of competing businesses (such as online-only supermarkets) with significantly different factors affecting entry and expansion; and
- 6.35.2 size and population density may affect the absolute operation costs but this is different to the prospects of entry, which are more likely to be affected by the proportion of the market that needs to be captured to achieve minimum efficient scale.

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<sup>357</sup> Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 18; Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [34]; NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [138]-[141];  
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<sup>358</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 28.



- 6.36 In relation to paragraph 6.35.1, we consider (as discussed in Chapter 4) that the majority of consumers have a preference for carrying out a main shop. While we agree population size and density may affect different business models differently (and these varying impacts are discussed at paragraph 6.43 below), we consider that it is still highly relevant to entry and expansion by supermarkets.
- 6.37 In addition, we also consider that population density is relevant to a potential entrant's ability to achieve minimum efficient scale.<sup>359</sup> As population density generally affects the size of the customer base for an individual store, it would likely be a factor influencing a potential entrant's ability to set up viable stores with sufficiently large customer bases to justify the investment into store development. The ability of a potential entrant to capture a sufficient proportion of the total market through a collection of these individual stores would in turn impact its ability to achieve minimum efficient scale.
- 6.38 Woolworths NZ submitted that it considers the New Zealand market is small and geographically dispersed, but the entry of large international retailers (eg, Costco, Chemist Warehouse, Ikea, Sephora, Zara, H&M, Mecca, Nick Scali and Tiffany & Co.) in recent years indicates that New Zealand is increasingly on the radar for entry and expansion, and the examples of those that have arrived demonstrates there are no material barriers to further retailers coming.<sup>360</sup>
- 6.39 We do not consider entry by most of these multinational retailers (except Costco) to be necessarily relevant to entry by supermarket operators as they operate in different sectors and would likely face different sets of conditions of entry and expansion. We do not consider Costco's entry demonstrates that current conditions are conducive to the scale of entry or expansion that would be sufficient to constrain the major grocery retailers as discussed in paragraph 6.29.2.
- 6.40 New Zealand has a relatively small population spread over a relatively large land area. This results in low population density on average although regional density does vary. According to an international comparison by the World Bank, New Zealand had a population density of 19 people per square kilometre in 2018.<sup>361</sup> For comparative purposes:
- 6.40.1 the average for OECD members was 38; and
- 6.40.2 the world average was 58.

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<sup>359</sup> Minimum efficient scale is the level of output that minimises average cost, relative to the size of demand. HR Varian "Intermediate Microeconomics: A modern approach" 6th ed, W.W. Norton & Company, New York (2003) at 432.

<sup>360</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 62.

<sup>361</sup> The World Bank "Population density (people per sq. km of land area) – New Zealand" (as of 5 July 2021)  
[https://data.worldbank.org/indicator/EN.POP.DNST?locations=NZ&most\\_recent\\_value\\_desc=false](https://data.worldbank.org/indicator/EN.POP.DNST?locations=NZ&most_recent_value_desc=false).

6.41 However, New Zealand has high rates of urbanisation at around 87%.<sup>362</sup> For comparative purposes:

6.41.1 the average for OECD members was 81%; and

6.41.2 the world average was 56%.

6.42 This suggests that while large areas are sparsely populated (suggesting potential customer bases are generally likely to be smaller), New Zealand's population may be clustered into relatively small areas (which suggests customer bases in these areas may be relatively larger). Large-scale entry and expansion may be made more difficult if New Zealand's population profile restricts the number of places a supermarket can be profitably operated. However, it may also be easier to enter or expand in urban areas containing larger population clusters. The overall effect of these differing factors on entry and expansion conditions is unclear.

6.43 In any event, population density is more likely to impact on grocery retailers to different extents depending on their business model. As discussed in paragraph 6.32, areas with relatively high population density are more likely to have larger customer bases within a catchment area.

6.43.1 Larger stores require greater development costs and would be expected to serve larger customer bases in order to provide adequate return on investment.<sup>363</sup> As such, population density may be a significant factor impacting entry and expansion by retailers operating larger stores such as the major grocery retailers or a potential large-scale supermarket entrant.

6.43.2 Retailers operating smaller stores such as convenience stores and specialist grocery retailers may be less affected by population density as their store development costs are likely to be lower, meaning that they are less likely to be required to serve large customer bases to provide sufficient returns.

6.43.3 Retailers selling relatively niche products (eg, international food stores) may primarily appeal to a subset or proportion of consumers in an area. These stores may need to be located in areas with relatively higher population density in order to access a sufficient level of customer demand for their products.

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<sup>362</sup> The World Bank "Urbanisation (% of population living in urban areas) – New Zealand" (as of 5 July 2021)  
[https://data.worldbank.org/indicator/SP.URB.TOTL.IN.ZS?locations=NZ&most\\_recent\\_value\\_desc=true](https://data.worldbank.org/indicator/SP.URB.TOTL.IN.ZS?locations=NZ&most_recent_value_desc=true).

<sup>363</sup> [ ].

6.43.4 Online-only supermarkets may be more likely to offer delivery to areas with high population density (ie, urban areas) to spread delivery costs over a larger customer base. We note that this is supported by the delivery offerings of recent online-only supermarket entrants. The Honest Grocer delivers to non-rural locations in the North Island, and Supie currently delivers to locations in Auckland.<sup>364</sup> However it is not clear why online-only supermarkets could not compete with, say Woolworths NZ, in offering more extensive delivery options at a charge.

### Store density

6.44 United Fresh's submission in response to our preliminary issues paper stated that New Zealand has "one of the highest densities in terms of supermarkets per head of population in the developed world".<sup>365</sup> This is a factor potentially affecting entry and expansion as it is likely to be more difficult to enter a saturated market where the maximum number of competitors which an area can support has already been reached. However, even in saturated markets, the competitive process may mean that successful firms can still enter and replace existing firms.

6.45 We note that United Fresh subsequently provided further analysis which indicated that New Zealand's supermarket density did not appear to be out of line with other OECD countries.<sup>366</sup> We have also analysed supermarket density in New Zealand in order to understand the extent to which demand is likely to be served by existing supermarkets.

6.46 United Fresh emphasised the importance of taking store size into consideration.<sup>367</sup> We therefore compared New Zealand's supermarket density internationally across different store sizes to control for the differences between large supermarkets like PAK'nSAVE, and smaller supermarkets, which are likely to serve significantly different catchment sizes.

6.47 A Nielsen report included a comparison of supermarkets per million inhabitants in 19 European countries from 2015.<sup>368</sup> This comparison was broken down into the following categories:

6.47.1 Small supermarkets, defined as being between 400 and 1,000 square metres (this is likely to be larger than most convenience stores);<sup>369</sup>

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<sup>364</sup> The Honest Grocer "Frequently Asked Questions" at <https://thehonestgrocer.co.nz/faq> (as of 5 July 2021); Supie "Common qs" at <https://supie.co.nz/#footer> (as of 5 July 2021).

<sup>365</sup> United Fresh "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 17.

<sup>366</sup> [ ].

<sup>367</sup> [ ].

<sup>368</sup> Nielsen "Nielsen Grocery Universe 2017" (2017) at 56, available at: <https://www.nielsen.com/wp-content/uploads/sites/3/2019/04/nielsen-grocery-universe-2017.pdf>.

<sup>369</sup> [ ];

[ ].

- 6.47.2 Large supermarkets, defined as being between 1,000 and 2,500 square metres (most New World stores and approximately half of Countdown stores would likely fall within this category);<sup>370</sup> and
- 6.47.3 Hypermarkets, defined as being above 2,500 square metres (most PAK'nSAVE stores and many Countdown stores would likely fall within this category).<sup>371</sup>
- 6.48 We used these store size categories to estimate the number of Small supermarkets, Large supermarkets and Hypermarkets in New Zealand. We note that we have used these size categories (as defined in the Nielsen report) for consistency when conducting this specific piece of analysis, but we do not use it more generally in the rest of the report.
- 6.49 The results of our analysis are set out in Attachment H, and indicate that relative to the 19 European countries considered, New Zealand has:
- 6.49.1 the lowest total number of supermarkets (Small supermarkets, Large supermarkets and Hypermarkets) per million people at 88, with the UK having the second lowest at 105 and Norway having the highest at 501; but
- 6.49.2 the sixth-equal highest number of Hypermarkets per million people at 25, with France having the highest at 33 and the Netherlands having the lowest at three.
- 6.50 While New Zealand has relatively low total supermarket density (relative to Europe), it has a relatively higher number of Large supermarkets serving larger catchments. The extent to which there is a sufficiently large customer base in New Zealand to facilitate entry and expansion will depend on the offsetting effects of our relatively higher number of Large supermarkets, and relatively smaller total number of supermarkets.
- 6.51 It is difficult to tell what the overall impact of these two contrasting factors is on the size of New Zealand's contestable customer base. However, the results of our analysis (as discussed in paragraph 6.49) suggest that New Zealand's overall supermarket density does not appear to be out of line when compared with European countries. We cannot conclude that the market is saturated, and there may be opportunities for entry and expansion, particularly in areas of expected population growth.

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- 6.52 We would expect supermarket density to largely impact on entry and expansion by supermarket operators (eg, the major grocery retailers and potential large-scale supermarket entrants). Other grocery retailers generally differentiate their offerings from the major grocery retailers rather than competing directly, which means that high supermarket density may not be a significant factor impacting on their entry and expansion.

### Potential feasibility

- 6.53 We have not undertaken detailed analysis of the financial viability of large-scale entry into grocery retailing. However, a more structurally competitive retail grocery sector previously existed before Progressive Enterprises' 2002 acquisition of the former Woolworths New Zealand entity, New Zealand's population has increased by 25% since that time, and we have observed very substantial and stable supra-normal profits accruing to the major grocery retailers which we would expect to incentivise new entry in a workably competitive market.
- 6.54 Therefore, we agree with submissions from the major grocery retailers that entry of a scale to effectively compete with the major grocery retailers is viable. While we consider there are constraints on such competition emerging, as discussed in Chapter 9 our preliminary view is that these could be resolved rather than being the inevitable consequence of scale economies combined with New Zealand's population and geography.

### Site availability and development

- 6.55 A wide range of stakeholders have generally indicated via submissions on our preliminary issues paper and comments at meetings that site availability is a significant factor impacting on entry and expansion, and/or that conduct (eg, land banking, restrictive covenants) by incumbent firms may reduce site availability.<sup>372</sup>
- 6.56 In this section we begin by introducing the requirements for a site to be suitable for grocery store development, before discussing factors which may impact on site availability or development:
- 6.56.1 restrictive covenants and exclusivity covenants in leases;
  - 6.56.2 land banking; and
  - 6.56.3 planning regulations.

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 [ ]; The Warehouse Group "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 4 – mentions limited access to supply of suitable sites, and that certain property leases contain restrictive covenants; Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [37] – mentions land banking to prevent potential rivals from establishing a presence; NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [135] – mentions land banking as a well-established strategic barrier to entry and expansion.

- 6.57 The impact of some of the factors discussed in this chapter on entry and expansion conditions is likely to vary significantly depending on a retailer's business model. Generally, none of the factors discussed in this chapter are likely to impact on entry and expansion by online-only supermarkets which do not have any physical stores.
- 6.58 Exclusivity covenants in leases and planning regulations are likely to have broadly similar impacts on entry and expansion regardless of a retailer's business model.
- 6.59 On the other hand, any restrictive covenants and land banking by the major grocery retailers would be more likely to occur in relation to sites which may be suitable for supermarket development.
- 6.59.1 This would largely impact site availability for retailers which would require sites above a certain size (eg, a new supermarket entrant, competing major grocery retailers, some other supermarkets).
- 6.59.2 They may be less relevant to entry and expansion by other grocery retailers which operate stores with different site requirements (eg, convenience stores, Bin Inn, Costco).

#### Site requirements

- 6.60 There are a minimum set of requirements for a site to be considered viable for supermarket development.
- 6.61 In general, a site for a supermarket would be expected to:
- 6.61.1 meet certain size requirements, which may vary depending on factors such as:<sup>373</sup>
- 6.61.1.1 retail banner (eg, PAK'nSAVE stores tend to be larger than Four Square stores);
- 6.61.1.2 format (eg, a Countdown large format supermarket would tend to be larger than a Countdown Metro store); and
- 6.61.1.3 sales potential (larger stores generate higher overhead costs and require larger populations with more sales potential);
- 6.61.2 have a suitable degree of access (eg, located on or close to a main road to allow consumers and delivery trucks easy access);
- 6.61.3 have a high level of exposure to passing traffic and pedestrians and be easy for consumers to find, particularly for Metro stores which are typically located in areas with high pedestrian counts and good public transport;

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- 6.61.4 have sufficient land area to provide carparking for consumers, which is of greater importance to larger format supermarkets than smaller Metro stores (which sometimes do not offer carparking);
  - 6.61.5 comply with planning regulations (eg, zoning requirements as defined in the Local Council's District Plan and resource consent applications as required); and
  - 6.61.6 have truck loading areas to allow products to be delivered and received into the store.
- 6.62 Site requirements are likely to vary significantly depending on a grocery retailer's business model.
- 6.62.1 Grocery retailers with online-only business models (eg, meal kit providers, online-only supermarkets) would likely have different land requirements. While they might require physical warehouses or assembly centres for the purposes of their operations, they would likely have many more options than bricks-and-mortar retailers when choosing locations.<sup>374</sup>
  - 6.62.2 Other grocery retailers (eg, other supermarkets, international food stores) have site requirements which may be similar in some ways to those required by the major grocery retailers. For example, easy access for consumers and exposure to passing traffic and pedestrians would still be important requirements. However, there may also be some differences depending on the grocery retailer in question, such as potentially requiring smaller floor areas or not requiring carparking.

6.62.3 Costco operates using a different concept from supermarkets and would likely have different land requirements, notably requiring significantly larger sites. For example, Costco's proposed Auckland store will be about 14,000 sqm, which is significantly larger than supermarkets currently run by the major grocery retailers.<sup>375</sup> In addition, as mentioned in Woolworths NZ's submission, Costco is widely regarded as being a shopping destination for its members.<sup>376</sup> It may therefore have differing site location requirements as it might expect consumers within a larger catchment area to visit its stores, which would lessen the requirements for its stores to have exposure to passing traffic and pedestrians and potentially create a need for a larger carparking area.<sup>377</sup>

### Site availability

- 6.63 Suitable sites are a key requirement for successful entry and expansion of supermarkets. Entry or expansion on a regional or national basis would require access to numerous suitable sites. Difficulty with locating suitable sites, or purchasing suitable sites at a price which is viable for store development, is likely to be a key factor preventing entry and expansion of supermarkets (particularly in urban areas).
- 6.64 Supermarket operators would need to receive a sufficient return on investment to justify developing a supermarket. New Zealand's population profile (as discussed in paragraph 6.40) may therefore contribute to the apparent lack of suitable site availability by reducing the likelihood that sites will have access to a sufficiently large customer base to justify supermarket development.
- 6.65 We have identified two key conditions of entry and expansion which may impact site availability or development:
- 6.65.1 conduct by the major grocery retailers which may affect the availability of store sites, including:
- 6.65.1.1 lodging of restrictive covenants (including encumbrances) restricting supermarket development;

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<sup>375</sup> Anuja Nadkarni and Debrin Foxcroft "Costco is coming to New Zealand, changing the way we shop" (11 June 2019) <https://www.stuff.co.nz/business/113355280/costco-is-coming-to-new-zealand>.

<sup>376</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 27 – Woolworths NZ also mentions it has seen analysis suggesting that Costco stores have in-person catchments of about 25 km; [ ].

<sup>377</sup> Anuja Nadkarni and Debrin Foxcroft "Costco is coming to New Zealand, changing the way we shop" (11 June 2019) <https://www.stuff.co.nz/business/113355280/costco-is-coming-to-new-zealand> – suggests Costco will have about 800 car parks. For reference, PAK'nSAVE Papakura has 265 car parking spaces: <https://www.paknsave.co.nz/upper-north-island/auckland/papakura>.



- 6.65.1.2 including exclusivity covenants in leases which prevent competing supermarkets or other retail grocery businesses from being set up (this largely appears to take place in relation to malls or shopping centres);
  - 6.65.1.3 buying land and holding it for future use without any specific plans for its development (land banking); and
- 6.65.2 issues relating to planning regulations for supermarket development.
- 6.66 We have not assessed the individual impact of each land banked or covenanted site on competition, or considered the availability of alternatives in each area where there is a land banked or covenanted site. We have instead analysed the impact each type of conduct is likely to have on the availability of sites more generally.

### **Restrictive covenants and exclusivity covenants in leases**

- 6.67 The major grocery retailers lodge covenants on land which prevent or restrict supermarket or other food retail store development (restrictive covenants).<sup>378</sup> The prevalence with which this conduct occurs varies amongst the major grocery retailers.
- 6.68 We have identified more than 80 restrictive covenants entered into by the major grocery retailers, the majority of which are still active.<sup>379</sup> At least 50 instances of these restrictive covenants were either not time limited or had terms of 20 years or more.<sup>380</sup> These covenants have been lodged across the country, but largely appear to be more concentrated in major urban areas (eg, Auckland, Wellington and Christchurch).<sup>381</sup>
- 6.69 A restrictive covenant is attached to or runs with the land. This means that the covenants restricting supermarket developments that we have identified would bind any third parties who subsequently acquire (or lease) that land. Examples of how and when restrictive covenants can be lodged include:
- 6.69.1 on sale of land by a grocery retailer to a third party; or

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<sup>378</sup> As part of our fuel market study, we observed that when fuel companies close retail sites, they sometimes place “restrictive covenants” on the land to prevent its future use by another fuel retailer (Commerce Commission “Market study into the retail fuel sector – Final report” (5 December 2019) at [X109]-[X110]). The UK Competition Commission’s groceries market investigation also identified restrictive covenants and exclusivity arrangements in leases as potential barriers to entry (UK Competition Commission “The supply of groceries in the UK market investigation” (30 April 2008) at [7.121]).

<sup>379</sup> [ ]. These figures include restrictive covenants which may have expired as they could have impacted on entry and expansion for the period of time when they were active.

<sup>380</sup> [ ].

<sup>381</sup> [ ].

- 6.69.2 where a site is purchased by a grocery retailer from a third party, and in consideration for that purchase the vendor agrees (or is required) to register a covenant against other land in the area that the vendor is retaining.
- 6.70 We are also aware that major grocery retailers enter into leases which contain covenants restricting the development of rival supermarket and/or other retail grocery businesses (eg, butcheries, bakeries, fruit and vegetable stores) on adjacent or proximate premises.<sup>382</sup> These exclusivity covenants in leases appear to largely take place in relation to shopping centres or malls. The prevalence with which this conduct occurs varies amongst the major grocery retailers.
- 6.71 We have identified over 120 exclusivity covenants in leases entered into by the major grocery retailers, the majority of which are still active.<sup>383</sup> At least 100 instances of these exclusivity covenants in leases had potential terms of 20 years or more (after taking into account rights of renewal).<sup>384</sup> These exclusivity covenants in leases have been lodged across the country, but largely appear to be more concentrated in major urban areas (eg, Auckland, Wellington and Christchurch).<sup>385</sup>
- 6.72 Exclusivity covenants in leases tend to be contained in lease agreements between the major grocery retailers and landlords. In general, they would not be binding on subsequent tenants or landlords, unless a subsequent tenant assumes possession as a consequence of an assignment of an existing lease during its term (rather than entry into a new lease).

*Relevance of restrictive covenants and exclusivity covenants in leases*

- 6.73 The lodging of restrictive covenants and exclusivity covenants in leases on sites that might otherwise be suitable for retail grocery development (including expansion of existing stores) is likely to be a significant factor preventing or slowing entry and expansion. This is particularly the case where there are no other suitable sites, or only less suitable sites in the vicinity. These arrangements also have the potential to breach sections 27 and 28 of the Act, which is discussed from paragraph 6.90 below.

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<sup>382</sup> Exclusive leases have also been discussed in overseas market studies, notably by the ACCC and South African Competition Commission. The ACCC found that in the vast majority of leases in larger metropolitan centres, there appears to be little justification for exclusivity clauses other than to prevent competitive entry (ACCC “Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries – July 2008” (20 July 2008) at XVIII), and the South African Competition Commission found that long-term exclusive leases in shopping centres have the effect of raising barriers to entry for small and independent retailers (Competition Commission: South Africa “The Grocery Retail Market Inquiry (Final Report, non-confidential)” (25 November 2019) at [40]).

<sup>383</sup> [ ]. These figures include exclusivity covenants in leases which may have expired as they could have impacted on entry and expansion for the period of time when they were active.

<sup>384</sup> [ ].

<sup>385</sup> [ ].

6.74 Restrictive covenants and exclusivity covenants in leases may allow incumbent firms to benefit from reduced competition and receive higher sales and profits than they would otherwise be able to. We have observed instances where:

6.74.1 a major grocery retailer noted the existence of covenants restricting supermarket entry when assessing potential opportunities for entry,<sup>386</sup> and

6.74.2 Foodstuffs NI commenced proceedings in the High Court against Woolworths NZ over a restrictive covenant which would prevent them from operating a PAK'nSAVE on a site. Comments from Foodstuffs NI's GM Membership & Property in a media article indicated while Woolworths NZ's view was that the restrictive covenant prohibited a supermarket operating on the site, Foodstuffs NI considered the restrictive covenant to be anticompetitive and not legally enforceable.<sup>387</sup> Subsequent comments indicated Foodstuffs NI wanted to "ensure customers benefit from substantially increased and vigorous competition, better prices, more choice and a brand new PAK'nSAVE".<sup>388</sup>

6.75 The lodging of a restrictive covenant reduces the scope of activities which can be conducted on a piece of land. In some instances, restrictive covenants may significantly reduce the value of the land in relation to which they are lodged.<sup>389</sup> This indicates that retailers may expect the benefits of lodging restrictive covenants (eg, increased sales and/or profits as a result of reduced competition) to outweigh any foregone asset value incurred as a result.

6.76 However, the extent to which a restrictive covenant or exclusivity covenants in a lease reduces competition would likely vary depending on factors such as:

6.76.1 the duration of the restrictive covenants or exclusivity covenants in leases, as a lengthy duration or no expiry date is a greater restriction on site availability; and

6.76.2 the availability of other suitable sites in the area, as placing restrictive covenants or exclusivity covenants in leases over sites when there are few or no alternatives in the area is likely to be more restrictive of competition.

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<sup>386</sup> [ ].

<sup>387</sup> FMCG Business "Battle at Highland Park" (August 2019) <https://www.fmcgbusiness.co.nz/battle-at-highland-park/>.

<sup>388</sup> FMCG Business "Battle at Highland Park" (August 2019) <https://www.fmcgbusiness.co.nz/battle-at-highland-park/>.

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- 6.77 We consider that restrictive covenants and exclusivity covenants in leases are particularly likely to impede entry and expansion where:
- 6.77.1 they are used in areas where there is a shortage of land appropriate for retail grocery use;
  - 6.77.2 they prevent former retail grocery sites from being used for that purpose, since these are likely to have a proven customer base; and/or
  - 6.77.3 they prevent undeveloped land in major urban areas and their fringes from being developed into a retail grocery site, but would permit other retail uses.
- 6.78 In addition, we note that these arrangements have a cumulative effect. As more restrictive covenants and lease covenants are lodged over time, the total number of sites subject to restrictive covenants and exclusivity covenants in leases is likely to increase. This is particularly the case where the covenants have significant durations or no expiry dates. As such, the impact which restrictive covenants and exclusivity covenants in leases have on entry and expansion may continue to grow over time.
- 6.79 The lodging of a restrictive covenant or exclusivity covenant in a lease would also be significantly less costly compared to land banking as:
- 6.79.1 it would either mean not having to incur the cost of purchasing land (exclusivity covenants in leases), or being able to recover at least some of the purchase price (by selling it after lodging a restrictive covenant); and
  - 6.79.2 it would allow parties to avoid incurring costs associated with holding land for an extended period of time.

*Lack of a pro-competitive rationale for restrictive covenants and exclusivity covenants in leases*

- 6.80 Restrictive covenants and exclusivity covenants in leases on sites which would have otherwise been suitable for grocery retailing (including expansion of existing stores) have the effect of reducing the availability of suitable sites for grocery store development, and thus make it more difficult for a competing grocery retailer to enter or expand. While these effects are the same regardless of the grocery retailer's purpose for holding that land, if a pro-competitive purpose can be articulated for the conduct, this is likely to be relevant to whether we make recommendations relating to the conduct.<sup>390</sup>

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<sup>390</sup> For example, we note that the restrictive covenants we observed as part of our fuel market study may have been placed on former retail sites by fuel stations to prevent potential disputes from occurring if a re-used site was found to have contaminated the land. This rationale does not appear to be relevant to the operation of supermarkets.

6.81 At this stage we consider that there are unlikely to be significant pro-competitive rationales for many of the restrictive covenants or exclusivity covenants in leases – the explanations we have received do not sufficiently explain why covenants of this nature are commercially legitimate such that their restrictive effect on competition should be justified. Rather, we are aware that this conduct may, at least in some instances, be intended to prevent entry and expansion in an area.

6.82 For instance, we understand that a restrictive covenant may often be registered against the title before it is sold, limiting future operation of a food or retail grocery business at the site.<sup>391</sup> We consider this illustrates that restrictive covenants may be lodged for the purposes of preventing competitive entry (and a corresponding reduction in an incumbent firm’s store revenues and profits).

6.83 We understand that:

6.83.1 a rationale for lodging restrictive covenants can be to prevent competitive entry into an area where the incumbent firm has no direct supermarket competition in the area;<sup>392</sup> and

6.83.2 sites are sometimes purchased for the purposes of restricting the development of a competitor’s store and subsequently sold after a restrictive covenant was lodged.<sup>393</sup>

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- 6.84 A further rationale for entering into exclusivity covenants in leases and lodging the restrictive covenants described in paragraph 6.69.2 involves placing an obligation on the land vendor to operate its remaining land in a certain manner (such as providing a wide variety of retail stores for the purposes of operating an integrated shopping centre).<sup>394</sup>
- 6.84.1 It is likely that it would align with the interests of the landlord or land owner to provide a wide variety of retail stores for the purposes of attracting foot traffic to a shopping centre (ie, it might be impractical to place two large supermarkets side by side in a shopping centre).
- 6.84.2 However, given that landlords or land owners would likely engage a single supermarket unilaterally if it would be beneficial to the shopping centre as a whole, the covenants would not appear to be necessary under such circumstances. As such, in circumstances where there is potential for the covenants to be pro-competitive, it appears likely that the same outcome would be achieved even in their absence.
- 6.84.3 On the other hand, these covenants would likely prevent a landlord or land owner from renting to an additional food retail store or supermarket where they consider it would be beneficial to their shopping centre. As such, there does not appear to be a benign or pro-competitive rationale for these covenants where they are most likely to have a practical effect.
- 6.85 We also understand that these restrictive covenants can be put in place because grocery store development on the remaining land or elsewhere in the centre would reduce sales and the financial viability of the purchasing retailer's own store development, which is the commercial basis upon which any rent or purchase price would be set.<sup>395</sup>
- 6.85.1 These arrangements, by reducing site availability, prevent or lessen the likelihood of competitive entry into an area. This in turn has the potential to reduce the level of competition faced by the incumbent firm, allowing them to receive higher revenues (in the form of increased sales) than they would likely have achieved in a more competitive market with the threat of entry.

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- 6.85.2 These increased revenues may subsequently be shared with the associated land owner or landlord in the form of higher rent payable or a higher purchase price for land intended to be used for store development. However, we do not consider this to be pro-competitive (although limited periods of exclusivity may be justified under the circumstances discussed in paragraph 6.86) as it comes at the expense of consumers in the area who might have otherwise received the benefits of increased competition (eg, lower prices) absent the restrictive covenant or exclusivity covenant in the lease. In essence, we consider this to be the equivalent of the two parties sharing the benefits of reduced competition.
- 6.86 The ACCC's study into the grocery sector mentioned that in some circumstances, a possible rationale for offering a period of exclusivity would be to attract a supermarket as an anchor tenant to a shopping centre or complex which might not have otherwise been built.<sup>396</sup>
- 6.86.1 The extent to which this rationale applies in a New Zealand context is unclear as we have not assessed each restrictive covenant and exclusivity covenant in a lease on an individual basis. However, we note that the ACCC also noted that while guaranteeing a period of exclusivity may be justified in some circumstances, restrictive provisions in supermarket leases appear to be employed simply to maximise the profitability of a supermarket by restricting its exposure to competition in many cases.<sup>397</sup>
- 6.86.2 In any event, this rationale would be unlikely to justify long periods of exclusivity. After a shopping centre has been established and a period of exclusivity was observed, the landlord may subsequently wish to add additional supermarkets or food retail stores to the shopping centre.
- 6.86.3 We note that (as discussed in paragraphs 6.68 and 6.69.2) most of the restrictive covenants and exclusivity covenants in leases we have observed have relatively lengthy durations (or potential durations) of more than 20 years. Our view is that the anchor tenant rationale is unlikely to justify exclusivity for such extensive periods.

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<sup>396</sup> ACCC "Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries – July 2008" (20 July 2008) at [XVIII].

<sup>397</sup> ACCC "Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries – July 2008" (20 July 2008) at [189].

6.87 A further rationale for restrictive covenants described in paragraph 6.69 may be to protect goodwill associated with existing retail banners.<sup>398</sup> For example, a grocery retailer which sells its former site may be concerned that goodwill relating to its retail banner or the location of its former store might be appropriated by a competing retailer. Goodwill could be generated where consumers develop a habit of shopping for groceries at a particular location. A grocery retailer could potentially appropriate location-related goodwill by developing a grocery store at a competitor's former store site.

6.87.1 However, the major grocery retailers have relatively distinct store brandings (including colours and logos) for each of their retail banners, and we consider it unlikely that competing retailers could capture significant brand-related goodwill when a store changes retail banner (eg, if a Countdown is turned into a New World).

6.87.2 In any event, we consider that any concerns relating to the protection of goodwill would only be a potential justification for lodging a restrictive covenant for a short period of time. This does not appear to be the case as discussed in paragraph 6.86.3.

6.88 In summary, restrictive covenants and exclusivity covenants in leases in relation to sites which would otherwise be suitable for grocery store development impact on entry and expansion conditions as they reduce site availability. Our view is that there do not appear to be significant pro-competitive rationales in relation to restrictive covenants or exclusivity covenants in leases.

*Restrictive covenants and exclusivity covenants in leases under the Commerce Act*

6.89 While the restrictive covenants and exclusivity covenants in leases we have identified are relevant to our study due to their potential to prevent or slow entry and expansion, they may also be relevant to us in our role as an enforcement agency.

6.90 Restrictive covenants and exclusivity covenants in leases may breach sections 27 and/or 28 of the Act:

6.90.1 section 27 prohibits the entering into or giving effect to a contract, arrangement or understanding containing a provision which has the purpose, effect, or likely effect of substantially lessening competition in a market.<sup>399</sup>

6.90.2 section 28 prohibits the requiring or giving of, or enforcing, a covenant that has the purpose, effect or likely effect of substantially lessening competition in a market. Such covenants are unenforceable.<sup>400</sup>

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<sup>399</sup> Commerce Act 1986, section 27.

<sup>400</sup> Commerce Act 1986, section 28.



6.90.3 We note that sections 3(5) and 3(6) of the Act allows for provisions of contracts, arrangements, or understandings (for the purposes of section 27) and covenants (for the purposes of section 28) to be aggregated where, taken together, they would have the effect or likely effect of substantially lessening competition.<sup>401</sup>

6.91 Independent of this study, we may consider further appropriate action utilising our competition compliance and enforcement functions and powers.<sup>402</sup> We observe that our prior experience with provisions of this nature has shown that the assessment as to whether such a provision may contravene section 27 or section 28 is complex and time consuming and any contested enforcement proceedings are consequently likely to prove protracted and expensive.

### Land banking

6.92 We are aware that the major grocery retailers identify, purchase, and hold land (including suitable store sites which meet the criteria discussed in paragraph 6.61) without specific plans for using that land for their operations within a set timeframe (also known as land banking).<sup>403</sup> Land banking was mentioned by stakeholders in submissions on our preliminary issues paper as being a factor which may impact on entry and expansion.<sup>404</sup>

6.93 Our starting point when assessing the effect of land banking on the conditions for competition is that it has the potential to impede entry and expansion by restricting the ability of competing retailers to access a key input in the form of suitable sites.<sup>405</sup> The extent to which land banking impacts on the ability of a new entrant or existing firm to find a suitable site would depend largely on factors such as the number of alternative sites available and the length of time which land is held for (the longer the period between the purchase and development of a site, the greater the impact it has on entry and expansion).

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<sup>401</sup> This requires the same person to be party to the agreements under section 27 or entitled to benefit from the covenants under section 28.

<sup>402</sup> Commerce Commission "Enforcement Response Guidelines" (October 2013) [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf).

<sup>403</sup> [ ].

<sup>404</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [37] – mentions land banking to prevent potential rivals from establishing a presence; NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [135] – mentions land banking as a well-established strategic barrier to entry and expansion.

<sup>405</sup> The UK Competition Commission's groceries market investigation also discussed land banking as a potential barrier to entry or expansion. UK Competition Commission "The supply of groceries in the UK market investigation" (30 April 2008) at [7.69].

- 6.94 Over the period of time we have examined, we have identified over 200 sites held (owned or leased) or previously held by the major grocery retailers which either were not used or have ceased being used for supermarket development. These sites appear to be located across the country, but largely appear to be concentrated in major urban areas (eg, Auckland and Christchurch).<sup>406</sup> At least 30 of these sites have been held or were previously held by the major grocery retailers for more than 20 years.<sup>407</sup> This provides an indication that there are a number of sites which may have been land banked (and the corresponding impact of any land banking which may have taken place).
  
- 6.95 The acquisition and holding of land is often necessary for grocery retailers for a range of reasons such as planned supermarket development, planned warehouse development, carparking or developing a property portfolio for investment purposes (ie, aggregating a number of contiguous titles as they become available).
  
- 6.96 Information we have gathered indicates that the major grocery retailers tend to take a long-term approach towards store development, which includes identifying and acquiring suitable sites or sites which may become suitable for future supermarket development (eg, based on forecast or anticipated population growth and residential expansion well in advance on a prospective basis) as they become available.<sup>408</sup>
  
- 6.97 However, grocery retailers may also have other reasons for purchasing and holding potential retail grocery sites – including to prevent use of that land by competing grocery retailers. Where large amounts of relevant land is acquired and held for a significant length of time without being utilised, this has an effect on entry and expansion conditions (ie, reduction in the availability of suitable sites).

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6.98 In general, as discussed at paragraph 6.82, the preferred strategy from the major grocery retailers appears to be to use restrictive covenants or exclusivity covenants in leases to impede store development by competitors. We have seen relatively few instances of the major grocery retailers buying and holding land for significant lengths of time primarily for this purpose.<sup>409</sup> These sites generally appear to be sold once their purpose is fulfilled (potentially after lodging a restrictive covenant).<sup>410</sup>

6.99 There appear to have been instances when the potential for a competitor to purchase or acquire the site is taken into consideration when making decisions regarding the purchase of land.<sup>411</sup> However, in the decisions we have reviewed, this was usually one of a number of factors considered in the decision-making process as opposed to being the primary driver.

6.100 We note that land banking is likely to be relatively costly as it would involve paying the purchase price for land and any subsequent costs associated with holding the land for extended periods of time (including the capital servicing costs).<sup>412</sup>

6.101 In summary, 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.

6.101.1 While there are a number of legitimate and potentially pro-competitive commercial reasons for grocery retailers to purchase and hold land (eg, future development of their own stores), we do not consider there to be similar significant pro-competitive rationales in relation to restrictive covenants or exclusivity covenants in leases.

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6.101.2 Where parties intend to restrict a competitor’s ability to enter or expand, they would appear more likely to do so using restrictive covenants and exclusivity covenants in leases than land banking given the costs associated with purchasing and holding land for extended periods of time.

6.101.3 However, we note that if restrictive covenants and exclusivity covenants in leases were no longer options for restricting entry and expansion by competitors, there might be a subsequent increase in the use of land banking for these purposes.

### **Planning regulations**

6.102 In addition to site availability, another key element required for store development is compliance with relevant planning regulations. This may include tasks such as:

6.102.1 complying with zoning requirements within a District Plan;

6.102.2 determining whether a proposed store development requires consent; and

6.102.3 where required, applying for a resource consent and engaging with the subsequent process.

### *Key features of planning regulation*

6.103 New Zealand’s planning laws are currently outlined in the Resource Management Act 1991 (RMA). We note that the Government recently undertook a full review of the RMA,<sup>413</sup> and intends to undertake significant reform.<sup>414</sup>

6.104 We do not intend to discuss current planning regulation in detail as it is not necessary to do so for the purposes of this chapter, and in light of the upcoming reform. However, some key features of current planning regulation are outlined below.

6.104.1 Under District (set by City and District Councils) and Regional Plans (set by Regional Councils), activities are assigned to a category which affects whether resource consents will be required and the conditions under which they are likely to be imposed. Examples include permitted activities which are allowed to occur without a resource consent, and controlled activities which require a resource consent.

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<sup>413</sup> Ministry for the Environment “New Directions for Resource Management in New Zealand” (June 2020) <https://www.mfe.govt.nz/publications/rma/new-directions-resource-management-new-zealand>.

<sup>414</sup> Hon David Parker “RMA to be repealed and replaced” (10 February 2021) <https://www.beehive.govt.nz/release/rma-be-repealed-and-replaced>.

6.104.2 The RMA also contains scope for parties to oppose their competitors' resource consent applications for anticompetitive reasons, such as to prevent or delay competitive entry.<sup>415</sup>

6.104.2.1 Section 104(3)(a) states that a consent authority must not have regard to trade competition or its effects when considering a resource consent application.<sup>416</sup>

6.104.2.2 Part 11A limits the ability for trade competitors to participate in objection and appeal processes, unless they are directly affected by an adverse effect of the activity on the environment. It also discourages the covert use of third parties by trade competitors.<sup>417</sup>

*Relevance of planning regulation to our study*

6.105 Planning regulations have the potential to impede or slow the ability of retailers to develop new stores if they create additional costs or significant delays in the store development process. We note that overseas market studies have found that planning regulation can impede entry, including by acting as a barrier to the establishment of new supermarkets, or by increasing the cost or time associated with development of a new retail outlet.<sup>418</sup>

6.106 Based on information we have received regarding recent resource consent applications by the major grocery retailers, we observe that some applications appear to have taken multiple years, and that there appears to have been significant cost involved with pursuing applications for resource consent in some instances.<sup>419</sup>

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<sup>415</sup> See: <https://environment.govt.nz/assets/Publications/Files/Resource-management-amendment-act-2009-Fact-Sheet-2.pdf>.

<sup>416</sup> Resource Management Act 1991, section 104(3)(a).

<sup>417</sup> Resource Management Act 1991, Part 11A.

<sup>418</sup> UK Competition Commission "The supply of groceries in the UK market investigation" (30 April 2008) at [29]-[31]; Irish Competition Authority "Grocery Monitor Report No. 3: The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007" (July 2008) at viii.

<sup>419</sup> [ ];  
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- 6.107 Aspects of the current planning process have the potential to impede or slow entry and expansion. Examples of the ways in which this may occur include:
- 6.107.1 Parties may seek to influence plans (eg, District Plans) in a way that restricts development of a new supermarket, or may attempt to slow down attempts to liberalise existing restrictions. Changing the category that supermarket activity falls into will significantly change the difficulty involved in obtaining resource consent. Appeals against plan changes take time, and plans generally remain idle while under appeal.
  - 6.107.2 Notification decisions, in relation to plan changes and resource consents, may be challenged by judicial review, and later appealed. This can delay resolution and result in the relevant plan change or consent being set aside, and may result in firms being unwilling to invest pending resolution of the challenge.
  - 6.107.3 Notified consent processes will involve submissions or hearings which can slow down or influence the grant of consent.<sup>420</sup> This may result in a declined consent, or a consent with conditions that render supermarket operation less successful or even unviable.
  - 6.107.4 The timing of large-scale entry could be significantly affected by the inconsistency of approach across the country. The lack of consistency between District Plans means each site will need to be considered independently, and if consent is required it will be subject to the relevant local rules. Even where the District Plans are similar, there can be significant differences between consent processing times across local authorities.
- 6.108 We note that the major grocery retailers have historically opposed each other's resource consent applications under the RMA. In at least some cases, these disputes have created significant impediments or delays in the store development process.

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<sup>420</sup> Notified consent processes allow potentially affected parties and members of the public to give feedback on resource consent applications that affect them. See <https://wellington.govt.nz/property-rates-and-building/building-and-resource-consents/resource-consents/applying-for-a-resource-consent/notified-resource-consents> for further information.

- 6.109 This point is illustrated by the Wairau Road PAK'nSAVE resource consent application, where resource consent disputes (including appeals to the Environment Court and High Court) raised by Progressive Enterprises delayed opening of the store for approximately 20 years. This was despite the likely benefits to consumers which would result from the opening of the store, as illustrated by the Environment Court finding that there was "a clear consensus among all the economist witnesses that the introduction of a strong competitor into the North Shore supermarket market would be a good thing for customers, even if its competitors would not welcome it".<sup>421</sup>
- 6.110 The RMA was amended in 2009 to limit trade competitors' use of the objection process under the RMA (as described in paragraph 6.103). The Environment Court, in a subsequent resource consent dispute between the major grocery retailers (*General Distributors Ltd v Foodstuffs Properties (Wellington) Ltd*), noted that in making the amendments to the Act, Parliament was motivated by:<sup>422</sup>
- ...the frustration of seeing developments (not least supermarket developments) being bogged down in seemingly endless RMA litigation that, in the end, was motivated by nothing more than the wish to stifle the opening of a rival store in a given location.
- 6.111 These amendments have limited the circumstances under which supermarket operators can oppose store developments by their competitors under the RMA.<sup>423</sup> However, there may still be barriers (in terms of time and cost) created by the resource consent process in relation to supermarket development.

*The role of competition under the current resource consent process*

- 6.112 It is difficult to determine the extent to which competition and consumer choice is in practice taken into account under the RMA at present. A review of applications filed and decisions made in relation to proposed supermarket developments will necessarily involve a degree of selection bias. Nevertheless, the evidence before us suggests that the benefits of competition and consumer choice appear to be raised by parties in some cases, but not all. Where competition is discussed in relation to a proposed supermarket development, it appears to be mentioned as part of a broader assessment of the "positive effects" which are likely to arise as a result of a resource consent application, and it is difficult to determine how much weight, if any, it was given. Competition does appear to have been taken into account by decision makers in some cases. Equally, in some cases it has been raised by the applicant but not taken into account by the decision maker.

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<sup>421</sup> *Progressive Enterprises Limited v North Shore City Council* W075/2008 [2008] NZEnvC 311 at [71], available at: <http://www.nzlii.org/cgi-bin/sinodisp/nz/cases/NZEnvC/2008/311.html?query=progressive%20enterprises%202008>.

<sup>422</sup> *General Distributors Ltd v Foodstuffs Properties (Wellington) Ltd* [2011] NZEnvC 212 at [11], available at: [http://www.nzlii.org/cgi-bin/sinodisp/nz/cases/NZEnvC/2011/212.html?query=title\(general%20distributors%20and%20foodstuffs%20\)](http://www.nzlii.org/cgi-bin/sinodisp/nz/cases/NZEnvC/2011/212.html?query=title(general%20distributors%20and%20foodstuffs%20)).

<sup>423</sup> See relevant commentary: <https://www.brookfields.co.nz/publications/environmental-resource-mangement/214-smoke-settles-on-supermarket-wars> and <https://www.lexology.com/library/detail.aspx?g=8cea536f-2c61-44bf-b994-884503391398>.

- 6.113 We consider that the benefits of competition and consumer choice are not being considered in a consistent or systematic manner. We acknowledge that we have only reviewed a limited sample of resource consent applications and decisions in relation to supermarket developments. It is possible that a wider review might reveal greater consistency of treatment. But, in any event, it does not appear to be taken into account in a systematic way, or consistently incorporated into the plans and processes that underpin individual applications. We note that the impact a proposal is likely to have on competition does not appear to be a specific factor which has to be taken into account under current planning regulations, as observed by its general incorporation into a broader discussion of “positive effects” when discussed.
- 6.114 In summary, we are aware that there are a wide range of factors which are generally considered as part of the decision-making process for a resource consent application. However, our preliminary view is that decision makers do not consistently take into account the benefits to consumers that arise from increased actual or potential competition, and it is likely that there would be room for the potential benefits of competition to be more consistently given appropriate consideration as a relevant factor as part of the planning process in relation to supermarket developments.

### **Cost advantages available to the major grocery retailers**

- 6.115 The major grocery retailers have significant cost advantages over other grocery retailers and new entrants. They are able to:
- 6.115.1 generate cost efficiencies through vertically integrated wholesale and distribution;<sup>424</sup>
  - 6.115.2 access economies of scale by spreading their fixed costs across large volumes or numbers of stores, achieving lower costs per unit; and

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 An article by Betancourt and Malanoski suggested that “supermarkets exhibit constant marginal costs with respect to the quantity of output or turnover and substantially declining marginal costs with respect to (distribution) services, which implies substantial multiproduct economies of scale”.  
 Betancourt, R., and M. Malanoski “An Estimable Model of Supermarket Behavior: Prices, Distribution Services and Some Effects of Competition” *Empirica* 26 (1999):55-73, at 1, available at:  
<http://econweb.umd.edu/~betancourt/distribution/estimable.pdf>.



- 6.115.3 receive lower prices and fees (eg, product prices and merchant service fees).<sup>425</sup>
- 6.116 The ability of the major grocery retailers to generate cost efficiencies for the reasons listed in paragraph 6.115 does not inherently raise competition issues. Economies of scale, volume discounts and vertical integration are all common features of a number of other retail sectors and overseas grocery markets. They generate significant efficiency benefits which ultimately benefit consumers if they are passed on in the form of lower prices.
- 6.117 However, incumbent firms' access to these cost efficiencies mean that they are likely to have cost advantages over new entrants that are not vertically integrated or operating at scale.
- 6.118 This is likely to make it difficult for new entrants and other grocery retailers to enter, expand, and compete effectively on price, even while operating at a small scale. This will also reduce their ability to gain market share by growing their customer base, and will, in turn, reduce their ability to achieve economies of scale or receive lower prices from buying in bulk.
- 6.118.1 While we have observed that other grocery retailers are able to compete with the major grocery retailers on price in relation to some products, they are unable to do so for the full range of groceries (as discussed in Chapter 4). This is likely because they:
- 6.118.1.1 may receive less competitive prices from suppliers due to their lower volumes;<sup>426</sup>

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<sup>425</sup> [ ]. This is supported by public statements made by the major grocery retailers in relation to the Alcohol Reform Bill. While these statements were made in the context of the alcohol category, they are likely to apply more broadly to the acquisition of groceries. Progressive Enterprises indicated that it is able to achieve retail prices for wine and beer below what may be the wholesale price for other retailers, see: Progressive Enterprises "Response to a question by the Justice and Electoral Select Committee on the Alcohol Reform Bill" (23 March 2011), available at: [https://www.parliament.nz/resource/en-NZ/49SCJE\\_EVI\\_00DBHOH\\_BILL10439\\_1\\_A179242/54b525c4b6e97c1ecb5792d10f392fda7bf8fdf9](https://www.parliament.nz/resource/en-NZ/49SCJE_EVI_00DBHOH_BILL10439_1_A179242/54b525c4b6e97c1ecb5792d10f392fda7bf8fdf9); Foodstuffs (NZ) indicated that due to their size and scale, supermarkets are able to negotiate substantially better pricing terms than other market participants, see: Foodstuffs (NZ) Limited "Supplementary submission to the Justice & Electoral Select Committee in response to the Alcohol reform Bill" (April 2011), available at: [https://www.parliament.nz/resource/en-NZ/49SCJE\\_EVI\\_00DBHOH\\_BILL10439\\_1\\_A182225/c4807b84de81482b1bac4a2fbe12575dfa5fc8bf](https://www.parliament.nz/resource/en-NZ/49SCJE_EVI_00DBHOH_BILL10439_1_A182225/c4807b84de81482b1bac4a2fbe12575dfa5fc8bf).

<sup>426</sup> [ ]; [ ]; [ ]; [ ].

- 6.118.1.2 do not enjoy economies of scale and scope in wholesaling, warehousing and distribution,<sup>427</sup> and
- 6.118.1.3 are unable to spread their fixed costs across significant retail volumes as the major grocery retailers do.
- 6.119 As a result, other grocery retailers generally differentiate their offering using non-price factors such as product range (as discussed in Chapter 4). This indicates that the cost efficiencies which major grocery retailers are able to access are likely to restrict the extent to which there can be effective large-scale entry, expansion and competition.
- 6.120 While it may be difficult for a new or smaller grocery retailer to match the cost efficiencies which the major grocery retailers are able to achieve, we note that there may be other possible means by which cost efficiencies could be generated to achieve entry and expansion. For example, the use of a model with low overhead costs (eg, online-only model) can help a new entrant to reduce their overall costs significantly, allowing them to compete with the major grocery retailers on price and (delivery) service. Some recent entrants into the sector have done so using an online-only model (eg, The Honest Grocer, Supie).
- 6.121 However, while entry using an online-only model may generate some cost efficiencies by lowering fixed costs, it still does not (at least until considerable scale has been achieved) allow retailers to match the volume discounts which major grocery retailers can access through bulk buying. In addition, as discussed in Chapter 3, the relatively low penetration and growth of online grocery sales in New Zealand indicates that online-only offerings are unlikely to provide significantly more competition to the major grocery retailers in the foreseeable future.
- 6.122 In summary, the major grocery retailers' significant cost advantages resulting from their ability to purchase large volumes at lower prices and access economies of scale may be factors limiting large-scale entry and expansion and hence direct competition with the major grocery retailers. However, the scale factor would be less important if entrants were better able to access a full range of competitively priced groceries. This is discussed in greater detail in the following section.

### Access to wholesale

- 6.123 It is not uncommon in overseas grocery markets for large incumbent firms to be vertically integrated or have access to economies of scale and volume discounts.

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- 6.124 However, a key feature of many overseas grocery markets is the presence of significant grocery wholesalers (eg, C&S Wholesale Grocers in the US, Bestway in the UK). Grocery wholesalers have the ability to purchase in bulk and negotiate lower prices by aggregating volumes from their retailer customers, and can also generate cost efficiencies by organising centralised storage (eg, at their own warehouses) and distribution to retail stores.
- 6.125 Grocery retailers who purchase from competitive grocery wholesale markets therefore have the potential to receive lower prices than they would likely be able to negotiate from suppliers directly,<sup>428</sup> in addition to reducing costs by not having to arrange distribution to their stores or operate their own warehouses and distribution centres.

### Availability of wholesale in New Zealand

- 6.126 We asked questions relating to the availability of wholesale in our preliminary issues paper.
- 6.126.1 Woolworths NZ submitted that there are wholesale options such as:<sup>429</sup>
- 6.126.1.1 purchasing directly from suppliers which perform their own wholesale function including transport and distribution (eg, Goodman Fielder, Heinz Watties);
  - 6.126.1.2 wholesalers focussed on particular product categories (eg, T&G Fresh, Wholesale Meats Direct);
  - 6.126.1.3 wholesalers focussed on the ethnic grocery store segment (eg, Tai Ping, AB International);
  - 6.126.1.4 online wholesalers (eg, The Warehouse Group's online TheMarket platform);
  - 6.126.1.5 foodservice wholesalers (eg, Bidfood, Service Foods); and
  - 6.126.1.6 entry by Costco and potentially Metcash (Australia's largest independent grocery wholesaler).
- 6.126.2 Foodstuffs NI and Foodstuffs SI similarly submitted that there is wholesale capability in the form of foodservice wholesalers such as Bidfood which could expand to supply new entrants.<sup>430</sup>

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<sup>428</sup> We note that whether or not this potential is realised may depend on the extent to which there is effective competition between grocery wholesalers. A single large independent wholesaler of groceries may not be incentivised to charge competitive prices to its customers.

<sup>429</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 63.

<sup>430</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 28-29. Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 18-19.

- 6.126.3 Some submissions indicated that wholesale is available for some product categories such as produce.<sup>431</sup> Other submissions indicated that there may be an overall lack of independent wholesale with sufficient scale.<sup>432</sup>
- 6.127 Current wholesale options for a full range of groceries at competitive prices and associated services in New Zealand appear to be limited.
- 6.127.1 We are aware that wholesale options appear to exist for sourcing some product categories in New Zealand such as fresh produce (eg, T&G Fresh and MG Marketing) and meat.<sup>433</sup>
- 6.127.2 We also note retailers have indicated that they are able to acquire some groceries from wholesalers of imported products (eg, AB International, Acorn Group, Tai Ping, Asian Savour). This appears to largely be the case for international products (eg, Indian, Chinese, Korean) and some categories of globally branded products (eg, confectioneries).<sup>434</sup> However, we note that importing might not provide access to locally branded products, including core brand products which consumers would expect to see in a supermarket.<sup>435</sup>
- 6.127.3 As mentioned in Woolworths NZ's submission, there are some larger suppliers which can essentially perform a wholesale function in some product categories. However, information provided by other grocery retailers indicates that purchasing directly from these suppliers may not be a viable option for smaller retailers. As the major grocery retailers purchase large volumes directly, they likely receive volume discounts which other grocery retailers are unable to match.<sup>436</sup> Some suppliers also impose volume requirements (such as requiring minimum order quantities) which may render it difficult for other grocery retailers or new entrants to purchase directly.<sup>437</sup>

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<sup>431</sup> T&G Fresh "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 6; United Fresh "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 17-18.

<sup>432</sup> For example: NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [135] and [147]; The Warehouse Group "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 3.

<sup>433</sup> See Beef + Lamb NZ's website for examples of meat suppliers and wholesalers <https://www.beeflambnz.co.nz/suppliers>.

<sup>434</sup> [ ];

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<sup>435</sup> [ ].

<sup>436</sup> Above n 426.

<sup>437</sup> [ ].

6.127.4 While the major grocery retailers own and operate firms which perform wholesale functions, receiving wholesale supply of a full range of groceries from these firms does not appear to be a viable option.

6.127.4.1 Wholesale Distributors Limited, which is owned by Woolworths NZ, does not wholesale to New Zealand grocery retailers other than those associated with Woolworths NZ (eg, FreshChoice and SuperValue stores).<sup>438</sup>

6.127.4.2 Trents, which is owned by Foodstuffs SI, and Gilmours, which is part of Foodstuffs NI, are primarily foodservice wholesalers. Trents supplies some products to dairies, and Gilmours also supplies some products to grocery retailers (primarily convenience stores, petrol stations, and dairies).<sup>439</sup> However, information provided indicates that they have a different offer from supermarkets, and that supermarkets such as PAK'nSAVE may be a better product sourcing option for other grocery retailers (eg, convenience stores) in terms of price or product availability.<sup>440</sup>

6.127.4.3 Information we have received indicates that prices charged by Gilmours and Trents for some products may, in some instances, be higher than the prices charged at supermarkets for the same products (for some sets of products the difference may be approximately 25%).<sup>441</sup>

6.127.5 TheMarket has been cited by major grocery retailers as being a potential option for grocery wholesale. Information provided by The Warehouse Group indicates that TheMarket does not directly sell groceries. Rather, it is largely an e-commerce platform which allows merchants to list their products and sell to consumers.<sup>442</sup> TheMarket does not appear to be a significant source of supply of groceries.<sup>443</sup>

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442 The Warehouse Group "Comments on submissions on preliminary issues paper" (12 April 2021).  
 443 The Warehouse Group "Comments on submissions on preliminary issues paper" (12 April 2021). The Warehouse notes that less than 0.6% of products offered on TheMarket are grocery related.

- 6.128 There do not appear to be any large independent wholesalers of a full range of groceries in the New Zealand grocery sector which perform similar functions to wholesalers which we have observed in overseas markets.
- 6.129 The lack of availability of competitively priced wholesale options for a full range of groceries in New Zealand is demonstrated by retailers generally displaying a large degree of vertical integration regardless of their size. We have observed that other supermarkets negotiate with and purchase directly from large numbers of suppliers and arrange distribution to their stores, which may include the operation of their own warehouses and distribution centres.<sup>444</sup>
- 6.130 As discussed in paragraph 6.127.3, other grocery retailers that offer a main shop have consistently indicated that they largely receive less competitive prices than the major grocery retailers when purchasing from suppliers directly due to differences in volume.<sup>445</sup> We are aware that in at least some instances, wholesale prices offered by suppliers to convenience stores and dairies may be higher than prices displayed in retail supermarkets.<sup>446</sup> The presence of volume requirements (eg, minimum order quantities) may prevent some retailers or new entrants from purchasing from some suppliers entirely.<sup>447</sup>

**Potential for increased wholesale availability in future**

- 6.131 Woolworths NZ, Foodstuffs NI and Foodstuffs SI submitted that there could be other avenues for accessing wholesale services in the market such as current foodservice wholesalers that could pivot to supplying groceries.<sup>448</sup> Woolworths also submitted that potential or future international entrants (Costco and Metcash) could potentially perform a wholesale function. However, we do not consider these are likely to be viable options for wholesale of a full range of groceries.

*Foodservice wholesalers as a grocery wholesale option*

- 6.132 Foodservice wholesalers which are owned by, or are part of, the major grocery retailers (Gilmours and Trents) supply some groceries to some grocery retailers (primarily convenience stores, petrol stations and dairies). However, as discussed at paragraph 6.127.4, they may not be a viable source of wholesale for a full range of groceries as they are primarily foodservice wholesalers with a differentiated offering, and appear to charge relatively high prices.

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444 [ ];  
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445 Above n 426.

446 [ ];  
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447 Above n 437.

448 Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 63; Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 28-29; Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 18-19.

6.133 Independent foodservice wholesalers (eg, Bidfood, Service Foods) operate in a different market from grocery wholesalers, and do not appear to be a viable source of a full range of groceries. Key reasons for this include:

6.133.1 their products are sold in formats that are suitable for foodservice but not retail grocery (eg, in bulk as opposed to packaged);<sup>449</sup> and

6.133.2 their likely inability to obtain competitive prices from suppliers if they were to purchase groceries suited to retail grocery sale due to lack of volumes.<sup>450</sup>

6.134 Based on information provided, we are not aware of any foodservice wholesalers which supply groceries on a significant scale.<sup>451</sup> In addition, we are not aware of any specific plans by independent foodservice wholesalers to expand into selling more groceries.<sup>452</sup>

*Potential or future international entrants as a grocery wholesale option*

6.135 Woolworths NZ submitted that Costco’s entry into New Zealand will provide another significant cash-and-carry option for retailers, and that Metcash already has a sizeable presence in New Zealand via its liquor business (Tasman Liquor, Bottle-O), which would provide a basis on which to expand in New Zealand.<sup>453</sup>

6.136 We have not received any information regarding specific plans for entry by a potential wholesale entrant offering a full range of groceries into the New Zealand grocery sector.<sup>454</sup>

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453 Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 63.

454 [ ].

- 6.137 We anticipate that Costco's prices may be significantly lower than those currently charged by the major grocery retailers, raising the possibility that it could be a wholesale option for grocery retailers.<sup>455</sup> However, there are some key limitations to Costco as a wholesale option for grocery retailers.
- 6.137.1 Costco purchases large quantities of branded products (eg, one brand of a type of product) in order to achieve higher volumes and negotiate for lower prices.<sup>456</sup> This means that it is unlikely to stock a wide variety of brands for the purposes of wholesale to grocery retailers. The larger package sizes of its products may also be unsuitable for sale by other grocery retailers.
- 6.137.2 Costco's focus is on providing its members with quality goods and services at the lowest possible price. Its aim is to provide good value to its customers, which involves a constantly rotating product range.<sup>457</sup> This means that Costco does not carry a core range of products outside of key commodities such as flour. While Costco may be a viable option for foodservice customers, the lack of certainty involved in its product range may make it difficult for a grocery retailer to consistently source a full range of products.
- 6.137.3 Costco has confirmed development of one store in Auckland, and there is speculation that it is interested in further stores in Wellington and Christchurch. Unless it expands its store network further, Costco may not be a significant wholesale option for many grocery retailers due to the locational constraints involved with only having three stores.
- 6.138 As such, we are not aware of any factors which are likely to change the current lack of competitively priced wholesale for a full range of groceries in the New Zealand grocery sector.

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## Impact of wholesale availability on different types of retailers

6.139 The lack of wholesale options for a full range of groceries is likely to have significantly different impacts on entry and expansion depending on retailer type.

6.139.1 The lack of competitively priced wholesale options for a full range of groceries would have more of an impact on retailers seeking to compete directly with the major grocery retailers by offering a main shop (eg, other supermarkets, online-only supermarkets, and any potential supermarket entrant).

6.139.1.1 They do not have access to competitively priced wholesale in a number of product categories which form part of a main shop, and would have to negotiate directly with a range of suppliers for the purchase of their products.<sup>458</sup> They would likely receive less competitive prices than major grocery retailers unless they are able to buy in bulk, in addition to incurring significant transaction costs.<sup>459</sup>

6.139.1.2 We also note that some product categories have larger suppliers which sell core brand products which consumers would expect to see as part of a main shop supermarket offering. However, as discussed at paragraph 6.127.3, other grocery retailers have indicated that they are largely unable to match the prices which the major grocery retailers receive for products from larger suppliers due to differences in volume. We have received information indicating that an inability to purchase core brand products for a product category at competitive prices may in turn make it difficult for retailers and new entrants to compete effectively within that product category even if they are able to source alternative brands.<sup>460</sup> As such, inability to access to particular core brands of products at competitive prices may also hinder a retailer's ability to compete for the provision of a main shop offering to consumers.

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<sup>458</sup> Above n 444.

<sup>459</sup> [

<sup>460</sup> Above n 435.

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6.139.2 As discussed at paragraphs 6.127.1 and 6.127.2, there appear to be viable wholesale options for some grocery product categories (eg, fresh produce, meat, international products). As such, grocery retailers which only sell products falling within these product categories, such as international food stores, meal kit providers and some specialist grocery retailers, appear to have access to wholesale options for the purposes of their customer offering. These businesses are less likely to have their entry and expansion impacted by the factors discussed in this section. It seems plausible that access to wholesalers catering to their needs has facilitated the entry of these grocery retailers.

6.139.3 Entry and expansion by grocery retailers which do not sell significant volumes of groceries, such as convenience stores or dairies would likely be significantly impacted by lack of wholesale of a full range of groceries at competitive prices. They would likely purchase lower volumes of groceries than other supermarkets or online-only supermarkets, and therefore may have less ability to negotiate lower prices from suppliers. The lack of alternative options is illustrated by some dairies purchasing products from supermarkets at retail prices for resale at their own stores.<sup>461</sup>

#### **Relevance of wholesale options for a full range of groceries**

6.140 When considering the conditions for entry or expansion on a scale sufficient to challenge the major grocery retailers, access to competitively priced groceries from suppliers seems to be a very significant factor.

6.141 Just as it seems efficient for the major grocery retailers to negotiate with suppliers and run their own internal distribution networks, there may also be efficiencies in other grocery retailers (eg, other supermarkets) with smaller store networks focussing on operating their retail stores and having a wholesaler carry out these functions on their behalf.

6.142 We also note that some submissions on our preliminary issues paper indicated lack of access to infrastructure (particularly for supply of temperature-controlled products) may be a condition impacting entry and expansion, indicating there may be a role for a wholesaler which can provide this capability.<sup>462</sup>

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<sup>461</sup> [ ];

<sup>462</sup> ].  
 Foodstuffs NI and Foodstuffs SI submitted that infrastructure (particularly to supply fresh produce on any scale to the market is a significant factor affecting entry and expansion. The Warehouse similarly submitted that there is a lack of access to large-scale independent supply chain and fulfilment infrastructure (chilled fridges, storage, transportation and labour etc) for a new entrant or smaller grocer to partner with or acquire. Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 27; Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 17; The Warehouse Group “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 3.

6.143 We therefore currently consider that a lack of wholesale availability for a full range of groceries is likely to be a key factor preventing entry and expansion in the New Zealand retail grocery sector. In the absence of wholesale options, other grocery retailers and new entrants:

6.143.1 purchase products directly from suppliers despite being less likely to receive competitive prices as they have relatively low volumes when compared to the major grocery retailers;

6.143.2 organise distribution with large numbers of suppliers despite purchasing relatively low volumes and/or having small store networks, likely incurring significant transaction costs;<sup>463</sup> and

6.143.3 may lack access to temperature-controlled supply chain expertise or infrastructure, preventing their entry into some product lines. This would in turn prevent them from providing a full grocery offering to consumers.

#### **Reasons for lack of entry and expansion in the grocery wholesale market**

6.144 We do not propose examining the wholesale level in great detail as our focus is on competition in the retail grocery sector. However, wholesale entry and expansion is relevant to retail competition as we have identified a lack of wholesale access as being a key factor preventing retail entry and expansion.

6.145 Demand for wholesale groceries from a sufficiently large customer base of retailers is a key requirement for viable entry at the wholesale level. Insufficient demand would limit the volumes that a wholesaler would be able to aggregate from retailers, in turn limiting their ability to negotiate lower prices from suppliers.

#### *Lack of demand for wholesale due to supplier concentration*

6.146 Foodstuffs NI and Foodstuffs SI submitted that there is not a separate wholesale level in the market for the full range of groceries. They submitted that this is because concentration at the supplier level across multiple product categories means that the number of suppliers that a grocery retailer has to deal with is small, and supplier relationships can be effectively managed by grocery retailers without need for a comprehensive wholesale functional level of the market.<sup>464</sup>

6.147 If these submissions are accurate, entry into the grocery wholesale market may be unlikely even if volumes from non-major grocery retailers would otherwise be sufficient for entry to be viable.

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<sup>463</sup> Above n 427.

<sup>464</sup> Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 18-19; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 28-30.

- 6.148 However, we generally do not consider there is significant concentration at a supplier level for most groceries which form part of a main shop.
- 6.148.1 We have observed that other supermarkets tend to purchase products directly from a large number of suppliers.<sup>465</sup>
- 6.148.2 Information provided by major grocery retailers also indicates that they each purchased from over a thousand suppliers in the 2020 FY.<sup>466</sup> In addition, the major grocery retailers also appear to deal with 20 or more suppliers in relation to more than 60% of product categories.<sup>467</sup> This suggests that a majority of product categories do not appear to be significantly concentrated.
- 6.148.3 There may be a degree of concentration in some product categories, particularly where there are a few core brands of products that consumers would expect to see as part of a supermarket offering. However, while the major grocery retailers are able to purchase directly from suppliers of these core brand products at competitive prices, other grocery retailers appear largely unable to receive competitive prices from larger suppliers due to lack of volumes (as discussed at paragraph 6.127.3). This is supported by our observation that other grocery retailers tend to differentiate their customer offerings (including brands sold) from the major grocery retailers.
- 6.149 We have observed that both major grocery retailers and other supermarkets tend to purchase from a large number of suppliers, and there does not appear to be a significant degree of supplier concentration in most of the product categories required to offer a main shop. Even in product categories where there might be some supplier concentration, other grocery retailers find it difficult to achieve competitive prices due to lack of volumes. It therefore appears unlikely that there would be a lack of demand for wholesale resulting from supplier concentration.

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<sup>465</sup> Above n 444.

<sup>466</sup> [ ].

<sup>467</sup> [ ].

6.150 Grocery retailers which offer a main shop tend to purchase products directly from a wide range of suppliers. However, this is not necessarily indicative of a lack of demand for wholesale of a full range of groceries. Rather, it may be that grocery retailers purchase directly from suppliers out of necessity given their lack of alternative options. Based on our observations of current arrangements in the retail grocery sector, there is likely to be some demand for new wholesale services offering a full range of groceries and associated services (eg, distribution, temperature-controlled supply chain expertise).

6.150.1 As discussed at paragraphs 6.119, other grocery retailers (including other supermarkets) have indicated they tend to differentiate their customer offerings from the major grocery retailers. One key reason for this is that differences in volumes mean that they are unable to receive competitive prices for the same products or brands. The availability of wholesale options for a full range of groceries may grant them access to more competitive prices for some products than they would be able to negotiate purely with their own volumes.

6.150.2 We also note that other grocery retailers that negotiate and make individual distribution arrangements with a large number of individual suppliers likely incur additional transactions costs, which could be mitigated to some extent if they had access to centralised distribution services.<sup>468</sup>

6.150.3 To the extent that a lack of access to infrastructure or expertise (particularly for supply of temperature-controlled products) may be a condition preventing entry or expansion into product categories which are required to provide a main shop offering, there may be a role for new wholesale services to provide this capability.<sup>469</sup>

6.150.4 Convenience stores and dairies currently do not have a cost-effective avenue for sourcing a wide range of groceries, which restricts their ability to move into selling more groceries.<sup>470</sup> They would likely be part of a retail customer base for new wholesale service providers selling a full range of groceries at competitive prices.

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<sup>468</sup> Above n 427.

<sup>469</sup> Above n 462.

<sup>470</sup> [ ;

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6.150.5 As part of their business model, some retailers (eg, other supermarkets) may choose to purchase products from smaller suppliers which do not sell to the major grocery retailers.<sup>471</sup> However, we do not consider this to be a factor removing them from the potential customer base for new wholesale service providers selling a full range of groceries as they would gain the option of purchasing a wider range of products while still sourcing some products directly from smaller suppliers as they are currently doing.

*Lack of demand for wholesale due to vertical integration by major grocery retailers*

- 6.151 A key factor reducing retailer demand for a full range of wholesale groceries is the fact that the major grocery retailers are unlikely to form part of a potential wholesale entrant's customer base. As the major grocery retailers have sufficiently large volumes to negotiate competitive prices from suppliers and gain efficiencies by internalising their wholesale and distribution functions, it is unlikely that they would form part of the contestable customer base for a potential wholesale entrant selling a full range of groceries.
- 6.152 The customer base which a potential wholesale entrant selling a full range of groceries could potentially service is therefore likely to be limited to grocery retailers challenging the major grocery retailers.
- 6.153 We do not have sufficient information to determine if demand from grocery retailers (excluding the vertically integrated major grocery retailers) would form a sufficiently large customer base to sustain entry by a wholesaler offering a full range of groceries.
- 6.154 However, it is our view that the level of concentration in the retail grocery sector could present challenges for potential wholesale entrants by significantly limiting their potential customer base. As previously discussed, a lack of wholesale options for a full range of groceries may in turn limit other grocery retailers' or potential retail entrants' abilities to source products at competitive prices, placing a constraint on their ability to enter and expand to a scale that would justify wholesale entry.
- 6.155 These factors may make it more difficult for parties to enter the New Zealand retail grocery sector at either the wholesale or retail levels. Rather, it may be the case that any potential new entrant looking to provide a main shop might need to enter two markets simultaneously (retail and wholesale), thus achieving vertical integration in order to be viable. This would presumably involve additional costs (eg, startup capital) and risk, and may be a factor impeding or slowing entry and expansion into the market by making it more difficult to enter or expand on a scale sufficient to challenge the major grocery retailers.

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- 6.156 As discussed at paragraph 6.25.1, we are not aware of specific plans for future large-scale entry or expansion by a supermarket operator in the retail grocery sector. As such, we do not have sufficient information to provide a good indication of what might be required for a potential supermarket entrant to achieve the necessary scale required for effective entry at both the retail and wholesale levels.
- 6.157 However, we understand that Aldi's method of entry typically involves entering at both the retail and wholesale levels by building a number of stores (with approximately 10 stores being cited as a benchmark figure) as well as distribution centres to service them.<sup>472</sup> While this may not be directly applicable to the New Zealand market, we consider that it still provides a useful indicator of the scale which may be required for successful entry.
- 6.158 As illustrated by paragraph 6.156, the need to enter at both the wholesale and retail levels means a significant amount of investment would likely be required for a supermarket operator to achieve sufficient scale in the New Zealand grocery sector to challenge the major grocery retailers.

#### **Summary of our preliminary views on access to wholesale**

- 6.159 Many overseas grocery markets feature wholesalers that supply a full range of groceries to grocery retailers at competitive prices, in addition to providing services in relation to other areas such as distribution to stores and capability relating to temperature-controlled products. We consider that all New Zealand grocery retailers and potential entrants should benefit from similar access to competitively priced wholesale services for a full range of groceries.
- 6.160 In summary:
- 6.160.1 There is currently a lack of competitively priced wholesale options for a full range of groceries and associated services such as distribution and temperature-controlled supply chain expertise. As a result, existing retailers purchase directly from suppliers or in some cases from the major grocery retailers.
- 6.160.2 We do not perceive a lack of demand for competitive grocery wholesaling services for the reasons discussed in paragraph 6.150.
- 6.160.3 On the contrary, a lack of wholesale options for a full range of competitively priced groceries may place a constraint on the ability of grocery retailers to enter and expand to a scale that would justify wholesale entry.

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6.160.4 Potential supermarket entrants may therefore have to enter at both the retail and wholesale levels simultaneously in order to achieve sufficient scale to challenge the major grocery retailers, which would likely require significant investment and be associated with increased risk.

**Conduct by suppliers and retailers which could potentially affect product sourcing**

6.161 In this section, we discuss conduct which was raised by stakeholders in submissions and subsequent meetings which in our view may potentially affect the ability of new entrants or existing firms to source products at competitive prices.

6.162 This conduct falls into two categories:

6.162.1 suppliers refusing to supply retailers which set retail prices below a certain level; and

6.162.2 contractual terms affecting the terms on which suppliers can supply to other parties.

**Refusal to supply due to low retail pricing**

6.163 The NZFGC has raised concerns about established grocery retailers seeking to limit entry and expansion by other grocery retailers, by pressuring suppliers. It submitted that:<sup>473</sup>

...pressure on suppliers has been aimed at limiting the access to products by the online provider, The Honest Grocer. After agreeing to supply The Honest Grocer and supplying the new player, many suppliers have withdrawn products due to genuine fear that they risk other parts of their business

6.164 We are aware of examples of some suppliers indicating that they are only willing to supply if a grocery retailer does not undercut the retail prices set by other grocery retailers of the supplier’s products.<sup>474</sup> We are also aware of several examples of suppliers allegedly refusing to supply grocery retailers where they are concerned that the retail prices being offered are too low.<sup>475</sup> In addition, we have received information which appears to suggest that in some cases the refusal to supply occurred after concerns were raised by another grocery retailer the supplier trades with.<sup>476</sup>

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<sup>473</sup> NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [134].

<sup>474</sup> [ ];  
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<sup>475</sup> [ ].

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- 6.165 A refusal by suppliers to supply due to low retail pricing has the potential to impact entry and expansion by reducing the ability of new entrants and grocery retailers to source products while competing effectively on price.
- 6.166 We note that the conduct discussed in this section could potentially breach sections 37 and 38 of the Act, which prohibit the practice of resale price maintenance.<sup>477</sup>
- 6.167 Independent of this study, we may consider further appropriate action utilising our competition compliance and enforcement functions and powers.<sup>478</sup>

### **Contractual terms affecting supply to other parties**

- 6.168 A submission raised exclusive buying and contractual provisions affecting prices suppliers can charge to other grocery retailers as possible examples of major grocery retailers using buyer power to exclude competition, which suggests they could impact on entry and expansion.<sup>479</sup>
- 6.169 We are aware of clauses in supply contracts which may affect the ability of suppliers to supply other parties.<sup>480</sup> Examples include:
- 6.169.1 best price clauses, or most favoured nation (MFN) clauses, which ensure a particular buyer obtains products from a supplier on terms that are at least as good as (or, in some cases, better than) those provided to other buyers;<sup>481</sup> and
- 6.169.2 clauses specifying that a supplier is to supply products or certain brands of products exclusively to a particular grocery retailer.<sup>482</sup>
- 6.170 The clauses described in paragraph 6.169 may potentially impact on entry and expansion if they limit other grocery retailers' ability to receive supply of products, or purchase products at prices which will enable them to compete effectively in the retail market (noting that other grocery retailers can still be competitive if they can be supplied at the same price). The extent to which this conduct impacts on entry and expansion would depend on factors such as:
- 6.170.1 term durations;

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<sup>477</sup> Commerce Act 1986, sections 37 and 38.

<sup>478</sup> Commerce Commission "Enforcement Response Guidelines" (October 2013) [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf).

<sup>479</sup> NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [15].

<sup>480</sup> The prevalence with which this conduct occurs varies amongst the major grocery retailers.

<sup>481</sup> [ ];

<sup>482</sup> [ ];

[ ];

- 6.170.2 the importance of the products or brands which are subject to these clauses (ie, whether the products are core brand products which consumers would expect to see as part of a main shop offering);<sup>483</sup> and
  - 6.170.3 the extent to which there are alternative suppliers or products available in the market.
- 6.171 There may also be efficiency benefits associated with best price and exclusivity clauses.
- 6.171.1 Suppliers may receive benefits in exchange for agreeing to such clauses (eg, volume or exclusivity commitments).<sup>484</sup>
  - 6.171.2 Best price clauses may reduce transactions costs between parties by reducing the need for renegotiations whenever prices fluctuate over time (eg, due to seasonal changes in availability or quality).<sup>485, 486</sup>
  - 6.171.3 They may also be used if a buyer has made relationship-specific investments into a product and wants to avoid other buyers free-riding on them.
- 6.172 Given the apparent limited use of these terms in the retail grocery sector, we have not assessed in detail whether their benefits are likely to outweigh the potential costs if they were to be used more widely.
- 6.173 Based on what we have observed to date, the clauses described in paragraph 6.169 currently appear unlikely to have a significant impact on entry and expansion in the retail grocery sector. The best price clauses do not appear to be very common, and we have not received any indication that they significantly restrict the availability of supply to grocery retailers or the price at which grocery retailers can purchase products from suppliers.<sup>487</sup> Similarly, exclusive supply arrangements do not appear to be widespread.<sup>488</sup>

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483 Above n 435.

484 [ ].

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- 6.174 Our preliminary view of these clauses (as discussed in 6.173) is based on our understanding of how they are currently used in the retail grocery sector. This should not be taken as a general endorsement of the use of such clauses, either in relation to the retail grocery sector or more generally. If the circumstances surrounding the usage of these clauses were different (eg, if they were to be used in a more widespread manner), they would likely have a more significant impact on entry and expansion.
- 6.175 Section 27 of the Act (as outlined in paragraph 6.90.1) would potentially apply to conduct of this nature if it were to have the purpose, effect or likely effect of substantially lessening competition in a market.
- 6.176 Independent of this study, we may consider further appropriate action utilising our competition compliance and enforcement functions and powers.<sup>489</sup>

### Alcohol licensing laws

- 6.177 Some retailers have raised the potential for current alcohol licensing laws to be a factor impacting on their ability to enter and expand in the retail grocery sector.<sup>490</sup>
- 6.178 Alcohol licensing laws were altered in 2012 to reduce the availability of alcohol, particularly through small retailers such as dairies or convenience stores.<sup>491</sup> As noted in Chapter 4, consumers value having a wide range of products in one place. Consumers seeking to purchase alcohol as part of their main shop might not consider shopping at grocery retailers that do not sell alcohol.
- 6.179 Alcohol licensing laws may therefore make it difficult for some prospective grocery retailers to offer a full range of products that consumers wish to buy, limiting their ability to compete for the provision of a main shop.<sup>492</sup> However, we acknowledge that there are public policy reasons for restricting the types of businesses which are licensed to sell alcohol.

### Loyalty programmes

- 6.180 Both Countdown and New World operate their own loyalty programmes (Countdown offers Onecard and New World offers Clubcard). Further details regarding specific features of these loyalty programmes are discussed in Chapter 7.

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<sup>489</sup> Commerce Commission "Enforcement Response Guidelines" (October 2013) [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf).

<sup>490</sup> [ ]; [ ].

<sup>491</sup> Sale and Supply of Alcohol Act 2012.

<sup>492</sup> [ ]; [ ]

- 6.181 Loyalty programmes can bring significant benefits to consumers if grocery retailers compete to provide discounted prices and/or accumulated rewards through their loyalty programme.
- 6.182 However, they can also reduce price transparency and make it more difficult for consumers to make informed purchasing decisions (discussed further in Chapter 7) and create conditions that impede or slow entry and expansion. There are two main ways in which the latter can occur:
- 6.182.1 providing loyalty programme operators with an extensive amount of consumer data to inform business decisions and allow for personalised offers to be made which attract and retain customers in a way that is not possible for grocery retailers without access to similar consumer data; and
- 6.182.2 ‘locking in’ consumers by increasing the costs to them of shopping elsewhere and making them less likely to use other grocery retailers, making it more difficult for other grocery retailers or new entrants to attract customers and capture market share.
- 6.183 We consider that these potential impacts are unlikely to vary significantly based on a grocery retailer’s business model.
- 6.184 However, a lack of access to consumer data gathered using loyalty programmes is likely to have a more significant impact on new entrants than existing grocery retailers looking to expand.
- 6.184.1 New entrants would likely find consumer data collected via loyalty programmes to be helpful for setting and adjusting their customer offering, but would be unable to collect this data without first entering the market.
- 6.184.2 On the other hand, existing grocery retailers either operate loyalty programmes by which they can collect consumer data, or have the option of starting their own loyalty programme to collect data from their existing customer base.
- 6.185 We received one submission which was consistent with the propositions discussed at paragraph 6.182.<sup>493</sup> Apart from this, we generally have not heard that loyalty programmes are a significant factor impacting on entry and expansion during the course of our study.

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<sup>493</sup> The NZFGC submitted that the major grocery retailers can access consumer data which they use to tailor their offerings and increase profitability, while entrants do not have access to this data. The NZFGC’s submission also mentioned that loyalty programmes make it less likely or harder for consumers to switch to another major grocery retailer (ie, increase switching costs). See NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [135] and [208].

- 6.186 However, we have heard that the major grocery retailers' loyalty programmes could adversely affect consumers, for example, by making it harder to make well-informed decisions, reducing retail competition and leading to different prices for different groups of consumers.<sup>494</sup> This is discussed further in Chapter 7.

### Access to data

- 6.187 It has been suggested to us that access to consumer data may be helpful to firms looking to enter and expand in the retail grocery sector as it would assist them to set and adjust their customer offerings, but they would be unable to collect this data without first entering the market. Meanwhile, existing competitors would have an advantage in attracting and retaining customers because of their established loyalty programmes and access to the data that they generate. We do not currently see this as a significant impediment to retail entry.
- 6.188 As mentioned in their submissions on our preliminary issues paper, the major grocery retailers collect large amounts of data from consumers through their loyalty programmes. This data can be analysed and used to inform business decisions such as product ranging or pricing decisions, which may give them a competitive advantage over new entrants or other grocery retailers without access to similar data. As such, there is potential for this access to consumer information generated by the collection of loyalty programme data to be a factor affecting entry and expansion. In addition, data may also be used to give grocery retailers with loyalty programmes a unique ability to target advertising to consumers, and this could be used to defend their market position from the threat of entry or expansion.
- 6.189 By its nature, loyalty programme data can only be collected after a grocery retailer enters the market and begins to build a customer base, and it would not be available to potential entrants. This in turn has the potential to impact on their ability to provide a competitive offering to consumers at start up and following.
- 6.190 However, we note that a number of other grocery retailers such as other supermarkets and international food stores also have their own loyalty programmes (eg, Farro Fresh, Moore Wilson's, Jadan and Huckleberry). This tends to indicate that it is possible for grocery retailers to collect consumer data to some extent using their own loyalty programmes after successful entry. They can use this to inform their business decisions and make personalised offers to consumers. Moreover, it is possible to source aggregated scanner data from Nielsen which would provide an initial basis for ranging decisions.

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<sup>494</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [72]-[87]; NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [207]-[223].

- 6.191 In addition, we have observed that in some circumstances grocery retailers do not have the ability to analyse or use the data collected using their loyalty programmes for the purposes of making business decisions.<sup>495</sup> This suggests that while loyalty programme data may be a helpful tool for a grocery retailer, it may not be a key requirement for a grocery retailer to operate.
- 6.192 Given this range of use of loyalty programmes and consumer data at present, our preliminary view is that the different abilities to access loyalty programme data is not a key factor impeding entry and expansion. While there is potential for access to data to impede entry and expansion for a competing grocery retailer, evidence collected during our study does not suggest this is the case at present. Neither has this been mentioned by grocery retailers as a significant issue.

### Loyalty programmes ‘locking in’ consumers

- 6.193 Loyalty programmes may impede entry and expansion to the extent that consumers that are reluctant to change grocery retailer, are effectively “locked in” to a particular grocery retailer. Potential competitors may conclude it is not possible to capture viable market share and/or capturing market share is in fact more difficult because customers are reluctant to shop elsewhere where they do not receive and/or accumulate the benefits offered by a loyalty programme.<sup>496</sup> The loyalty programmes offered by New World and Countdown do not require exclusive membership by consumers. Consumers can and do participate in multiple programmes.
- 6.194 Nevertheless, loyalty programmes operated by the major grocery retailers may have the effect of incentivising some consumers to shop with a particular retail banner and increase their reluctance to shop with others, particularly consumers who value accumulated rewards. This is because those consumers may be less inclined to switch their spend to another grocery retailer if they may risk delaying the reward or losing accumulated points. A competing retailer may need to offer an additional benefit to compensate a consumer who feels they are forfeiting a benefit with their existing grocery retailer or loyalty programme by shopping with the competing retailer. We discuss the potential effects of accumulated rewards in more detail in Chapter 7.

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<sup>495</sup> [ ].

<sup>496</sup> We note that the ACCC considered that retailers use loyalty programmes to influence consumer behaviour by, for example, encouraging consumers to make repeat or additional purchases (and by default, spend less with their competitors) and introducing resistance to competing offers. ACCC “Customer loyalty schemes – Final report” (December 2019) at 17 and 90, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

- 6.195 Our preliminary view is that loyalty programmes are unlikely to have a material constraint on entry or expansion as a consequence of lock-in effects because:
- 6.195.1 Consumers have a diverse range of preferences and there are multiple factors influencing store choice. Loyalty programmes may drive store choice for some consumers. However, as discussed in Chapter 4, price and convenience appear to be key drivers of choice for many consumers.
- 6.195.2 As noted above, consumers can and do participate in more than one loyalty programme. Consumers are able to join multiple programmes and enjoy many of the benefits of each so they do not appear particularly committed to one loyalty programme and one grocery retailer each.
- 6.195.3 Some consumers value accumulated rewards and may therefore be more inclined to exclusively shop with one grocery retailer in order to accumulate points. However, many consumers value member-only discounts instead which provide an immediate reward at the time of each transaction. Our consumer survey, the Ipsos research, and research conducted by the major grocery retailers (see Chapter 7 for further detail) consistently indicates that many consumers sign up to grocery loyalty programmes primarily to gain access to the member-only discounts.<sup>497</sup> These consumers are less likely to experience perceived lock-in effects from loyalty programmes or be as disincentivised to shop around as those who value accumulated rewards and risk losing progress towards those rewards if they switch to an alternative retailer.<sup>498</sup>
- 6.195.4 The rate of reward for accumulated rewards offered by Onecard and Clubcard is relatively lower than the minimum spend required. We therefore consider it unlikely that accumulated rewards would significantly raise costs for consumers to switch retailers in the longer term. However, there may be short-term effects for consumers that value these rewards when they are closer to the expiry date of already accumulated points.<sup>499</sup>
- 6.196 Our preliminary view is that Clubcard and Onecard are unlikely to significantly impede entry or expansion by making it more difficult to attract consumers. However, the potential effects of these programmes may change as these programmes and the use of consumer data develops, for example, in relation to personalised offers. We discuss this potential, and the basis for our conclusions in more detail in Chapter 7.

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<sup>497</sup> This may be because they appear more tangible and consumers receive instant gratification. For example: Matilda Dorotic et al., "Loyalty Programmes: Current Knowledge and Research Directions" (2011) 14 International Journal of Management Reviews 217 at 226.

<sup>498</sup> ACCC "Customer loyalty schemes – Final report" (December 2019) at 93, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

<sup>499</sup> New World Dollars expire after 24 months, and Onecard points and e-vouchers expire after one year.

## Chapter 7 Consumer-facing issues

### Summary of preliminary findings

- Promotions and loyalty programmes can provide value to consumers and drive competition between the major grocery retailers. When consumers can make meaningful comparisons between offers, they can make informed choices between them and develop more accurate perceptions of value over time, to help them choose where they would like to shop. This incentivises retailers to improve their offers to attract consumers from one another. Conversely, if it is difficult for consumers to compare offers, they may make less-informed purchasing decisions which can reduce price competition.
- The major grocery retailers use an array of different promotional mechanisms. Their complexity and frequent use, particularly when used in combination with one another, may make it harder for consumers to accurately assess the value of competing offers or to develop accurate perceptions of value over time, even when there are genuine savings on offer and the information provided is clear.
- This may make consumers less likely to shop around between products and between grocery retailers, affecting the quality of information retailers receive about consumer preferences and impacting competition.
- It is unclear whether one-off non-price promotions are affecting competition beyond the shorter term.
- Use of unit pricing can assist consumer decision making and competition. However, these benefits are less likely to be achieved when unit pricing is inconsistently or unclearly displayed.
- Consumer understanding of loyalty programmes appears low. This is particularly in relation to how accumulated rewards are earned and redeemed, and how consumer data is collected and used by the major grocery retailers. This can make it difficult for consumers to assess the value of these programmes to them and make well-informed decisions about their participation. This can make consumers less responsive to price competition, reduce the major grocery retailers' incentives to engage in price competition and inhibit competition for consumers with certain privacy or data use preferences.
- Loyalty programmes may also cause some consumers, particularly those that value accumulated rewards, to focus on earning rewards through a particular loyalty programme and be less inclined to shop around.
- Personalised or targeted promotional offers for loyalty programme members can facilitate price discrimination which may raise competitions concerns as it becomes more sophisticated.
- During our study, we have received complains relating to pricing and promotional practices and we have analysed these practices over time. Independent of our study, we are considering what further action may be required in relation to these matters utilising our Fair Trading compliance and enforcement functions and powers.



## Introduction

- 7.1 This chapter considers how the major grocery retailers' pricing and promotional practices, including loyalty programmes, affect consumers' ability to seek out the best deals based on their preferences, and in turn stimulate competition among the major grocery retailers.
- 7.2 Consumers play an important role in ensuring competition is effective. Markets work better when consumers are confident market participants. Consumers have confidence when they have access to accurate information that helps them make informed purchasing decisions and when they can assess whether businesses are trading fairly.<sup>500</sup>
- 7.3 When consumers can make meaningful comparisons between offers, firms are more likely to be incentivised to improve their offerings or reduce prices to attract consumers from one another.<sup>501</sup> Conversely, if it is difficult for consumers to compare offers, this could lead to less-informed purchasing decisions which can reduce price competition. In addition, this may lead to retailers receiving poor information on actual consumer preferences, making it more difficult to respond to consumer demand.
- 7.4 The major grocery retailers told us that consumers have access to a large amount of information to enable comparisons including advertising and in-store price information.<sup>502</sup> However, Consumer NZ raised concerns that the major grocery retailers' pricing and promotional practices are a major barrier to informed consumer choice including because they are confusing.<sup>503</sup> These submissions are not necessarily in conflict with each other: both could be correct. This chapter considers the impact of these practices on competition.
- 7.5 Our consumer survey has helped us to better understand consumer behaviour and provided us with consumers' views on how they decide where to shop and what to buy. Our promotional pricing analysis, qualitative research and experimental economic research have also informed our understanding of how consumers shop for groceries. We discuss the insights we gained through these sources of information in more detail later in this section.

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<sup>500</sup> Commerce Commission "Statement of Intent – Our Approach for 2020-2024" (30 July 2020), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0014/222305/Statement-of-Intent-20202024.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0014/222305/Statement-of-Intent-20202024.PDF) at 13.

<sup>501</sup> Competition Markets Authority "Consumer protection: enforcement guidance" (17 August 2016) CMA58 at 2.2, available at: <https://www.gov.uk/government/publications/consumer-protection-enforcement-guidance-cma58>.

<sup>502</sup> For example: Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 68-69; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 33; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 22.

<sup>503</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [45].

- 7.6 Our preliminary view is that some consumers find it hard to make purchasing decisions in store, particularly when retailers use complex and/or multiple pricing and promotional mechanisms, and when loyalty programmes have complex rewards structures and terms and conditions. These complexities have the potential to limit consumers' ability and willingness to access, assess and act on information when choosing between grocery retailers.
- 7.7 This chapter focuses on the effects of these practices on in-store decision making. However, these practices may also impact the accuracy of consumers' perceptions of price and value of the major grocery retailers which can influence where consumers choose to shop.
- 7.8 In addition to the effects on competition we discuss in this chapter, some practices discussed may also raise issues relevant to consumer experience which are beyond our terms of reference for this study. These include issues in relation to:
- 7.8.1 whether the promotional mechanisms and pricing strategies used by the major grocery retailers are in some cases misleading;
  - 7.8.2 the potential for consumer data collection and use practices to raise privacy concerns; and
  - 7.8.3 whether the terms and conditions governing loyalty programmes are fair to consumers.
- 7.9 We provide comments on these issues at the end of this chapter.
- 7.10 The remainder of this chapter discusses:
- 7.10.1 our approach to analysing consumer-facing issues;
  - 7.10.2 how pricing and promotional practices used by the major grocery retailers can affect consumer behaviour, and the effect this has on competition;
  - 7.10.3 whether and how unit pricing can help to facilitate informed decision making by consumers;
  - 7.10.4 our analysis of potential competition concerns arising out of loyalty programmes, particularly in relation to consumer understanding of how these programmes work, effects on consumer willingness to shop around, and how they may facilitate price discrimination; and
  - 7.10.5 other issues within the retail grocery sector arising during the course of our study which fall outside the scope of our study and we will consider further independent of our findings and recommendations.

## Our approach to analysing consumer-facing issues

- 7.11 This section sets out some key concepts and background information relevant to our discussion of issues facing grocery consumers in the rest of this chapter. It explains:
- 7.11.1 the importance to competition of ensuring consumers are well-informed;
  - 7.11.2 the pricing and promotional practices that we have considered;
  - 7.11.3 the nature of the loyalty programmes offered by the major grocery retailers including the different types of benefits offered to consumers; and
  - 7.11.4 the information we have relied upon for the purposes of our analysis.

### Well-informed and confident consumers are a key part of competition

- 7.12 Consumer confidence in the integrity of pricing and promotional activity is a key driver of competition.<sup>504</sup> Promotions are an important marketing tool for retailers, and discounting strategies are common in New Zealand retail markets. They can drive competition among retailers and value for consumers.
- 7.13 Markets work better when consumers can easily compare offers and choose the products and the provider that best meets their needs. Consumers who shop around incentivise retailers to meet these needs by offering new products and services, and/or by reducing prices.<sup>505</sup>
- 7.14 Competition is therefore facilitated by consumers having:
- 7.14.1 ready access to the information they need to compare offers by alternative providers;
  - 7.14.2 the ability to easily assess this information; and
  - 7.14.3 the ability and willingness to act on this information (ie, use the information to inform decisions).

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<sup>504</sup> Commerce Commission “Misleading pricing: An open letter to New Zealand retailers” (11 May 2017), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0019/90073/Misleading-pricing-An-open-letter-to-New-Zealand-retailers-11-May-2017.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0019/90073/Misleading-pricing-An-open-letter-to-New-Zealand-retailers-11-May-2017.pdf); Competition Markets Authority “Pricing Practices in the Groceries Market – Response to a super-complaint made by Which? on 21 April 2015” (16 July 2015) at [1.9], available at: <https://www.gov.uk/cma-cases/groceries-pricing-super-complaint>.

<sup>505</sup> Competition Markets Authority “Consumer protection: enforcement guidance” (17 August 2016) CMA58 at [2.2], available at: <https://www.gov.uk/government/publications/consumer-protection-enforcement-guidance-cma58>; Christine Riefa, Harriet Gamper and Paolo Siciliani “Consumer Theories of Harm: An Economic Approach to Consumer Law Enforcement and Policy Making” (Hart Publishing, 2019) at 142.

- 7.15 This also enables consumers to accurately signal their preferences to retailers. When retailers have accurate information about what consumers want, they are better placed to compete for consumers by providing the mix of price, range, quality and service they value. Consumers have a diverse range of preferences that influence where they choose to shop and what products to buy once in store.<sup>506</sup> As discussed in Chapter 4, there are multiple drivers of store choice and these vary, including by demographic and shopping mission, and non-price factors such as convenience or range may be determinative. Consumers may therefore use different types of information to help make these decisions.
- 7.16 Nevertheless, price-related factors contribute to store choice and consumer decisions relating to what products to buy. Price comparisons can give consumers helpful information to develop perceptions of value and can promote competition among retailers.
- 7.17 This chapter primarily focuses on pricing information available to consumers, by considering pricing and promotional mechanisms used by the major grocery retailers in store and related issues such as consumer awareness of rewards structures and the terms and conditions of loyalty programmes. These issues all impact the ease with which consumers can assess the best deals based on their preferences and form a broader view of where they want to shop.

#### **Pricing and promotional mechanisms considered in this chapter**

- 7.18 At this stage of our study, we have observed that price is consistently cited as one of the key drivers of store choice for many consumers.

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<sup>506</sup> See paragraphs 4.65 to 4.81. This is also evidenced in documents provided by major grocery retailers, for example: [ ]; [ ].

- 7.19 Two thirds of the respondents to our consumer survey report “always” or “usually” comparing prices when shopping for groceries.<sup>507</sup> Some consumers report using an internal reference point of value, rather than relying on external information. Internal reference points could include a general perception that private label products are cheaper than branded products, or that multi-buy offers provide good value.<sup>508</sup> However, many consumers report using external information such as unit prices and promotional price tickets to guide their decision making.<sup>509</sup> We have seen evidence that these factors, including promotions, discounts, and loyalty programmes affect consumers’ perceptions of price and value.<sup>510</sup>
- 7.20 This chapter considers the effect of pricing and promotional activity on consumers’ ability to make product choices in store that best reflect their preferences and to develop accurate perceptions of value, and the potential effects on competition between the major grocery retailers. These include:
- 7.20.1 promotional mechanisms, such as reference prices;
  - 7.20.2 non-promotional pricing such as unit prices and everyday low pricing (EDLP);
  - 7.20.3 loyalty programmes; and
  - 7.20.4 one-off, non-price promotions such as collectibles and give-aways.

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<sup>507</sup> Figure F27. This is consistent with: Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 44; Internal research provided by the major grocery retailers, for example, [ ]].

<sup>508</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 16. See also, for example: BDRC Continental “Grocery Pricing – Qualitative Research Report” (12 June 2015) prepared for the Competition Markets Authority, at 4, available at: [https://assets.publishing.service.gov.uk/media/55a68c41ed915d151b000005/Annex\\_F\\_-\\_Grocery\\_Pricing\\_Qualitative\\_Research\\_Report\\_Prepared\\_by\\_BDRC\\_Continental\\_for\\_the\\_CMA\\_12\\_June\\_2015.pdf](https://assets.publishing.service.gov.uk/media/55a68c41ed915d151b000005/Annex_F_-_Grocery_Pricing_Qualitative_Research_Report_Prepared_by_BDRC_Continental_for_the_CMA_12_June_2015.pdf); Nadine Sonnenberg and Daleen Van der Merwe “An exploratory investigation into the role of shelf-edge signage in urban grocery consumers’ decision-making behaviour” (July 2006), available at: [https://www.researchgate.net/publication/266260370\\_An\\_exploratory\\_investigation\\_into\\_the\\_role\\_of\\_shelf-edge\\_signage\\_in\\_urban\\_grocery\\_consumers'\\_decision-making\\_behaviour](https://www.researchgate.net/publication/266260370_An_exploratory_investigation_into_the_role_of_shelf-edge_signage_in_urban_grocery_consumers'_decision-making_behaviour).

<sup>509</sup> For example, a piece of research commissioned by [ ] found that about [ ] of consumers regularly look for ticketing devices when shopping [ ]. Respondents to our consumer survey reported a high rate of checking unit price: see Figure F24.

<sup>510</sup> For example: [ ]; [ ].

### *Pricing and promotional mechanisms*

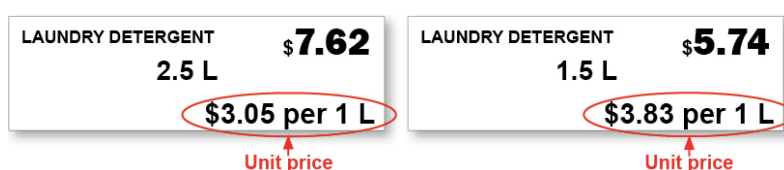
- 7.21 Grocery retailers commonly use a range of discounting mechanisms to encourage consumers to shop at their store and purchase certain products. Using these discount representations to advertise a product generally conveys to consumers that they can purchase the products at a lower price which is not usually available to them.<sup>511</sup>
- 7.22 In this chapter, we consider the major grocery retailers' use of pricing and promotional mechanisms and the information provided to consumers. We consider whether these mechanisms impact consumer decision making and value perceptions, and the potential effects on competition.
- 7.23 We refer to the pricing and promotional mechanisms that we have observed are commonly used by grocery retailers as follows. Examples of the visual tickets used to highlight prices are included in Table 7.1 below.
- 7.23.1 **Specials:** short-term discounts that do not require the consumer to meet any certain requirements to redeem the offer (for example, they do not have to swipe a loyalty card, or purchase a certain number of units). Retailers may signal that a discount is being offered by displaying a ticket referring to "Special" or "Saver". Retailers may also use a reference price to indicate the product is being sold at a price lower than its usual price. For example, "Was \$5, now \$3.50". This practice can also be referred to as "was-now" pricing or "reference" pricing.
- 7.23.2 **Multi-buys:** offers where consumers receive a discount if they purchase a certain number of units of a product (or a selection of products). For example, "buy two, get one free", "2 for \$5" or "any 3 for \$8". These offers can often be complemented by representations such as "Save \$2.00" or "Special". This practice may also be known as a volume offer or volume discount.
- 7.23.3 **Members-only discounts:** price discounts which are only available to consumers who swipe the relevant loyalty programme card. If the consumer is not a member, or does not swipe their card, they are charged a different, typically higher, price. For example, "Club Deals" are only available to New World shoppers who swipe their Clubcard when completing their purchase. Similarly, "Club Prices" are only available to Countdown shoppers who swipe their Onecard.

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<sup>511</sup> Commerce Commission "Pricing fact sheet", available at: <https://comcom.govt.nz/consumers/dealing-with-typical-situations/buying-goods-and-services/pricing>.

- 7.23.4 **EDLP:** a pricing strategy based on offering a “low” price on certain products for an extended period, as opposed to cycling between discounted and non-discounted prices. Products which are offered at an EDLP may also be subject to a shorter-term discount. The major grocery retailers typically promote EDLP offerings through advertising and displaying tickets such as “Great Price” (Countdown) or “Everyday Value” (New World).
- 7.23.5 **Unit pricing:** the practice of displaying the price for a product with reference to standard units of measurement (for example, per litre or per kilogram).

**Figure 7.1 Example of unit price**



Source: ACCC, Grocery unit prices.<sup>512</sup>

- 7.24 Where the retail banner offers an online service, we understand the same tickets are used, though different promotions may be available (ie, “online-only” promotions may be offered).
- 7.25 It appears common for other grocery retailers to offer specials and, like the major grocery retailers, to dedicate webpages or sections for browsing discounted products.<sup>513</sup> Some smaller grocery retailers also appear to offer member-only discounts. However, these appear to be less prevalent than among the major grocery retailers.<sup>514</sup>

<sup>512</sup> See: <https://www.accc.gov.au/consumers/groceries/grocery-unit-prices>.

<sup>513</sup> For example: Panda Mart “Specials”, available at: <https://www.pandamart.co.nz/specials>; Farro “Specials”, available at: <https://shoonline.farro.co.nz/collections/specials>; Commonsense Organics “Specials”, available at: <https://commonsenseorganics.co.nz/shop-online/specials/>.

<sup>514</sup> For example: Farro Fresh “Friends of Farro”, available at: <https://www.farro.co.nz/friends-of-farro/>; Japan Mart “Join Japan Mart Club Card today”, available at: <https://club.japanmart.co.nz/customer/>.

**Table 7.1** Examples of promotional tickets used by the major grocery retailers

Mechanism	PAK'nSAVE	Countdown	New World
EDLP <sup>515</sup>			
Special (including reference price) or multi-buy <sup>516</sup>		 	 
Member-only discount (including member-only multi-buys) <sup>517</sup>			

Source: Commission analysis of information provided by major grocery retailers.<sup>518</sup>

### *One-off promotions*

7.26 Grocery retailers also sometimes offer “one-off” non-price promotions to all consumers such as competition entry or collectibles campaigns. Examples of these include New World’s “SMEG knives” promotion and Countdown’s “Disney Words” promotion. The mechanics of these promotions vary. Some may offer consumers tokens when certain spend thresholds are met, and a certain number of tokens can be redeemed on a gift, such as a SMEG knife. Others may offer consumers a gift for spending a certain amount on selected products.

7.27 We refer to these non-price promotions as “one-off promotions” in this chapter.

### *Relevant loyalty programmes structures and benefits*

7.28 In this chapter, we also consider potential competitive effects of loyalty programmes, as another dimension of competition.

<sup>515</sup> For Woolworths NZ, the average duration of a Great Price offering is currently on average [ ], [ ]. For New World stores, the target duration of an Everyday Value offering is approximately [ ], [ ]; [ ].

<sup>516</sup> Individual New World stores in the North Island may also offer ‘Store Savers’.

<sup>517</sup> New World stores in the North Island also display a yellow ‘Club Deal’ ticket.

<sup>518</sup> [ ]; [ ]; [ ].



- 7.29 There are three common design elements of loyalty programmes:
- 7.29.1 **Coalition points-based programmes with multiple partners:** where a variety of partners are brought together under one programme so members can generally earn and redeem points with different partners.
  - 7.29.2 **Stand-alone points-based programmes:** which generally offer members the ability to earn points when they buy the products or services of the loyalty programme operator.
  - 7.29.3 **Member benefit programmes:** where members may be offered access to discounts, other member-only benefits such as competition entry or personalised rewards.
- 7.30 Clubcard (New World) and Onecard (Countdown) are both coalition programmes, because rewards can be earned with partners such as Flybuys or AA Smartfuel, and member benefit programmes. Most of the programmes offered by other smaller retailers are stand-alone, member benefit programmes as rewards are generally earned and redeemed on products and services offered by those retailers.
- 7.31 Both Clubcard and Onecard offer member-only discounts, accumulated rewards and personalised offers as described below, as well as entry into competitions. Clubcard holders must register their Clubcard to gain access to any of the benefits of that programme. Onecard holders do not need to register their Onecard to gain access to member-only discounts, they can simply swipe their card at the point of sale, but they do need to register to be eligible for the other benefits.<sup>519</sup>
- 7.31.1 **Club Deals and Club Prices:** consistent with our earlier definition, we refer to Club Deals (Clubcard) and Club Prices (Onecard) as “member-only discounts” throughout this draft report. These discounts are instant discounts provided to Clubcard members and Onecard holders.
  - 7.31.2 **Accumulated rewards:** we refer to “accumulated rewards” to mean fuel, food or other travel rewards such as Flybuys and Airpoints earned via Clubcard and Onecard. This includes “New World Dollars” and Countdown “e-vouchers”.
  - 7.31.3 **Personalised offers:** personalised offers are rewards or benefits that are more targeted at individual consumers. Both Countdown and New World currently provide targeted offers to some registered Onecard members and Clubcard members respectively.
- 7.32 We discuss loyalty programmes from paragraph 7.117 of this chapter.

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<sup>519</sup> This means consumers can gain access to member-only discounts via Onecard without registering the card with Woolworths NZ and providing certain information such as their name and contact details. Transaction information will still be provided.

### **Our survey, qualitative research and experimental economics helped to build our understanding of the issues facing consumers**

- 7.33 As noted earlier, our consumer survey of New Zealand grocery consumers helped us identify themes relevant to our study and to better understand consumer behaviour. We particularly sought consumers' views on how they decide where to shop and what to buy, and why consumers join loyalty programmes. We received 12,269 responses to our consumer survey across a wide range of demographics. Further information on our consumer survey is contained in Attachment F.
- 7.34 The qualitative research Ipsos conducted also helped to inform our understanding of consumers' behaviour when they shop for groceries. Ipsos recruited consumers to participate in this research from across the country. They participated by preparing a "grocery diary" and attending an interview or a focus group. The research is not intended to represent the views of all New Zealanders but provides deeper insights into a range of perspectives. The report summarising the findings of this research has been published alongside this report.<sup>520</sup>
- 7.35 Additionally, the experimental economic research conducted by NZIBR at the University of Waikato assisted our understanding of consumer decision making under complexity. This research tested how complexity around promotional mechanisms affects consumer decision making, using laboratory experiment data from 180 participants. Its research also considered whether displaying unit pricing could mitigate some of these effects, if there are any. The findings of this research have been published alongside this report.<sup>521</sup>
- 7.36 WEEL conducted this research under controlled laboratory conditions using experimental methods, which are common practice in the field of behavioural economics. There are many benefits of the experimental economic method, including credibility, observability, and replicability.
- 7.37 The findings of the WEEL research have provided valuable insights into the impact of promotional mechanisms of varying complexity on consumer decision making in the New Zealand retail grocery environment. While there are likely to be differences between the findings observed in a controlled laboratory environment and consumer behaviour when shopping at grocery stores, we consider these findings provide a useful indication of the effect complex promotional practices may be having on consumers.

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<sup>520</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021).

<sup>521</sup> The University of Waikato "Consumer Decision-Making Under Complexity" (May 2021).

- 7.38 It is possible consumers may be more likely to be affected by complexity in a retail grocery context than a controlled lab environment, in which case the scale of the effects found by WEEL would tend to understate the real-world effects:
- 7.38.1 In a retail grocery environment, consumers may have less cognitive capacity to compare products and offers due to time pressures and other distractions. For example, grocery stores have a range of stimuli, not present in a lab environment, which may split focus and attention (such as smells, sounds, signage, and other shoppers).<sup>522</sup>
- 7.38.2 The experimental setting controlled for non-price preferences (ie, participants were indifferent between the “products”). Grocery products have a range of characteristics (for example, flavour, brand, nutrition) which consumers may also consider when selecting products.
- 7.38.3 Participants were required to make 20 product selection decisions, split across four stages. Although this appears higher than an average grocery basket, a grocery shopping trip likely requires many other decisions not present in the experiment (such as where to shop and which categories to purchase from).<sup>523</sup> Where more, or more complex, decisions are required to be made, this can cause consumers to exert less effort in making each decision, increasing their reliance on decision-making shortcuts.<sup>524</sup>
- 7.39 We also conducted a range of analysis on pricing and promotion data provided by the major grocery retailers. Relevant to this chapter, this work explored the promotional pricing practices of these retailers, including the prevalence of promotions within and between the PAK’nSAVE, New World, Countdown and Four Square, the frequency of promotions, and comparisons between promotional and non-promotional prices. Attachment E summarises the relevant preliminary findings of this analysis.
- 7.40 The analysis of promotional pricing is based on 12 months of pricing data from the major grocery retailers over calendar year 2019. This period was chosen to ensure any analysis would not be influenced by any impacts the COVID-19 pandemic had on the grocery sector.

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<sup>522</sup> New Zealand grocery retailers utilise a wide variety of in-store cues, merchandising and display methods. For example: Christina Bava, Sara Jaeger and John Dawson “In-store influences on consumers' grocery purchasing decisions: a qualitative investigation” (2009) *8(3) Journal of Customer Behaviour* 221 at 226, [ ].

<sup>523</sup> The average units purchase per transaction appears to be in the region of 10 to 15, depending on the retail banner. For example, the average units purchased per transaction from Countdown was [ ] for the year to 22 November 2020 [ ]. Although we do not have data on average units for PAK’nSAVE and New World transactions, spending data indicates this is comparable to Countdown [ ]; [ ].

<sup>524</sup> For example: Anastasia Pocheptsova, On Amir, R Dhar and R Baumeister “Deciding without Resources: Resource Depletion and Choice in Context” (2009) *46(3) Journal of Marketing Research* 344, [ ].

- 7.41 Media reports noted that many grocery retailers reduced the number of discounts offered during the emergence of the COVID-19 pandemic in early 2020.<sup>525</sup> We therefore consider analysis conducted on 2020 data may not have provided an accurate reflection of discounting practices in the sector.

*Other sources of information we have relied upon*

- 7.42 Other key sources of information we have relied on when assessing these issues are:
- 7.42.1 information provided by the major grocery retailers in response to our information requests regarding their pricing and promotional practices, consumer research and loyalty programmes;
  - 7.42.2 submissions on our preliminary issues paper; and
  - 7.42.3 academic literature and studies conducted by overseas agencies and organisations, including the ACCC and the OECD.

**Promotional mechanisms and practices may affect consumers' ability to compare offerings and perceptions of value**

- 7.43 Well-functioning markets build consumer confidence to participate in markets by providing consumers with access to information that helps them to make informed decisions.<sup>526</sup>
- 7.44 Well-informed consumers may be better able to compare product offerings both within store and between retailers and may develop a more accurate perception of value that makes them more inclined to shop around between products and between retailers. This kind of consumer behaviour encourages retailers to compete for consumers and creates value for consumers in the form of better prices, range and quality of goods and services that competition can be expected to produce.
- 7.45 The major grocery retailers told us that they provide information to assist consumers with making informed decisions, including in relation to product shelf prices, any promotional pricing, and, for some products, unit pricing.<sup>527</sup>

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<sup>525</sup> Stuff "Countdown to resume 'specials' and pay staff lockdown bonuses" (30 March 2020), available at: <https://www.stuff.co.nz/business/120666733/supermarkets-coming-under-scrutiny-over-lockdown-prices>. Also see: Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 11: "[We] very temporarily suspended promotions and specials...to manage extreme demand fluctuations, avoid running out of stock, and stabilise our supply chains."

<sup>526</sup> Commerce Commission "Statement of Intent – Our Approach for 2020-2024" (30 July 2020), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0014/222305/Statement-of-Intent-20202024.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0014/222305/Statement-of-Intent-20202024.PDF) at 13.

<sup>527</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 33; Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 68-69; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 22-23.

- 7.46 Woolworths NZ told us that it recognises the importance of consumers having access to clear and useful information to make informed decisions and has a focus on providing clear information about its products.<sup>528</sup> Foodstuffs NI and Foodstuffs SI consider that consumers have access to a large amount of information about products and prices which supports a highly competitive and consumer-responsive market.<sup>529</sup>
- 7.47 However, others told us that the information provided can be confusing. This can decrease consumer confidence and make it harder for consumers to develop an accurate perception of value, leading to less-informed purchasing decisions and poor information being received by retailers which could reduce competition for these consumers.
- 7.48 For example, Consumer NZ considers that the major grocery retailers' pricing and promotional strategies including inconsistent unit pricing and complex, and frequent promotions, are a major barrier to informed consumer choice.<sup>530</sup> Another submission argued that non-standardised, inconsistent use of unit pricing means it is not easy for consumers to compare offerings.<sup>531</sup>
- 7.49 Each of the major grocery retailers compete for consumers by engaging in promotional pricing as part of their pricing strategies (see Figure 7.1). Foodstuffs SI told us that there has been a historical consumer demand for products sold on promotion, and it has responded to this demand by offering promotional pricing.<sup>532</sup> Woolworths NZ made a similar submission, that "New Zealand consumers are highly price conscious and love to purchase products on promotion."<sup>533</sup>

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<sup>528</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 68.

<sup>529</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 34; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 23.

<sup>530</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 10.

<sup>531</sup> Ian Jarratt Preliminary "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 6. This is consistent with Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 9.

<sup>532</sup> Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 23.

<sup>533</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 71.

- 7.50 Research conducted by the major grocery retailers indicates, for example, that some consumers want to see “eye-catching” specials, and many consumers report looking for promotions most or all the time when shopping.<sup>534</sup> The Ipsos report similarly found that promotions had broad appeal to a range of participating consumers.<sup>535</sup>
- 7.51 We received submissions that the major grocery retailers intend to increase their emphasis on EDLP and decrease their use of short-term promotional pricing.<sup>536</sup>
- 7.51.1 Woolworths NZ submitted this change has been driven by an effort to simplify its pricing offer to consumers so they can make decisions that best meet their needs.
- 7.51.2 Foodstuffs SI submitted this drive reflects “growing trend” among consumers for more consistent pricing.
- 7.52 However, promotions are currently frequently offered on a significant proportion of products sold at New World, Countdown and PAK’nSAVE. In 2019, promotions (of any kind) were relatively common for products in alcohol, dairy, meat, frozen products, and general grocery categories.<sup>537</sup> Many of these categories appear to generate high proportions of revenue for these retail banners.<sup>538</sup>
- 7.53 Where promotions are not misleading and offer genuine savings to consumers, they can provide value to consumers in the form of cost savings and drive price competition. Different discounting strategies may be used to influence consumer behaviour and encourage consumers to purchase the discounted product. These are common techniques with sound commercial rationales. Discounts may be offered to manage demand for products (for example, to shift products off the shelf), to retain consumers, or attract consumers or certain types of consumers to a retailer and increase market share.

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<sup>534</sup> For example: [ ]; [ ]; [ ].

<sup>535</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 9-10 and 43-44.

<sup>536</sup> Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 23; Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 71-72.

<sup>537</sup> For example: paragraph E31; [ ]. From October 2020 to January 2021 [ ] of New World sales in the North Island were from products were on promotion: Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) (Confidential Version) at 36-37. This figure was [ ] for PAK’nSAVE North Island and [ ] of sales for Four Square sales in the North Island. The proportion of products sold on promotion at Countdown is [ ]; Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) (Confidential Version) at 68.

<sup>538</sup> For example: [ ]; [ ].

- 7.54 However, even when discounts are not misleading and offer a genuine saving to consumers, the way promotions are framed, and the frequency and prevalence of promotions, can add complexity to consumer comparisons of offerings.<sup>539</sup> Additionally, this can shift consumer attention away from the price paid and towards the magnitude, or other features, of the discount.
- 7.55 Some participants in the Ipsos research expressed feelings of frustration with the frequency of specials and the inability to clearly discern whether a price represents good value.<sup>540</sup> Research provided by the major grocery retailers also indicates that consumers want promotions to be clearer and easier to read.<sup>541</sup>
- 7.56 In addition, participants in the WEEL research were least likely to make optimal choices and tended to experience the greatest losses, when they were asked to select the best option across multiple promotional mechanisms at the same time, or when faced with a more complex mechanism.<sup>542</sup> We discuss this, and other findings from the WEEL research, in the next section of this chapter.
- 7.57 Our preliminary view is that the major grocery retailers' use of an array of different promotional mechanisms, and their complexity and frequent use particularly in combination with one another, makes it hard for consumers to accurately assess the value of competing offers. This is unlikely to currently be mitigated by the major grocery retailers' display of unit pricing, because of inconsistencies and other issues with their unit pricing practices.

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<sup>539</sup> Also see Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [58]-[63].

<sup>540</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 10; also see, for example: Gorkan Ahmetoglu, Adrian Furnham and Patrick Fagan "Pricing practices: A critical review of their effects on consumer perceptions and behaviour" (2014) *Journal of Retailing and Consumer Services* 21(5) at 696-707, available at: [https://www.researchgate.net/publication/263049644\\_Pricing\\_practices\\_A\\_critical\\_review\\_of\\_their\\_effects\\_on\\_consumer\\_perceptions\\_and\\_behaviour](https://www.researchgate.net/publication/263049644_Pricing_practices_A_critical_review_of_their_effects_on_consumer_perceptions_and_behaviour).

<sup>541</sup> For example: [ ];  
[ ]

<sup>542</sup> The University of Waikato "Consumer Decision-Making Under Complexity" (May 2021) at Table 6: Stage 3 Experimental Results. The optimal choice means the choice which maximised the value the participant gained from the transaction. Losses refer to the difference between the value of the choice the participant made, and the value of the optimal choice. Value means the difference between the maximum price the consumer was willing to pay and the price actually paid. We also refer to this as consumer welfare.

- 7.58 In these circumstances, consumers may find it harder to shop around and compare competing price offers or to develop accurate perceptions of value. This may reduce the effectiveness of price competition in the longer term. This could also affect the quality of information retailers receive about consumer preferences, impacting their ability to respond to consumer demand. The same principles may apply to smaller grocery retailers using the same or similar promotional practices.<sup>543</sup>

### **Multiple and complex promotional mechanisms can make it harder for consumers to make comparisons**

- 7.59 The major grocery retailers use a range of pricing and promotional mechanisms in store and online (where online shopping is available). New World and Countdown each display at least four pricing tickets and use a greater number of mechanisms (for example, the same ticket might be used for a multi-buy and a special or an EDLP offering might also be part of a multi-buy). See Table 7.1 above for visual examples of these tickets. They also appear to sometimes use multiple tickets or representations to indicate a product is on promotion.<sup>544</sup> For example, reference prices may be accompanied by other representations such as “Save \$2.00” or “Special”.
- 7.60 Consumer NZ considers that the major grocery retailers’ promotional pricing practices make it difficult for consumers to assess the value of a “special”.<sup>545</sup> It raised concerns that this difficulty is compounded by the major grocery retailers’ use of different and types of promotions, such as offering specials, EDLP and member-only discounts.<sup>546</sup>
- 7.61 Consumer NZ’s view is consistent with research provided by the major grocery retailers which indicated that the number of promotional labels could be causing visual clutter and potentially confusing customers.<sup>547</sup>
- 7.62 The WEEL research tested how consumer purchasing decisions in a retail grocery context are influenced by the existence of multiple promotional mechanisms, and whether this leads to a reduction in consumer welfare compared to when consumers are faced with fewer, or no promotional mechanisms. We commissioned this research to help us to test any impact these mechanisms may be having on consumer choice and competition.

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<sup>543</sup> Common Sense Organics “Specials” <https://commonsenseorganics.co.nz/shop-online/specials/>; Tai Ping “Promotions” <https://www.taiping.co.nz/>; Farro Fresh “Specials” <https://shoponline.farro.co.nz/pages/specials>. Some smaller retailers also offer discounts to loyalty programme members.

<sup>544</sup> [ ]; [ ];

[ ].

<sup>545</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [60].

<sup>546</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [60]-[61].

<sup>547</sup> For example: [ ]; [ ];

[ ];



- 7.63 The experiment was conducted in four stages, with each stage consisting of multiple decision rounds with varying mechanisms. In each decision round, participants were asked to decide how many (if any) units of the fictitious good(s) on offer they would like to buy. The aim in each decision round was to maximise the value of the purchase.
- 7.64 To calculate the value of each purchase, WEEL assigned “buy back values” for the goods which decreased with each additional unit purchased. Participants’ earnings from each round were determined by the difference between the price they paid for that unit and the “buy back value” of that unit.
- 7.65 The four stages of the experiment were:
- 7.65.1 **Stage 1: One pricing mechanism at a time.** Participants were presented with only one mechanism at a time and asked to select the quantity of units which would provide them the most value.
  - 7.65.2 **Stage 2: Multiple pricing mechanisms but participants could only purchase from one mechanism.** Participants selected the quantity from one mechanism which would provide them the most value.
  - 7.65.3 **Stage 3: Multiple pricing mechanisms and participants could purchase from any combination of mechanisms.** Participants selected the combination of mechanisms and quantities which would provide them the most value.
  - 7.65.4 **Stage 4: Multiple pricing mechanisms with unit price.** The same as Stage 3 but each product also displayed the unit price.
- 7.66 The mechanisms and tickets used in this experiment were modelled on those commonly used by the major grocery retailers, described earlier in this chapter, and incorporated both “simple” and “complex” mechanisms.<sup>548</sup> For example:
- 7.66.1 One mechanism was a non-discounted price label “Good Value” and another was a 20% discount labelled “Special”. These were considered “simple” mechanisms.
  - 7.66.2 More complex mechanisms were also tested, such as a multi-buy labelled “Extra Saver” which offered a 25% discount if participants bought five units or a “Club Discount” which offered a 15% discount if participants “joined” the programme.

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<sup>548</sup> For a description of all mechanisms used, see: The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at Table 2: Pricing schemes.

- 7.67 The WEEL report found that the use of multiple promotional mechanisms caused participants to make sub-optimal purchasing decisions.<sup>549</sup> This means participants were less likely to choose the offer providing the best value (ie, the pricing mechanism and product quantity combination that offered the greatest benefit) when faced with multiple pricing mechanisms, compared with when faced with one, simple mechanism such as a “Special”.<sup>550</sup>
- 7.68 Depending on the range of mechanisms offered, participants were between 50% and 90% less likely to make the optimal choice to meet their needs, compared to when participants were presented with only one option with no discounting (ie, a product at full price with either no label or a “Good Value” label).<sup>551</sup>
- 7.69 The WEEL report also found that participants tended to experience greater losses when they had to choose between a greater number of mechanisms in Stages 2 and 3, than in Stage 1.<sup>552</sup> This means the difference between the value of the choice the participant made, and the value of the optimal choice, tended to be larger than when making other less-complex decisions.
- 7.70 We consider these findings are relevant to the use of similar mechanisms and practices in the retail grocery sector. The use of multiple promotional mechanisms by the major grocery retailers may be making it harder for consumers to make purchasing decisions that best reflect their preferences and meet their particular needs. This is because:
- 7.70.1 participants faced real financial consequences in the experiment, as their payment was dependent on their ability to choose the best outcome;<sup>553</sup>
  - 7.70.2 the schemes presented to participants in the experiment were designed to replicate those commonly offered by the major grocery retailers;<sup>554</sup> and
  - 7.70.3 decision making in the retail context is likely to be more challenging than the conditions participants were presented with in a laboratory environment (discussed above at paragraph 7.36).

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<sup>549</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at iii and 16.

<sup>550</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at iii and 16. The magnitude of this effect did not depend on how the “special” was framed ie, “was/now” or “save \$x”.

<sup>551</sup> This result controls for unobservable, and some observable, differences between participants, such as their willingness to exert effort and their performance in the simplest task. The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at Table 6: Stage 3 Experimental Results.

<sup>552</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at Table 6: Stage 3 Experimental Results in comparison to Table 4: Stage 1 Experimental Results.

<sup>553</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at 2 and 6.

<sup>554</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at 6.

- 7.71 Our preliminary finding is that the use of complex and/or multiple promotional mechanisms by the major grocery retailers may make it harder for consumers to compare prices of products in store, even when there are genuine savings and the information provided is clear. Similar observations were made in Consumer NZ's submission and research provided by the major grocery retailers, as noted in paragraphs 7.59 and 7.60, respectively. This means consumers may not be able to easily choose the best option for them, which may feed inaccurate information on preferences back to retailers and reduce the effectiveness of price competition between grocery retailers in the longer term.

### **Framing of promotions may distort consumer decision making**

- 7.72 The way that a promotional mechanism is framed can also affect consumer decision making. Our preliminary view is that the more complex the mechanism, the more difficult it may be for consumers to reach an informed decision about the value that it offers them. Nevertheless, as previously discussed, discounts can provide value to consumers and drive price competition between the major grocery retailers.
- 7.73 While the use of any single discount mechanism does not necessarily impact competition in a material way, the frequent and prevalent use of multiple and/or complex mechanisms makes it harder for consumers to easily understand and evaluate price information, form accurate perceptions of price and value, and cause consumers to be less inclined to shop around for products and retailers.<sup>555</sup>
- 7.74 Participants in the WEEL research were less likely to make the optimal purchase decision (ie, purchase the correct number of units) when asked to select from a complex discount mechanism, compared to when they were asked to select from a simple mechanism.<sup>556</sup> The effect on participants' decision making depended on the mechanism:<sup>557</sup>
- 7.74.1 **Multi-buy:** 85% less likely to make the optimal choice.
- 7.74.2 **Buy 3, get 1 free:** 59% less like to make the optimal choice.
- 7.74.3 **Member-only discount:** 46% less likely to make the optimal choice.

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<sup>555</sup> For example: Gorkan Ahmetoglu, Simon Fried, John Dawes, and Adrian Furnham "Pricing Practices: Their Effects on Consumer Behaviour and Welfare – prepared for the Office of Fair Trading" (March 2010) at 20, available at: [https://webarchive.nationalarchives.gov.uk/20140402172955/http://oft.gov.uk/shared\\_oft/business\\_leaflets/659703/Advertising-of-prices/Pricing-Practices.pdf](https://webarchive.nationalarchives.gov.uk/20140402172955/http://oft.gov.uk/shared_oft/business_leaflets/659703/Advertising-of-prices/Pricing-Practices.pdf); Gorkan Ahmetoglu, Adrian Furnham and Patrick Fagan "Pricing practices: A critical review of their effects on consumer perceptions and behaviour" (2014) *Journal of Retailing and Consumer Services* 21(5) at 699, available at: [https://www.researchgate.net/publication/263049644\\_Pricing\\_practices\\_A\\_critical\\_review\\_of\\_their\\_effects\\_on\\_consumer\\_perceptions\\_and\\_behaviour](https://www.researchgate.net/publication/263049644_Pricing_practices_A_critical_review_of_their_effects_on_consumer_perceptions_and_behaviour).

<sup>556</sup> The University of Waikato "Consumer Decision-Making Under Complexity" (May 2021) at 15.

<sup>557</sup> The University of Waikato "Consumer Decision-Making Under Complexity" (May 2021) at Table 4: Stage 1 Experimental Results.

- 7.75 In addition to participants being less likely to make the optimal choice, the WEEL report found that participants tended to experience greater losses when faced with a single more complex mechanism. This means the difference between the value of the choice the participant made, and the value of the optimal choice, tended to be larger than when making less-complex decisions (such as choosing between fewer, or simpler, mechanisms).
- 7.76 For example, in Stage 1, when participants were presented with only the complex “5 for \$x” multi-buy, and then asked to select the quantity that would provide them the best value, they experienced a 16% greater loss compared to when they had to select from a simpler mechanism.<sup>558</sup>
- 7.77 Participants’ losses were slightly less in Stage 3 when they were presented with many mechanisms (including the complex multi-buy offer), but were able to select from any of them.<sup>559</sup> However, the proportion of participants who made the optimal choice was similarly low in both Stage 1 and 3. WEEL considered this may be because, when given the option, some participants chose to ignore the complex mechanisms and instead focus on the simpler ones.<sup>560</sup>
- 7.78 In this section of this chapter, we describe the features of the commonly used promotional mechanisms that have the potential to benefit consumers, and those that may distort consumer decision making.
- 7.79 As we discuss in the final section of this chapter, we regularly receive complaints from consumers about promotional mechanisms creating confusion or being misleading. Whether or not complaints disclose any breach of the Fair Trading Act, the fact that complaints are made, and the volume of complaints, may indicate that some consumers lack confidence in the major grocery retailers’ pricing practices and this may decrease consumer sensitivity to price-based competition.

### *Reference pricing*

- 7.80 Research shows that some consumers find secondary cues, such as a reference price, important for assessing the value of longer-term offers.<sup>561</sup>

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<sup>558</sup> In the case of the multi-buy, participants could purchase five units at a discount, or single units at the full price. This may explain why participants faced losses even under one scheme, as the optimal quantity may have required purchasing a combination of the multi-buy and single units.

<sup>559</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021), Table 6: Stage 3 Experimental Results at 19.

<sup>560</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at 16.

<sup>561</sup> For example:

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- 7.81 Accurate and clearly indicated reference prices that offer a genuine saving can be beneficial for consumers trying to select the offer that best reflects their preferences.<sup>562</sup> Reference prices can be an efficient way for retailers to demonstrate discount price offers that may be valued by consumers and help reduce search costs associated with finding a good deal.<sup>563</sup>
- 7.82 However, even when they offer a genuine saving, reference prices may also influence consumer perceptions of the value of the product and shift consumer focus away from the actual price paid to the size of the discount or perceived savings.<sup>564</sup> For example, reference pricing can affect consumer perceptions of the lowest price available in the market and the potential savings they may gain by purchasing the advertised product.<sup>565</sup>
- 7.83 This may influence consumers to buy products they would not otherwise have considered buying and/or be less inclined to shop around and compare prices.<sup>566</sup> This can limit their ability to develop a well-informed perception of value and their awareness of alternative offers between retailers, influencing where they choose to shop.
- 7.84 Some research indicates the effect of reference prices on consumer perceptions appears to be larger with unfamiliar brands, and with expensive or infrequently encountered products.<sup>567</sup> It does not appear that familiarity with reference prices over time reduces or mitigates the distortion of consumer decision making.<sup>568</sup>

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<sup>562</sup> Gorkan Ahmetoglu, Simon Fried, John Dawes, and Adrian Furnham “Pricing Practices: Their Effects on Consumer Behaviour and Welfare – prepared for the Office of Fair Trading” (March 2010) at 20, available at: [https://webarchive.nationalarchives.gov.uk/20140402172955/http://oft.gov.uk/shared\\_oft/business\\_leaflets/659703/Advertising-of-prices/Pricing-Practices.pdf](https://webarchive.nationalarchives.gov.uk/20140402172955/http://oft.gov.uk/shared_oft/business_leaflets/659703/Advertising-of-prices/Pricing-Practices.pdf).

<sup>563</sup> Office of Fair Trading “Advertising of Prices” (December 2010) at [4.3]-[4.4], available at: [https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared\\_oft/market-studies/AoP/OFT1291.pdf](https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared_oft/market-studies/AoP/OFT1291.pdf).

<sup>564</sup> For example: Office of Fair Trading “Advertising of Prices” (December 2010) at [4.4], available at: [https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared\\_oft/market-studies/AoP/OFT1291.pdf](https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared_oft/market-studies/AoP/OFT1291.pdf).

<sup>565</sup> Gorkan Ahmetoglu, Adrian Furnham and Patrick Fagan “Pricing practices: A critical review of their effects on consumer perceptions and behaviour” (2014) *Journal of Retailing and Consumer Services* 21(5) at 696-707, available at: [https://www.researchgate.net/publication/263049644\\_Pricing\\_practices\\_A\\_critical\\_review\\_of\\_their\\_effects\\_on\\_consumer\\_perceptions\\_and\\_behaviour](https://www.researchgate.net/publication/263049644_Pricing_practices_A_critical_review_of_their_effects_on_consumer_perceptions_and_behaviour).

<sup>566</sup> Office of Fair Trading “Advertising of Prices” (December 2010) at [4.4] and [4.9]-[4.22], available at: [https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared\\_oft/market-studies/AoP/OFT1291.pdf](https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared_oft/market-studies/AoP/OFT1291.pdf).

<sup>567</sup> Biswas and Blair “Contextual effects of reference prices in retail advertisements” (1991) at 1-12; Nottingham University Business School. “Research Into Misleading Price Comparisons: A report prepared for the Office of Fair Trading” (June 2005).

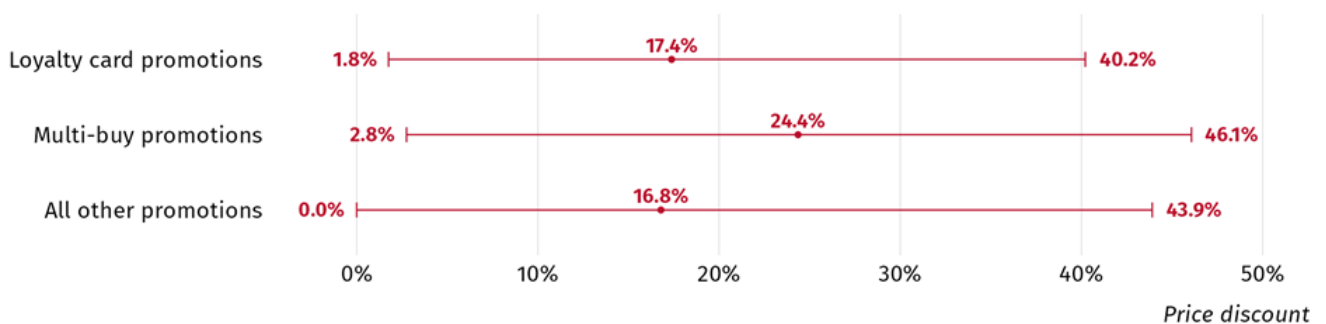
<sup>568</sup> Office of Fair Trading “Advertising of Prices” (December 2010) at [4.26] to [4.31], available at: [https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared\\_oft/market-studies/AoP/OFT1291.pdf](https://webarchive.nationalarchives.gov.uk/20140402173016/http://oft.gov.uk/shared_oft/market-studies/AoP/OFT1291.pdf).

- 7.85 If the reference price does not offer a genuine saving, for example, if the claimed “usual” or “was” price is inaccurate, including because products are rarely sold at the reference price, the pricing practice may be misleading in breach of the FTA.<sup>569</sup>

### *Multi-buy offers*

- 7.86 Where multi-buy (or volume) offers are clear, there can be benefits to consumers in the form of a lower per-unit price. However, they are a more complex promotional mechanism which make it harder for consumers to assess the value of the promotion. Consumer NZ submitted that “confusing multi-buys are [a] barrier to product comparisons”.<sup>570</sup>
- 7.87 Multi-buy offers appear to be used relatively less frequently by the major grocery retailers than other forms of promotions.<sup>571</sup> However, as shown in Figure 7.2 below, in 2019 multi-buys offered slightly greater discounts than other promotions. Across retail banners, the median discount ranges from around 10% to 30% depending on the retail banner and type of promotion, compared to the weighted average non-promotional price.

**Figure 7.2 Median and 2.5<sup>th</sup>/97.5<sup>th</sup> percentiles of weighted average promotional prices versus non-promotional prices across all retail banners, by promotion type**



Source: Commission analysis of pricing and promotional data.<sup>572</sup>

<sup>569</sup> For further information on potentially misleading referencing pricing, see our Pricing Guidance, available at: <https://comcom.govt.nz/consumers/dealing-with-typical-situations/buying-goods-and-services/pricing>.

<sup>570</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [55].

<sup>571</sup> While their prevalence varied by retail banner, and by store, multi-buy offers were offered anywhere between five and 25 times less often than simple discounts in any given week in 2019: Figure E6. Woolworths NZ has advised that in calendar year 2019, approximately [ ] SKUs on average were on multi-buy in any single week: [ ].

<sup>572</sup> [ ].

- 7.88 The major grocery retailers offer multi-buys to drive consumer engagement, attract certain groups of customers that may be more inclined to purchase discounted products and/or grow sales of a particular product.<sup>573</sup> However, some evidence shows that some consumers feel sceptical of multi-buy offers or like they had to purchase more than they need.<sup>574</sup> This may harm consumer confidence. Complex multi-buy offers may also:<sup>575</sup>
- 7.88.1 induce some consumers to buy more of a product than they would if it was subject to a single-unit discount even if the level of the discount is the same;
  - 7.88.2 induce some consumers to switch towards the promoted product, even when they do not purchase enough units to qualify for the offer and are therefore not benefitting from the saving; and
  - 7.88.3 signal to some consumers that there is a saving, even if consumers are unable to verify this.
- 7.89 As noted above, the WEEL research found that, out of all discounting mechanisms tested, multi-buy offers (either “buy 3 get 1 free” or “5 for \$x”) caused the greatest loss in consumer welfare for participants, compared to when they were displayed with only the simplest pricing display (ie, no discount).<sup>576</sup> This is consistent with the Ipsos report where some participants said that multi-buy offers can make it more difficult to determine value.<sup>577</sup>

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<sup>573</sup> [ ]; [ ].

<sup>574</sup> [ ].

<sup>575</sup> For example: Gorkan Ahmetoglu, Simon Fried, John Dawes, and Adrian Furnham “Pricing Practices: Their Effects on Consumer Behaviour and Welfare – prepared for the Office of Fair Trading” (March 2010) at 30, available at: [https://webarchive.nationalarchives.gov.uk/20140402172955/http://oft.gov.uk/shared\\_of/business\\_leaflets/659703/Advertising-of-prices/Pricing-Practices.pdf](https://webarchive.nationalarchives.gov.uk/20140402172955/http://oft.gov.uk/shared_of/business_leaflets/659703/Advertising-of-prices/Pricing-Practices.pdf). See also: Gorkan Ahmetoglu, Adrian Furnham and Patrick Fagan “Pricing practices: A critical review of their effects on consumer perceptions and behaviour” (2014) *Journal of Retailing and Consumer Services* 21(5) at 701, available at: [https://www.researchgate.net/publication/263049644\\_Pricing\\_practices\\_A\\_critical\\_review\\_of\\_their\\_effects\\_on\\_consumer\\_perceptions\\_and\\_behaviour](https://www.researchgate.net/publication/263049644_Pricing_practices_A_critical_review_of_their_effects_on_consumer_perceptions_and_behaviour).

<sup>576</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at 15.

<sup>577</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 45. This is consistent with qualitative research conducted in the UK: BDRC Continental “Grocery Pricing – Qualitative Research Report” (12 June 2015) prepared for the Competition Markets Authority, at 23, available at: [https://assets.publishing.service.gov.uk/media/55a68c41ed915d151b000005/Annex\\_F\\_-\\_Grocery\\_Pricing\\_Qualitative\\_Research\\_Report\\_Prepared\\_by\\_BDRC\\_Continental\\_for\\_the\\_CMA\\_12\\_June\\_2015.pdf](https://assets.publishing.service.gov.uk/media/55a68c41ed915d151b000005/Annex_F_-_Grocery_Pricing_Qualitative_Research_Report_Prepared_by_BDRC_Continental_for_the_CMA_12_June_2015.pdf); participants reported finding multi-buy offers confusing and made it harder to compare the value of products.

*Member-only discounts*

- 7.90 When offering a member-only discount, both New World and Countdown display the member-only and non-member/standard shelf price for products. However, Consumer NZ receives regular complaints from consumers who choose an item expecting to receive a discount which they are not entitled to as a non-member.<sup>578</sup>
- 7.91 The Ipsos report noted that some participants disliked that the price shown on in-store signage may be a members-only price and differ from the product price that they may be expected to pay. Some participants said this is ‘unfair’ and ‘misleading’.<sup>579</sup> We received approximately 20 comments in response to our consumer survey raising difficulties with ascertaining and comparing prices where a member-only discount was offered.<sup>580</sup> Most of these comments related to New World’s Club Deals.
- 7.92 Our pricing analysis for the calendar year 2019 found that Club Deals in New World across the North Island and Club Prices in Countdown appeared to be less prevalent than other types of promotions such as New World’s “Saver” and “Super Saver” and Countdown’s “Super Saver”.<sup>581</sup> That is, member-only discounts were applied to a lower proportion of SKUs than other types of promotions. In the South Island, the opposite was true: Club Deals were more common than other types of promotions.
- 7.93 Member-only discounts may increase complexity of decision making. Member-only discount tickets present consumers with two prices – a shelf price and a member-only price – in addition to other information. Consumers must then use this information to assess which price they will pay depending on whether they are entitled to receive the discount. Even when this information is available and displayed prominently, these discounts may make it more time consuming for consumers to make product comparisons and selections.
- 7.94 Consumers may face further difficulties and ultimately mistake a member-only discount for a regular promotion where:<sup>582</sup>
- 7.94.1 the member-only price is prominently displayed, compared to the shelf price which may be shown in smaller font; and/or
  - 7.94.2 the member-only price ticket is not easily distinguishable from other promotional tickets.

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<sup>578</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [87].

<sup>579</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 43.

<sup>580</sup> See paragraph F172 in Attachment F.

<sup>581</sup> At Figure E3.

<sup>582</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [85]-[86].



**Figure 7.3 Examples of member-only discounts in store**



Source: Ipsos report.<sup>583</sup>

- 7.95 Some consumers may therefore mistakenly select a product that is subject to a member-only discount, assuming they will pay the discounted price even if they are not eligible to receive the discount because they are not members of the relevant loyalty programme or do not have their loyalty card with them to swipe at the point of sale.

#### *Everyday Low Price*

- 7.96 We have also seen that some consumers appear to have low awareness or understanding of the major grocery retailers' EDLP mechanisms. In particular, some consumers do not appear to understand that these mechanisms offer a low longer-term price.<sup>584</sup> Instead, some consumers interpret these mechanisms as limited or short-term promotions, which may influence consumer perceptions of the value of the offer and consequent purchasing decisions.

#### **It is unclear if one-off promotions are harming competition**

- 7.97 One-off non-price promotions are an example of how the major grocery retailers compete. They are generally designed to drive short-term increased spend (over the promotion period) and encourage consumers to come back to their store more frequently.<sup>585</sup>

<sup>583</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 44.

<sup>584</sup> [

<sup>585</sup> [

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- 7.98 The mechanics of these promotions can vary, along with the benefits offered to consumers. For example:
- 7.98.1 New World's (both North Island and South Island) week-long "Start Fresh" free Sistema lunch box promotion whereby consumers could receive a free Sistema lunch box when they spent \$150 in a single transaction on qualifying products.<sup>586</sup>
- 7.98.2 Countdown's "Containers" 14-week promotion provided consumers an opportunity to earn stamps by spending \$20 which were redeemable on containers of different sizes.<sup>587</sup>
- 7.99 One-off promotions may, however, desensitise consumers to price competition by raising consumer switching costs. This is more likely for promotions structured like the latter example above, where consumers earn a certain number of tokens to redeem a benefit. Like with loyalty programmes, discussed later in this chapter, a "points pressure mechanism" can encourage consumers to increase the frequency and/or spend to obtain the benefit. The points pressure mechanism is a type of bias that highlights consumer behaviour in reaction to goals whereby the closer someone is to reaching a goal, the faster consumers move to try to achieve it.<sup>588</sup> Switching to another retailer could mean consumers are delayed in reaching their goal or will not earn enough tokens before the promotion ends.
- 7.100 The major grocery retailers indicate that one-off promotions do drive at least short-term sales growth and market share increases for the duration of the promotion.<sup>589</sup> Some consumers report they would be more likely to shop at a major grocery retailer while it was running a one-off promotion, and some say they would continue shopping at the relevant retailer after the promotion had ended.<sup>590</sup>
- 7.101 Where the potential effects are transitory, our preliminary view is that one-off promotions may be unlikely to raise significant competition concerns. The scope for these effects on consumer switching costs may be increased the longer the promotion runs, the more frequently they are run and/or how valuable the potential reward is to consumers.

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<sup>586</sup> [ ]; [ ].

<sup>587</sup> [ ].

<sup>588</sup> This can be seen often in loyalty programmes where firms offer, for example, bonus points when a consumer is close to a threshold, as an incentive to increase spend. For example: Matilda Dorotic, Tammo Bijmolt and Peter Verhoef "Loyalty Programmes: Current Knowledge and Research Directions" (2011) *International Journal of Management Reviews*, Vol. 14, at 219, available at: [https://www.researchgate.net/publication/229915137\\_Loyalty\\_Programmes\\_Current\\_Knowledge\\_and\\_Research\\_Directions/link/5a02c38c0f7e9b68874e170e/download](https://www.researchgate.net/publication/229915137_Loyalty_Programmes_Current_Knowledge_and_Research_Directions/link/5a02c38c0f7e9b68874e170e/download).

<sup>589</sup> For example: [ ]; [ ].

<sup>590</sup> For example: [ ]; [ ].

- 7.102 In addition, the frequent and prevalent use of one-off promotions, combined with the other promotional mechanisms identified earlier, may add to the complexity of consumer decision making, making it harder for consumers to develop accurate perceptions of value.

### **Unit pricing can lead to more informed decisions and drive competition**

- 7.103 Ready access to unit pricing can help consumers compare prices across products of differing qualities to assist consumers assess their relative value, and more easily choose the product that is best for them.<sup>591</sup> We received submissions that agreed with this proposition.<sup>592</sup> When consumers are better able to compare offers, they can develop more accurate perceptions of value over time, and retailers are more likely to be incentivised to compete on price.
- 7.104 Research indicates that the display of unit pricing for products facilitates better value comparisons beyond price, decreasing the time consumers take to make decisions, and improving the accuracy of the results.<sup>593</sup> It assists consumers by improving the information available to them, particularly within a store, and can increase price competition between products and between stores.<sup>594</sup> Some research has shown that over time unit pricing will result in cost savings for consumers as the quality of price comparisons can improve.<sup>595</sup>

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<sup>591</sup> Competition Markets Authority “Pricing Practices in the Groceries Market, Response to a super-complaint made by Which? on 21 April 2015” (16 July 2015) at 4, available at: <https://www.gov.uk/cma-cases/groceries-pricing-super-complaint>.

<sup>592</sup> Ian Jarratt “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 2; Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 23; Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 33-34; Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 71.

<sup>593</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 47-48; Dr Svetlana Bogomolova and Ian Jarratt “Unit pricing in supermarkets: review of past evidence from academic and industry studies” (18 October 2016) prepared for Working Group of the International Standards Organisation Project Committee ISP/OC 294, at 10, available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2853977](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2853977).

<sup>594</sup> For example: ACCC “Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries” (July 2008) at 450, available at: <https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf>. Unit pricing can also provide some assistance to consumers comparing prices between retailers.

<sup>595</sup> For example: ACCC “Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries” (July 2008) at 449, available at: <https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf>.

- 7.105 Unit pricing is not currently mandatory in New Zealand in any retail market but is used to an extent by the major grocery retailers. For example, Foodstuffs SI displays unit pricing on all barcoded products to assist consumers with comparing product offerings, and Foodstuffs NI has increased its use of unit pricing for this reason.<sup>596</sup> Woolworths NZ told us that its prices are transparent and accessible including through the display of unit pricing for most products.<sup>597</sup>
- 7.105.1 Foodstuffs NI and Foodstuffs SI advised that New World and PAK'nSAVE provide unit pricing for most products.<sup>598</sup> Unit price is not always displayed for products on promotion.<sup>599</sup> We understand from Foodstuffs NI that from August 2021 all products that normally display a unit price will do so when on and off promotion, except for products on multi-buy offer.<sup>600</sup> Unit price is not provided for, for example, tobacco products which are not displayed to consumers, and products that are not sold by a standard measurement of weight or volume. We understand this approach is consistent across all New World and PAK'nSAVE stores and online (where applicable).
- 7.105.2 Countdown displays unit pricing for most of its packaged grocery and perishable products including for products on promotion.<sup>601</sup> Countdown does not provide unit pricing for "pre-priced" items such as gift cards, tobacco, and products with no weight data. We understand this approach to unit pricing is consistent across all Countdown stores and online.
- 7.106 Each major grocery retailer currently determines the appropriate unit of measurement for their respective approach to unit pricing and it varies by product. For example, herbs and spices may display the price per 10 grams and flour per kilogram.

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<sup>596</sup> Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 23; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 33-34.

<sup>597</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 71.

<sup>598</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 33; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 23; [ ]; [ ].

<sup>599</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [52]-[54].

<sup>600</sup> [ ].

<sup>601</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 71; [ ]; [ ].

- 7.107 The major grocery retailers do not appear to collect information about how consumers use unit pricing in the context of purchasing decisions. However, many consumers have reported referring to unit pricing when assessing the value of grocery products. For example, over 30% of respondents to our consumer survey reported always checking unit pricing when it is available, and over a further 30% said they “usually” check the unit price.<sup>602</sup>
- 7.108 In addition, the WEEL research reported weak statistical evidence that display of unit price may help to mitigate the effects of the use of multiple promotional mechanisms on the optimality of consumer decision making (discussed earlier).<sup>603</sup>

### **Inconsistent use of unit pricing by the major grocery retailers may inhibit decision making**

- 7.109 Although unit pricing is offered by the major grocery retailers for many products, we have heard concerns regarding the consistency and clarity of the display of unit price information.
- 7.110 There is less scope for consumers to realise the benefits of unit pricing, and increased potential for confusion, if unit pricing is poorly or inconsistently displayed.<sup>604</sup> This was a theme in several submissions received in response to our preliminary issues paper.
- 7.111 For example, Consumer NZ submitted:<sup>605</sup>

Product comparisons in store are complicated by several factors. Inconsistent unit pricing is one of these. While both supermarket chains have voluntarily introduced unit pricing, our surveys have found its display is variable.

[...] Where the unit price is displayed, its often shown in very small font, much smaller than the retail price. Unless shoppers make an effort to look for the information, they may not know it's there.

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<sup>602</sup> See Figure F24; Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 47: many participants reported that they look at unit pricing when shopping.

<sup>603</sup> The University of Waikato “Consumer Decision-Making Under Complexity” (May 2021) at iii.

<sup>604</sup> Competition Markets Authority “Pricing Practices in the Groceries Market, Response to a super-complaint made by Which? on 21 April 2015” (16 July 2015) at 4, available at: <https://www.gov.uk/cma-cases/groceries-pricing-super-complaint>; Dr Svetlana Bogomolova and Ian Jarratt “Unit pricing in supermarkets: review of past evidence from academic and industry studies” (18 October 2016) at 13-14, available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2853977](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2853977).

<sup>605</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [51]-[52].

- 7.112 Consumer NZ also identified differences in the units of measure used, and that unit pricing is not always shown for products on promotion.<sup>606</sup> For example, Consumer NZ's 2020 online supermarket price survey identified that New World does not provide unit prices for Super Saver, Club Deal or multi-buy products online.<sup>607</sup> These inconsistencies can further complicate product comparisons and assessments of value.
- 7.113 Another submission noted that it is not easy enough for consumers to compare value for money because grocery retailers are not required to provide:<sup>608</sup>
- 7.113.1 the unit price for grocery products sold in fixed measure pre-packages; or
- 7.113.2 unit pricing that meets certain standards of accuracy and consistency in the units of measure used.
- 7.114 This is consistent with the findings of the Ipsos report. Participants expressed that they find unit pricing useful, but that it needs to be more consistent and more simply communicated by the retailers.<sup>609</sup> Participants noted differences in the units of measurement displayed across brands and reported frustration that some products did not display the unit price at all.<sup>610</sup>
- 7.115 Inconsistencies in the approach to unit pricing may limit the benefits consumers can derive from it, and adversely affect consumers' ability to make meaningful comparisons between products.<sup>611</sup> The same may apply to comparisons between retailers and the development of an informed perception of value which helps consumers choose where they would like to shop.
- 7.116 Where unit pricing information is not consistently available or cannot easily be assessed and acted upon by consumers, they may be less able to make informed decisions and less likely to shop around. This may reduce the major grocery retailers' incentives to engage in price-based competition.

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<sup>606</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [52]-[54].

<sup>607</sup> Consumer NZ "Supermarket price survey", available at: <https://www.consumer.org.nz/articles/supermarket-price-survey>.

<sup>608</sup> Ian Jarratt "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 6.

<sup>609</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 10.

<sup>610</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 47-48.

<sup>611</sup> Competition Markets Authority "Pricing Practices in the Groceries Market, Response to a super-complaint made by Which? on 21 April 2015" (16 July 2015) at 4, available at: <https://www.gov.uk/cma-cases/groceries-pricing-super-complaint>.

## Loyalty programmes may affect consumer decision making and reduce price competition

- 7.117 It is common for New Zealand grocery consumers to be members of one or more loyalty programmes. A 2020 review of loyalty programmes by Consumer NZ found that Countdown’s Onecard programme had two million members; New World’s Clubcard had 1.6 million.<sup>612</sup> The majority of sales at both New World and Countdown are associated with the respective loyalty programmes.<sup>613</sup>
- 7.118 Loyalty programmes can be pro-competitive by intensifying price competition and providing consumer benefits through loyalty discounts and lower prices.<sup>614</sup>
- 7.119 Through these programmes, retailers can also gather consumer data, including on consumers’ preferences and purchasing behaviour. This data can be used to improve product ranges, and to offer a more personalised consumer experience, which some consumers may value. This is consistent with the submissions by the major grocery retailers.<sup>615</sup>
- 7.120 However, the primary purpose of loyalty programmes is to attract and retain consumers and some features have the potential to adversely affect competition. Some consider that the major grocery retailers’ loyalty programmes could adversely affect consumers, for example, by making it harder to make well-informed decisions, reducing retail competition and leading to different prices for different groups of consumers.<sup>616</sup>

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<sup>612</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [73] citing Consumer NZ “How much are loyalty schemes earning from your data?” (28 January 2020), available at: <https://www.consumer.org.nz/articles/how-much-are-loyalty-schemes-earning-from-your-data>. This appears to be consistent with information provided by the major grocery retailers, though additional consumers may hold an unregistered Onecard (and can access member-only discounts). For example: [ ]; [ ].

<sup>613</sup> For example, the latest figures provided by Woolworths from March 2021 recorded that [ ] of sales and [ ] of transactions occur with a Onecard [ ]; Foodstuffs NZ reported that in April 2018, Clubcard scan rates were over [ ] of sales for the South Island and around [ ] for the North Island [ ].

<sup>614</sup> ACCC “Customer loyalty schemes – Final report” (December 2019) at 104-105, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

<sup>615</sup> For example: Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 24-25; Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 72-74.

<sup>616</sup> For example: Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [72]-[87]; NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 52.

- 7.121 Our preliminary view is that consumers do not have a good understanding of the terms and conditions applying to the loyalty programmes that they subscribe to. This can make it difficult for consumers to understand how discounts and rewards are earned, and to compare them with those offered through other loyalty programmes and other promotional mechanisms. Like confusion relating to promotional mechanisms, this can reduce price transparency, make consumers less responsive to price-based competition, and reduce the major grocery retailers' incentives to engage in price competition.
- 7.122 The major grocery retailers also compete to obtain consumer data through loyalty programmes by offering incentives such as member-only discounts and rewards. Consumers with certain data and privacy preferences may not make decisions that accurately reflect their preferences if they do not clearly understand how their data collected through the loyalty programme is used. This may inhibit competition for consumers with strong privacy or data use preferences.
- 7.123 Loyalty programmes can also adversely impact competition if they deter consumers from sufficiently shopping around so as to create barriers to entry or expansion for competing grocery retailers. Our preliminary view, as discussed in Chapter 6, is that loyalty programmes do not create a material constraint on entry or expansion. In this chapter, we discuss the evidence supporting that conclusion in more detail. We also describe how loyalty programmes may nevertheless reduce competition between grocery retailers. The ACCC considered that retailers use loyalty programmes to influence consumer behaviour by, for example, encouraging consumers to make repeat or additional purchases (and by default, spend less with their competitors) and introducing resistance to competing offers.<sup>617</sup>
- 7.124 In this section, we consider the nature of the loyalty programmes offered by the major grocery retailers, including the different types of benefits offered to consumers, their effect on consumer decision making, and therefore on competition. We focus on:
- 7.124.1 consumer understanding of the benefits offered through the relevant loyalty programmes and the impact of consumer understanding on informed decision making;
  - 7.124.2 consumer understanding of the extensive collection and use of consumer data through these programmes, and potential effects of these practices on competition;
  - 7.124.3 whether Onecard and Clubcard may harm competition by making it less likely or harder for consumers to switch to another retailer; and

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<sup>617</sup> ACCC "Customer loyalty schemes – Final report" (December 2019) at 17 and 90, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>; Omar Duque "The Costs of Loyalty: on Loyalty Rewards and Consumer Welfare" (2017) 8(2) *Economic Analysis of Law Review* 411 at 420-422, available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3058504](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3058504).



7.124.4 the potential for loyalty programmes to facilitate price discrimination.

### Other loyalty programmes offered by smaller retailers

- 7.125 We are aware many other grocery retailers also operate their own loyalty programmes. Some of these programmes have similar attributes to those discussed in this chapter (for example, accumulated rewards).
- 7.126 Some examples of programmes offered by smaller retailers include:
- 7.126.1 Farro Fresh offers its “Friends of Farro” loyalty programme. Members receive “member-only” specials, entry into competitions, and other rewards such as a \$10 voucher for every \$400 spent in a month.<sup>618</sup>
- 7.126.2 Huckleberry offers members the ability to earn “Good Dollars”. Every \$200 spent collects one Good Dollar, which can be used like cash in store.<sup>619</sup>
- 7.126.3 Moore Wilson’s offers its cardholders exclusive access and entry into promotions, access to partnership loyalty programmes, and marketing.<sup>620</sup> In addition, cardholders can become a “Gold Customer” and eligible for certain specials by spending \$2,000 in store in one year.
- 7.126.4 Jadan Supermarket offers its members store credit when a certain spending threshold is reached.<sup>621</sup>
- 7.127 However, given the larger scale of the major grocery retailers and the uptake of their loyalty programmes, we focus this part of our study on the potential impact on competition of Clubcard and Onecard. We consider that these loyalty programmes are more likely to influence competition. However, our preliminary findings may apply more widely.
- 7.128 Loyalty programmes are not offered by Woolworths NZ at either FreshChoice or SuperValue,<sup>622</sup> or by Foodstuffs NI or Foodstuffs SI at Four Square, PAK’nSAVE, On the Spot, or Raeward Fresh.<sup>623</sup>

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<sup>618</sup> Farro Fresh “Friends of Farro”, available at: <https://www.farro.co.nz/friends-of-farro>.

<sup>619</sup> Huckleberry “Huckleberry Loyalty”, available at: <https://www.huckleberry.co.nz/pages/huckleberry-loyalty>.

<sup>620</sup> Moore Wilsons “Our card”, available at: <https://moorewilsons.co.nz/about/our-card>.

<sup>621</sup> [ ].

<sup>622</sup> Some individual franchisees have engaged external parties to offer a loyalty programme on a store-specific basis. FreshChoice Picton was also part of a trial for the Onecard programme in early 2021, [ ].

<sup>623</sup> Foodstuffs SI launched “Sticky Club” in PAK’nSAVE across the South Island in September 2017 and included a fuel rewards programme. Sticky Club is now solely used for customers to sign up to SHOP’nGO services and has no rewards element. See: <https://www.foodstuffs-si.co.nz/about-us/news-announcements/2017/8/23/pak%E2%80%99nsave-launches-sticky-club-rewards-programme/>; <https://www.paknsave.co.nz/sticky-club/>.

### Consumers appear to have limited understanding of the rewards structures

- 7.129 Foodstuffs NI and Woolworths NZ both submitted that their programmes are pro-competitive because they result in discounts and lower prices for consumers.<sup>624</sup>
- 7.130 However, our preliminary view is that many consumers do not have a good understanding of how loyalty programme rewards are earned and redeemed. This may be because they use points-based structures that make it more complex for consumers to work out the benefits available.
- 7.131 Loyalty programmes, particularly those with complex reward structures, can reduce price transparency and make it harder for consumers to make meaningful comparisons with competing price-based offers.<sup>625</sup> This may result in consumers engaging in less frequent and less-informed price comparisons, limiting consumers' ability to signal their preferences to retailers, and reduce price competition between the major grocery retailers. We have previously discussed the importance to competition of consumers' ability to make informed purchasing decisions (see, for example, paragraphs 7.12 to 7.17 above).
- 7.132 It may be difficult to accurately assess or compare the value of the benefits offered by loyalty programmes where:<sup>626</sup>
- 7.132.1 members earn different volumes of points from various partners such as airlines and the value of the reward when those points are redeemed will vary depending on the rewards selected;
  - 7.132.2 members can earn both member-only discounts and accumulated rewards with the retailer or with a partner (for example, an airline) where competing retailers do not offer the same accumulated rewards; and
  - 7.132.3 non-monetary rewards are offered, for example, entry into competitions.

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<sup>624</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 72-74; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 35.

<sup>625</sup> ACCC "Customer Loyalty Schemes – Final report" (December 2019) at 104, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>; Loyalty & Reward Co "Australian Loyalty Schemes: A Loyalty & Reward Co report for the ACCC" (June 2019) at 69, available at: <https://www.accc.gov.au/system/files/Australian%20Loyalty%20Schemes%20-%20A%20Loyalty%20and%20Reward%20Co%20report%20for%20the%20ACCC.PDF>.

<sup>626</sup> Loyalty & Reward Co "Australian Loyalty Schemes: a Loyalty & Reward Co report for the ACCC" (June 2019) at 104, available at: <https://www.accc.gov.au/system/files/Australian%20Loyalty%20Schemes%20-%20A%20Loyalty%20and%20Reward%20Co%20report%20for%20the%20ACCC.PDF>; ACCC "Customer Loyalty Schemes – Final report" (December 2019) at 96, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>; OECD "Policy Roundtables – Loyalty and Fidelity Discounts and Rebates" (2002) *DAFFE/COMP(2002)21* at 24 and 93, available at: <https://www.oecd.org/daf/competition/abuse/2493106.pdf>.

- 7.133 Onecard and Clubcard contain elements of each of these scenarios. These programmes offer points that accumulate over time and at certain spend thresholds earn the consumer a reward either with the respective retailer or one of the partner firms, such as Flybuys or fuel rewards. The rate of reward and the partner firms for each loyalty programme are different. Members of these programmes can also gain benefits other than discounts or vouchers such as entry into competitions and personalised offers.
- 7.134 Like some one-off promotions, points-based loyalty programmes such as these may cause consumers to overestimate or underestimate the true value of the reward, which adds to the challenges of comparing prices. This is because points-based programmes exploit size heuristics, and other heuristics such as anchoring, to make a reward appear of greater value than it is.<sup>627</sup> Heuristics are mental shortcuts that are used to evaluate situations or simplify information when consumers do not have the time and/or capacity to evaluate all available information.<sup>628</sup>
- 7.135 Clubcard and Onecard both convey members' ability to earn and progress towards obtaining a reward through points earned, rather than the dollar spend required to earn a reward, or the dollar value of the reward. This may shift consumers' focus away from the monetary value of the reward, toward the number of points accumulated, making it harder for consumers to accurately assess the value of the rewards offered.
- 7.136 Consumers may anchor their perceptions of the value of the reward on the high numeric points value. Anchoring perceptions around a large numeric value can inflate perceptions of value, and consumers may not be able to adjust their understanding easily or adequately, even when additional information is provided.<sup>629</sup> For example, Onecard offers members 1 point for every \$1 spent on qualifying products and 2,000 points earns a \$15 e-voucher. After spending \$1,000, consumers may assess value by referring to the points they have accumulated (ie, 1,000), rather than the dollar value of the points they have earned (ie, \$7.50).

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<sup>627</sup> ACCC "Customer Loyalty Schemes – Final report" (December 2019) at 96-97, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

<sup>628</sup> ACCC "Customer Loyalty Schemes – Final report" (December 2019) at 19, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

<sup>629</sup> ACCC "Customer Loyalty Schemes – Final report" (December 2019) at 19, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

- 7.137 As we discuss below, some consumers cite the ability to accumulate rewards as being one of the reasons they signed up for a grocery loyalty programme.<sup>630</sup> Other consumers report being “obsessed” with earning rewards.<sup>631</sup> However, consumers’ enthusiasm for loyalty programmes is not necessarily indicative of their understanding of what they are signing up to, or the rewards they will earn and may reflect an uninformed perception of value of the programme.
- 7.138 The Ipsos report noted that participants generally found loyalty programmes confusing. Some participants were unaware of the extent of the discount or value of the points earned through grocery loyalty programmes.<sup>632</sup> Although participants were aware that, at some point, they may receive a benefit (for example, a voucher), there was limited understanding of how the benefit was earned.<sup>633</sup> Many also struggled to express a tangible benefit from participating in some of the programmes, or to compare their benefits across programmes.<sup>634</sup>
- 7.139 Complex rewards structures, such as points-based mechanisms, and the limited understanding of how these programmes work, could shift consumers’ focus away from retail prices and increase consumer sensitivity to rewards-based offers.<sup>635</sup> Consumers that value these offers may therefore engage in less frequent price and quality comparisons, or find it more difficult to do so, including with competing retailers that do not offer the same rewards. This can lead to less-informed purchasing decisions which in turn affects competition.<sup>636</sup>
- 7.140 We have also observed that many consumers do not earn enough points to receive accumulated rewards, and, if they do, some are never redeemed.<sup>637</sup> Many consumers therefore do not receive the accumulated benefits offered by these programmes.

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<sup>630</sup> At Figure F29.

<sup>631</sup> [ ].

<sup>632</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 43-44.

<sup>633</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 43-44.

<sup>634</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 43-44.

<sup>635</sup> ACCC “Customer Loyalty Schemes – Final report” (December 2019) at 96, available at:

<https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

<sup>636</sup> ACCC “Customer Loyalty Schemes – Final report” (December 2019) at 96, available at:

<https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

<sup>637</sup> For example, some research indicates that [ ] of points earned in a [ ] period expire before they are converted to a reward, [ ] of members earn enough points in a [ ] period to receive a reward, and some [ ] of the rewards earned are never redeemed:

[ ]. [ ].

7.141 These findings are consistent with evidence provided by the major grocery retailers that indicate that consumer understanding of how loyalty programmes work, and how much they need to spend to get a reward, is generally low.<sup>638</sup>

### **Some consumers appear to have limited understanding of data practices**

7.142 The offering of a loyalty programme is a dimension of competition between the major grocery retailers. Some consumers' decisions about whether to participate in a loyalty programme may be influenced by their preferences regarding the collection and use of their personal information. However, we have identified that some consumers may not be aware of or understand how the major grocery retailers collect consumer data and how the data is used.<sup>639</sup> This can make it harder for these consumers to make well-informed decisions about their participation because the costs in doing so are not clear.<sup>640</sup>

7.143 The privacy and data practices of these loyalty programmes are dimensions of quality. If consumers are not aware of or do not understand these practices, the major grocery retailers will not be incentivised to compete on these quality dimensions.

7.144 Although consumers are not charged a fee to participate in these programmes, consumers pay by providing their data to the major grocery retailers. One of the key functions of loyalty programmes for retailers is to collect consumer data.<sup>641</sup> The major grocery retailers collect large amounts of data from members of their loyalty programmes including demographic information, transactions and purchase behaviour, and other information provided by members such as contact details.<sup>642</sup>

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<sup>638</sup> For example: [ ]; [ ]; [ ]; [ ].

<sup>639</sup> See Figure F31; Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report" (July 2021) at 44.

<sup>640</sup> Consumer NZ submitted in support of this proposition: Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [82]; NZFGC also raised concerns about the terms and conditions of loyalty programmes and their disclosure, particularly around data: NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [221].

<sup>641</sup> For example: Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 24; Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [72].

<sup>642</sup> [ ]; [ ]. This is consistent with the submissions received from the major grocery retailers. For example, Woolworths NZ noted that any data collected supports "customer-led and fact-based decisions in relation to ranging, store layout, and other decisions to the significant benefit of customers and our business..." Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 74.

- 7.145 This information is used to inform business decisions, for example, in relation to produce ranges to and to provide a personalised experience for consumers. For example, consumer data collected through the loyalty programmes may be used to group or profile consumers and inform in-store or personalised promotional strategies.<sup>643</sup> Some consumers may value receiving more targeted, relevant, and personalised marketing or benefits such as personalised promotional offers.
- 7.146 This data, or insights derived from it, may also be provided to other parties, such as suppliers (discussed below). Each major grocery retailer appears to be working to expand their access to and use of consumer data.<sup>644</sup>
- 7.147 The major grocery retailers compete to gain this data by encouraging consumers to sign up to their loyalty programmes and then to swipe their membership card. This competition can be seen, for example, in the use of incentives to swipe a loyalty card such as offering member-only discounts and other rewards. Consumers appear to have a diverse range of preferences in relation to how businesses use their data. Consumers with certain data and privacy preferences may be more receptive to these incentives than if they understood how their data is used.
- 7.148 Many New Zealanders report that they feel strongly about these practices.<sup>645</sup> Some consumers report that they do not want to sign up to loyalty programmes as they do not want to give away their personal information.<sup>646</sup> Approximately 18% of respondents to our consumer survey who were not members of a loyalty programme report they did not sign up because of concerns about data collection.<sup>647</sup>

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<sup>643</sup> For example: [ ]; [ ];

<sup>644</sup> For example: [ ]; [ ]; [ ];

<sup>645</sup> For example, in a representative survey commissioned by the Privacy Commission in 2020, respondents were most concerned about businesses sharing their personal information without their permission. Two thirds of respondents felt there should be more regulation regarding what companies can do with their personal information. See Privacy Commission “Privacy concerns and sharing data” (April 2020) at 11 and 24, available at: <https://privacy.org.nz/assets/DOCUMENTS/Privacy-concerns-and-sharing-data-OPC-reportApr-20.pdf>.

<sup>646</sup> [ ];

<sup>647</sup> Figure F33.

- 7.149 Others say they would not mind their behaviour being tracked if it means they receive personalised deals.<sup>648</sup> Similarly, the Ipsos report found that some participants saw data collection as an opportunity to improve the personalisation of the overall shopping experience.<sup>649</sup>
- 7.150 We have, however, identified two practices engaged in by the major grocery retailers that raise issues that may be important to some consumers, but which consumers may not be aware of: the linking of loyalty memberships to payment cards and the provision of consumer data to third parties.
- 7.151 While there is some disclosure relating to these practices, consumers are not necessarily provided with the specific details about how their data is used and the true cost of joining the programme may not be known or understood. Nearly 35% of respondents to our consumer survey reported having no understanding of how their data is used by loyalty programmes, and over 25% reporting knowing a “little” about it is used.<sup>650</sup>
- 7.152 Even if terms and conditions are published clearly, consumers may lack the necessary time, or other resources, to adequately assess all details of these practices.<sup>651</sup> The terms and conditions are lengthy, and consumers may face “information overload”.<sup>652</sup> When faced with complex or a high volume of information, consumers tend to pull out the certain details they consider most important at the time they read it. Over 60% of respondents to our consumer survey reported that they either skimmed the key parts or did not read all of the terms of conditions of the loyalty programme they use most often.<sup>653</sup> Less than 10% reported that they read all the terms and conditions.<sup>654</sup>

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<sup>648</sup> [ ]. Similarly, case studies in other sectors suggest competition between retailers on the terms of their privacy policies does not appear to drive consumer usage of services. For example: Alex Marthews and Catherine Tucker “Privacy policy and competition” (December 2019) *Economic Studies at Brookings*, at 5, available at: <https://www.brookings.edu/wp-content/uploads/2019/12/ES-12.04.19-Marthews-Tucker.pdf>.

<sup>649</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 44.

<sup>650</sup> Figure F31.

<sup>651</sup> For example, some consumers have reported infrequently engaging in tasks which were potentially time or resource intensive, such as reading New Zealand privacy laws or reading a business’ privacy policy: [ ].

<sup>652</sup> “Information overload” is a type of heuristic where consumers make a mental shortcut when faced with complex information and limited time or capacity to process it. For example, OECD “Improving online disclosures with behavioural insights: Towards better outcomes for consumers” (12 April 2018) at 20, available at: <https://www.oecd-ilibrary.org/docserver/39026ff4-en.pdf?expires=1624245521&id=id&accname=guest&checksum=6F0E09D5B6CC33E4F01B48607F1B7126>.

<sup>653</sup> Figure F30.

<sup>654</sup> Figure F30.

- 7.153 This means some consumers may not be aware of what they are giving up or how they are paying to participate in these programmes. Consumers with certain data collection and privacy preferences may therefore not be able to easily make informed decisions that accurately reflect their preferences.<sup>655</sup>
- 7.154 Our preliminary view is that these issues are not likely to be a main driver affecting competition in the retail grocery market at the current time. However, these are important issues for consumers that also have the potential to affect consumer decision making and competition if consumers with privacy and data preferences are not able to make informed decisions about their participation in these programmes. Competition for these consumers will be inhibited.

*Some retailers may link payment cards to loyalty cards and track both*

- 7.155 New World's privacy policy states that Foodstuffs NI and Foodstuffs SI may, from time to time, collect payment card information that can be combined with other personal information held by them.<sup>656</sup> We understand this term was added to the privacy policy on 1 December 2020. The policy states:

From time to time we may also collect from you in the course of providing you, or by you using and using, the Services, information that is not personal information at the time of collection (Non-identifiable Information), for example payment card information. However, by choosing to register to use any of the Services, you agree that we may combine the Non-identifiable Information with your personal information that we collect, or that is otherwise held by Foodstuffs, its partners or service providers, in a manner that will change the nature of the Non-identifiable Information such that it becomes personal information. You agree that we may use this Non-identifiable Information in accordance with this Privacy Policy.

- 7.156 This means that if a Clubcard member swipes their Clubcard and their payment card (for example, a credit or EFTPOS card) in the same transaction, all future New World, PAK'nSAVE and Four Square (in-store or online) purchases with that payment card can be linked to the consumer's Clubcard data, regardless of whether the Clubcard is swiped during the future transactions.<sup>657</sup> This allows consumer purchasing behaviour of Clubcard members to be tracked even if they do not scan their Clubcard.<sup>658</sup>
- 7.157 The same applies to consumers who have registered to shop online. Transactions using the same payment card online and subsequently online or in store at New World, PAK'nSAVE or Four Square can be linked to allow purchase behaviour to be tracked.

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<sup>655</sup> Consumer NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [82].

<sup>656</sup> New World "Privacy Policy" (22 February 2021), available at: <https://www.newworld.co.nz/privacy-policy>. We note that the policy applies to data collected outside Clubcard. For example, personal information that is collected when consumers use New World's online store or sign up to receive marketing material.

<sup>657</sup> [ ]; [ ].

<sup>658</sup> Foodstuffs NI has this capability and Foodstuffs SI is developing it, [ ].



- 7.158 Valuable consumer data can therefore be collected and used without those consumers receiving any of the benefits associated with Clubcard (for example, member-only discounts or Flybuys) for that transaction. We anticipate that it is likely that most consumers would have difficulty understanding or be unaware that this can be done.<sup>659</sup>
- 7.159 The ACCC observed that irrespective of disclosure, consumers are unlikely to know that their data is collected and used by supermarkets even where they have chosen not to scan their loyalty card.<sup>660</sup> Further, when consumers no longer want to participate, they are unlikely to actively cancel their membership (due to the time and effort of doing so), yet the supermarkets will continue to collect information via payment cards. Retailers engaging in this practice would continue to collect consumer data, while the consumer no longer gains the benefits of the programme.

*The major grocery retailers disclose consumer data and insights to third parties*

- 7.160 The major grocery retailers also sell consumer insights derived from loyalty programme data to third parties. These third parties include suppliers and partners, such as Flybuys or AA Smartfuel, and research firms. We understand that personal information about consumers (ie, information which might identify them) is not provided.
- 7.161 These practices are referred to in the respective privacy policies of New World and Countdown.
- 7.161.1 New World's privacy policy states that personal information, including that collected via Clubcard, may be disclosed to "any relevant third party that offers good or services that Foodstuffs thinks may be of interest to the consumer (for example, fuel providers)" and "a third party outside of New World who is contracted to us (or Foodstuffs) to provide a particular service to you on our behalf" or to New World or Foodstuffs.<sup>661</sup>
- 7.161.2 Countdown's privacy policy states personal information is generally never disclosed to its suppliers, except to enable them to contact a consumer if they have won a prize.<sup>662</sup> However, anonymous and aggregated information is shared with "contractors, affiliates, business partners and third parties."

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<sup>659</sup> Only 9% of respondents to our consumer survey said they read the loyalty programme's terms and conditions in full, see: Figure F31.

<sup>660</sup> ACCC "Customer Loyalty Schemes – Final report" (December 2019) at 66, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

<sup>661</sup> New World "Privacy Policy" (22 February 2021), available at: <https://www.newworld.co.nz/privacy-policy>.

<sup>662</sup> Countdown "Privacy policy" (15 July 2019), available at: <https://www.countdown.co.nz/about-us/our-policies/privacy-statement>.

7.162 These privacy policies lack details about who might be provided with consumer data and on what basis. This makes it hard for consumers to understand how their data will be used which can impact consumers' ability to accurately assess the value of the loyalty programmes to them. As noted at 7.143, this can reduce incentives for loyalty programme operators to compete on these dimensions.

### **Loyalty programmes may raise perceived switching costs for some consumers**

7.163 Consumers have a range of preferences that contribute to store choice. This can include price, convenience and promotional and loyalty offerings.<sup>663</sup> Some consumers say they will always go to a particular store or use a certain brand because of loyalty offers.<sup>664</sup>

7.164 Most respondents to our consumer survey said they participate in more than one loyalty programme:

7.164.1 33% of respondents are members of two grocery loyalty programmes;

7.164.2 a further 21% are members of three; and

7.164.3 a further 15% are members of four programmes.<sup>665</sup>

7.165 This is consistent with evidence provided by the major grocery retailers.<sup>666</sup>

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<sup>663</sup> Paragraphs F107 to F110 note convenience and low prices as the most common drivers of main store choice for survey respondents. However, a small proportion of respondents also cite loyalty programmes or good specials as the key reason for their choice of main store.

<sup>664</sup> For example: [ ].

<sup>665</sup> Figure F28.

<sup>666</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 72-74; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 35-36 and [ ]. Also, for example, [ ]; [ ].

- 7.166 However, we received submissions that loyalty programmes make it less likely or harder for consumers to switch to another major grocery retailer (ie, increase switching costs) resulting in these consumers being effectively “locked in” to a retail banner.<sup>667</sup> Consumer lock-in may reduce the effectiveness of price competition and raise barriers to entry to the extent that it discourages or makes it harder for consumers to make price comparisons between retailers.<sup>668</sup>
- 7.167 Our preliminary view in Chapter 6 is that loyalty programmes are not a material constraint on entry or expansion. We have consistently seen that consumers have a diverse range of preferences and can and do participate in multiple programmes. In addition, consumers appear to value loyalty programmes most highly for the member-only discounts, and the rate of reward offered by Clubcard and Onecard is relatively low so long-term effects are unlikely to significantly affect competition.
- 7.168 Despite our conclusions in Chapter 6 regarding barriers to entry, a degree of consumer lock-in may occur for those consumers who value the accumulation of points to earn a delayed reward.<sup>669</sup> We discuss this in more detail below. Consumers that value these rewards may be less incentivised to make price comparisons (since they are encouraged to funnel spend towards one retailer) and become resistant to competing offers.

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<sup>667</sup> NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [208]. Also see ACCC “Customer loyalty schemes – Final report” (December 2019) at 91, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>; Lars Meyer-Waarden and Christophe Benavent “Grocery Retail Loyalty Program Effects: Self Selection or Purchase Behaviour Change?” (2007) *Journal of the Academy of Marketing Science*, available at: [https://www.researchgate.net/publication/227148922\\_Grocery\\_retail\\_loyalty\\_program\\_effects\\_Self-selection\\_or\\_purchase\\_behavior\\_change](https://www.researchgate.net/publication/227148922_Grocery_retail_loyalty_program_effects_Self-selection_or_purchase_behavior_change); OECD Policy Roundtables “Loyalty and Fidelity Discounts and Rebates” (2002) *DAFFE/COMP(2002)21* at 89, available at: <https://www.oecd.org/daf/competition/abuse/2493106.pdf>.

<sup>668</sup> Loyalty programmes can deter entry where potential competitors conclude it will not be possible to capture viable market share because consumers are “locked in” to incumbents or without access to the data incumbents have gathered through their loyalty programmes. For further discussion on entry and expansion and issues relating to access to this data, see Chapter 6.

<sup>669</sup> For example: Omar Duque “The Costs of Loyalty: on Loyalty Rewards and Consumer Welfare” (2017) *8(2) Economic Analysis of Law Review* 411 at 414, available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3058504](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3058504); ACCC “Customer loyalty schemes – Final report” (December 2019) at 93, available at: <https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF>.

### Consumers that value accumulated rewards may be less inclined to shop around

- 7.169 Where rewards are based on thresholds of accumulated points, a points pressure mechanism can encourage consumers to increase the frequency and/or amount of spend to obtain the reward.<sup>670</sup> Research suggests that the closer a consumer is to obtaining a reward, the more likely they are to remain loyal to and make additional purchases to reach it.<sup>671</sup> Switching to another retailer could mean they will be delayed in reaching their goal. Consumers may also risk losing the points they have earned if points must be redeemed before a certain expiry date.<sup>672</sup>
- 7.170 There is a diverse range of consumer preferences relating to accumulated rewards offered by loyalty programmes, such as fuel savings or food vouchers. Some consumers say these rewards are unachievable or are not worth the spend required.<sup>673</sup> Other research indicates that some consumers consider they are “obsessed” with earning rewards points and some report using loyalty programmes to save for expensive items such as flights (through earning Airpoints).<sup>674</sup>
- 7.171 41% of respondents to our consumer survey said collecting points to redeem vouchers and rewards was one of the reasons they joined loyalty programme they use most often.<sup>675</sup> Some participants in the Ipsos research reported monitoring their points balances closely.<sup>676</sup>
- 7.172 These consumers who value accumulated rewards are more likely to perceive higher switching costs and consider they are “locked in” to the retailer with which they accumulate points.
- 7.173 There is a minimum spend threshold to earn accumulated food, fuel, or travel rewards via Onecard and Clubcard, as set out in Table 7.2 below.

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<sup>670</sup> For example: Matilda Dorotic, Tammo Bijmolt and Peter Verhoef “Loyalty Programmes: Current Knowledge and Research Directions” (2011) *International Journal of Management Reviews*, Vol. 14, at 217, available at:

[https://www.researchgate.net/publication/229915137\\_Loyalty\\_Programmes\\_Current\\_Knowledge\\_and\\_Research\\_Directions/link/5a02c38c0f7e9b68874e170e/download](https://www.researchgate.net/publication/229915137_Loyalty_Programmes_Current_Knowledge_and_Research_Directions/link/5a02c38c0f7e9b68874e170e/download).

<sup>671</sup> Matilda Dorotic, Tammo Bijmolt and Peter Verhoef “Loyalty Programmes: Current Knowledge and Research Directions” (2011) *International Journal of Management Reviews*, Vol. 14, at 219 and 225, available at:

[https://www.researchgate.net/publication/229915137\\_Loyalty\\_Programmes\\_Current\\_Knowledge\\_and\\_Research\\_Directions/link/5a02c38c0f7e9b68874e170e/download](https://www.researchgate.net/publication/229915137_Loyalty_Programmes_Current_Knowledge_and_Research_Directions/link/5a02c38c0f7e9b68874e170e/download). This is also known as a “suction effect” on consumer behaviour, where consumers funnel purchases toward a single seller.

<sup>672</sup> Airpoints Dollars currently expire after four years.

<sup>673</sup> [ ]; [ ]; [ ]; [ ]. Similar sentiments were expressed by respondents to our consumer survey: see paragraph F173.

<sup>674</sup> [ ] and [ ] respectively [ ].

<sup>675</sup> At Figure F29.

<sup>676</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 44.

**Table 7.2 Rewards earned through Onecard and Clubcard**

Programme	NZD spend	Points earned	Conversion	Rate of reward
Countdown's Onecard <sup>677</sup>	\$1	1	2,000 points = \$15 e-voucher	0.75% savings
New World's Clubcard	\$25 (on qualifying products)	0.185 Airpoints or 1 Flybuys point	28 Flybuys points = \$5 New World Dollars	0.71% savings

Source: New World FAQs and Countdown Onecard Benefits.<sup>678</sup>

- 7.174 Alternatively, members can earn accumulated fuel discounts, depending on their total spend:
- 7.174.1 Onecard members can choose AA Smartfuel rewards to save 3 cents per litre if they spend \$100 at Countdown in a week.
- 7.174.2 Clubcard members who choose to earn Flybuys when they shop at New World earn 6 cents off per litre (up to 50 litres) at Z and Caltex fuel stations for every four Flybuys earned.
- 7.175 The rate of reward for accumulated food rewards offered by Onecard and Clubcard is relatively lower than the amount of spending required (less than 1% savings as shown in Table 7.2 above). We therefore consider it unlikely that accumulated food rewards would significantly raise costs for consumers to switch retailers in the longer term. There may be short-term effects for consumers that value these rewards when they are closer to the expiry date of already accumulated points. New World Dollars expire after 24 months, and Onecard points and e-vouchers expire after one year.
- 7.176 Consumers accruing Airpoints or Flybuys through Clubcard may be more reluctant to shop at an alternative grocery retailer where equivalent spend may not similarly earn these rewards.<sup>679</sup> These points can contribute to purchases that are generally high in value and infrequent in nature, such as flights with Air New Zealand.

<sup>677</sup> Onecard members also get 6 cents off per litre at BP and participating G.A.S outlets when they spend \$40 or more on fuel in a single transaction.

<sup>678</sup> New World "FAQ About New World Dollars" <https://www.clubcard.co.nz/newworld/en/fag/newworlddollars>; Countdown "Onecard benefits", available at: <https://www.countdown.co.nz/oncard/oncard-benefits/oncard-food-rewards>.

<sup>679</sup> These effects may be particularly strong for loss-averse consumers. Loss aversion refers to the tendency to prefer avoiding losses to acquiring equivalent gains based on a point of reference. For example, if a person starts with \$100 and loses that \$100, the decrease in utility is greater than the increase in utility if they had \$0 and found another \$100.

7.177 At this stage, however, we do not consider that this element of Clubcard is likely to significantly weaken competition. Airpoints and Flybuys can be earned in many ways. These other opportunities to earn these rewards should mitigate any potential reluctance to switch grocery retailers. It is unclear to us at this stage whether these effects may differ for different groups or consumers and/or whether the effects of these programmes will change over time with technological developments.

### **Consumers that prefer member-only discounts are unlikely to face perceived higher switching costs**

7.178 Consumers that value member-only discounts over accumulated benefits are more likely to consider they are free to switch their spend to another retailer and therefore less likely than other groups of consumers to experience perceived lock-in effects.

7.179 Our research and research conducted by the major grocery retailers indicates that more consumers tend to participate in grocery loyalty programmes to gain access to these member-only discounts, rather than accumulated rewards:

7.179.1 Over 50% of respondents to our consumer survey who participated in a loyalty programme said that the reason they joined Clubcard and/or Onecard was to gain access to the Club Deals or Club Prices respectively.<sup>680</sup>

7.179.2 Research shows that many consumers across the country are members of loyalty programmes primarily to receive member-only discounts.<sup>681</sup>

7.180 Our preliminary view is that member-only discounts are unlikely to cause consumers to face perceived higher switching costs.

### **Loyalty programmes may facilitate a form of price discrimination**

7.181 Consumer NZ considers that both Clubcard and Onecard result in price discrimination because consumers who sign up to these programmes gain access to certain discounted prices.<sup>682</sup> Members of these programmes receive benefits in exchange for providing their data to the major grocery retailers. Consumers that do not hold a loyalty card are charged a higher price for the same product.

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<sup>680</sup> In addition: [ ]; Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector – Consumer study report” (July 2021) at 44.

<sup>681</sup> The Register “New Zealand loyalty program members want rewards quickly” (21 October 2019), available at: <https://theregister.co.nz/2019/10/21/new-zealand-loyalty-program-members-want-rewards-quickly/>;

[ ]  
; [ ]

<sup>682</sup> Consumer NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [75]. We did not receive cross-submissions on this issue. Price discrimination involves charging different prices to different consumers for the same good or service based on the maximum price a consumer is willing to pay for that good or service (ie, their “willingness to pay”).

- 7.182 Price discrimination is not necessarily a competition concern.<sup>683</sup> Some consumers may benefit from increasingly personalised pricing and offers by receiving recommendations and discounts they value. In addition, it is possible that in some circumstances retailers may have the opportunity to serve some consumers with a lower willingness to pay, increasing output.
- 7.183 Price discrimination may adversely affect competition where retailers can identify likely marginal consumers (ie, those likely to switch to another retailer) who swipe their loyalty card and target them with specific discounts, while raising or maintaining prices for other consumers who do not participate in the programme or are less likely to switch in response to a price change. However, we have not seen information indicating that shelf prices are increasing in this way.
- 7.184 Onecard and Clubcard currently facilitate two forms of discounting off the shelf price: member-only discounts and personalised offers. We do not consider member-only discounts are likely to cause competition concerns based on price discrimination in the grocery retailer sector. This is mainly because most shoppers participate in the loyalty programme offered by their grocery retailer/s of choice and therefore benefit from member-only discounts, and most sales are associated with loyalty cards.<sup>684</sup>
- 7.185 We also received submissions that the major grocery retailers intend to decrease promotional pricing and increase EDLP pricing strategies.<sup>685</sup> This will reduce the scope for price discrimination through these discounts.

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<sup>683</sup> However, we note that price discrimination would be unlikely to occur in a perfectly competitive market, given a retailer would be unable to raise its prices above its marginal costs without losing customers.

<sup>684</sup> As noted earlier, over one-half of transactions and over two-thirds of sales at both New World and Countdown are associated with a loyalty card: For example: [ ]; [ ]; [ ]; [ ].

<sup>685</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 71; Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 23. [ ].

## Personalised offers can make price discrimination more effective

- 7.186 We expect that personalised offers by the major grocery retailers will likely become more targeted and individualised, being offered instead of (or in addition to) generic promotional pricing.<sup>686</sup> Consumers can receive benefits in the form of lower prices and personalised promotional offers, as well as a more relevant shopping experience. However, it is possible the price gap between members (who pay a discounted price in exchange for providing their data) and non-members (who pay the shelf price), may increase.<sup>687</sup>
- 7.187 For example, without price discrimination, all consumers would be charged the same price (say, \$4). With price discrimination, members of the loyalty programme would be charged \$3 and non-members would be charged \$5 for the same product. This results in the “surplus” being transferred from the former group to latter in the form of a lower price. Whether the overall effect of this practice is good for consumers depends in part on whether the \$3 price would cover the cost of supply.<sup>688</sup>
- 7.188 This practice may be detrimental to consumers where it occurs in less competitive markets.<sup>689</sup> This is because it can enable retailers to extract this “surplus” from consumers by charging each consumer a price which is higher, but not to the extent that they do not buy it.<sup>690</sup> However, we have not seen any information to indicate this is practice is currently a concern.
- 7.189 As data is increasingly collected from consumers on individual preferences, the scope for retailers to extract all surplus from more consumers is increased.

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<sup>686</sup> The same may apply to suppliers that gain access to the relevant consumer data.

<sup>687</sup> Personalised pricing of this nature generally transfers the surplus of transactions (ie, any value gained above the purchase price) from consumers who are willing to pay more for a product to consumers who are willing to pay in different ways, including by sharing personal information, by charging them a lower price. For example: OECD “Discussion on Personalised Pricing in the Digital Era” (27 April 2020) *DAF/COMP/M(2018)2/ANN8/FINAL*, available at [https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M\(2018\)2/ANN10/FINAL&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M(2018)2/ANN10/FINAL&docLanguage=En).

<sup>688</sup> In this example, price discrimination enables more transactions to take place (as it allows the “\$3” group of consumers to be served), which can result in an increase in aggregate consumer benefits.

<sup>689</sup> OECD “Discussion on Personalised Pricing in the Digital Era” (27 April 2020) *DAF/COMP/M(2018)2/ANN8/FINAL* at 3, available at: [https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M\(2018\)2/ANN10/FINAL&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M(2018)2/ANN10/FINAL&docLanguage=En).

<sup>690</sup> OECD “Discussion on Personalised Pricing in the Digital Era” (27 April 2020) *DAF/COMP/M(2018)2/ANN8/FINAL* at 3, available at: [https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M\(2018\)2/ANN10/FINAL&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M(2018)2/ANN10/FINAL&docLanguage=En).



## Other issues within the retail grocery sector raised by consumers

- 7.190 Since the start of our study, consumers and consumer groups have raised an increased number of complaints relating to potentially misleading promotional pricing practices, pricing inaccuracies, unfair contract terms and conditions of loyalty programmes, and privacy principles relating to data collection. To the extent these issues relate to whether competition in the grocery sector is working effectively, we have considered them above. In addition, we have closely analysed pricing practices over time to the extent they relate to competition. We have not analysed whether the information provided to us discloses a breach of the FTA or a potential matter of interest to the Office of the Privacy Commissioner under the Privacy Act 2020.
- 7.191 Independent of this study, we are considering what further action may be required in relation to the major grocery retailers' pricing practices, utilising our Fair Trading compliance and enforcement functions and powers.<sup>691</sup>
- 7.192 However, we set out below the nature of the information shared with us. We emphasise that a complaint does not necessarily mean that any law has been breached, rather it relates to alleged conduct by the subject of the complaint and, as noted above, can provide an indication of the level of confidence that consumers have in the retail grocery sector. This level of confidence can itself affect competition in the sector.

### *Potentially misleading promotional pricing practices*

- 7.193 We regularly receive complaints from the public relating to our role in enforcing competition and consumer law.<sup>692</sup> We received 376 complaints about grocery retailers for the seven-month period from 1 November 2020 to 31 May 2021. This made up 7.5% of all FTA related complaints we received.
- 7.194 Of the complaints received, 111 related to supermarket promotions. These complaints make allegations about promotional representations (such as "great price" or "extra low") causing confusion, or that promotions such as multi-buy offers provide little or no saving. Some consumers have also complained that the use of a "special" price ticket is misleading as some products are almost always represented at a promotional price, so the offer could not be considered "special". Similar points were discussed by some respondents to our consumer survey.<sup>693</sup>

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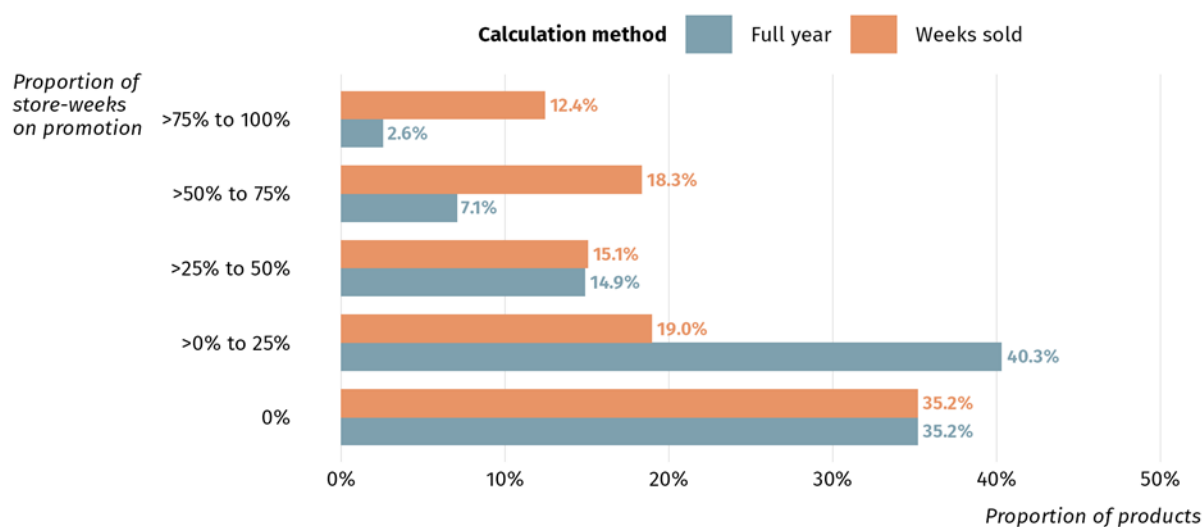
<sup>691</sup> Commerce Commission "Enforcement Response Guidelines" (October 2013), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf).

<sup>692</sup> A complaint does not necessarily mean that any law has been breached, rather it relates to alleged conduct by the trader.

<sup>693</sup> See paragraph F160 in Attachment F.

- 7.195 We also received a complaint from Consumer NZ in September 2020 alleging some grocery stores' price promotions were likely to breach the FTA.<sup>694</sup> The complaint contained price tracking data for 22 products offered at Countdown, New World and PAK'nSAVE stores collected between April and June 2020. Consumer NZ alleged this data showed some products were on "special" so often that shoppers risked being misled about the savings available.
- 7.196 In addition, our pricing analysis identified that, for the calendar year 2019, a small proportion of products at each of the major grocery retailers appeared to be on promotion for a significant part of the year. This is shown in Figure 7.4 which shows between 2.6% and 12.4% of products offered by the major grocery retailers were on promotion for at least three quarters of the year.<sup>695</sup>

**Figure 7.4 Frequency of all types of promotions across all retail banners in 2019<sup>696</sup>**



Source: Commission analysis of pricing and promotional data.<sup>697</sup>

- 7.197 The proportion of products which were on promotion for more than half the year appeared to be particularly high at PAK'nSAVE stores in the North Island. Figure 7.5 shows that at least a quarter of products at PAK'nSAVE stores in the North Island were on promotion for more than half of 2019. This proportion was also high for PAK'nSAVE stores in the South Island, where at least 17.8% of products were on promotion for more than half of 2019.

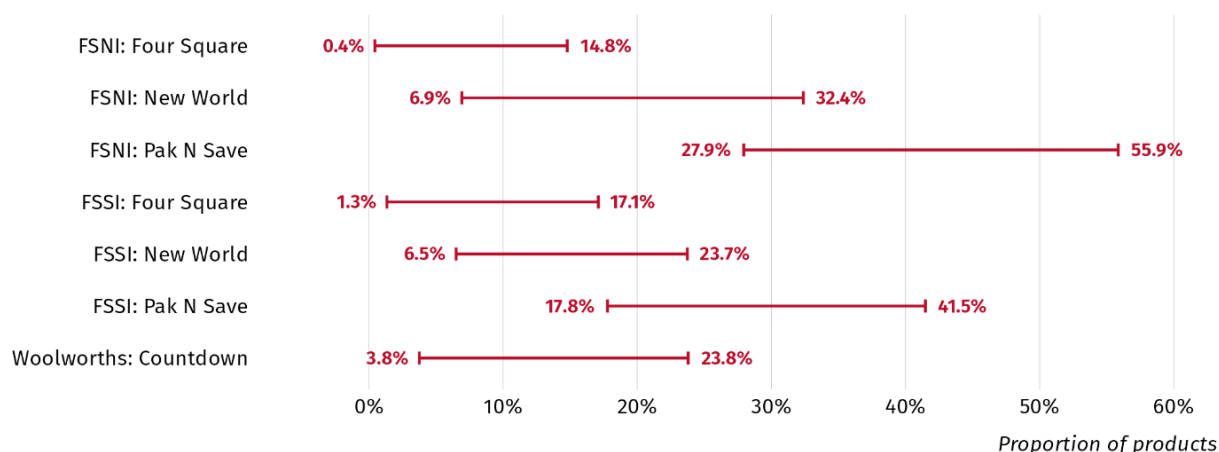
<sup>694</sup> For a summary of the complaint, see: Belinda Castles "Supermarket Price Survey" (5 August 2020) Consumer NZ <https://www.consumer.org.nz/articles/supermarket-price-survey>.

<sup>695</sup> This figure shows all SKUs sold by the major grocery retailers in 2019 grouped by the proportion of the year they were on promotion for. For example, the two bars at ">75% to 100%" show the proportion of SKUs which were on promotion for >75% to 100% of 2019. Two bars are shown for each group as, given the limitations in the data, two methods were used to calculate these proportions, noted as the 'full year' and 'weeks sold' methods. The true proportions are likely to lie somewhere between the bounds of each of these two bars.

<sup>696</sup> This analysis does not include EDLP mechanisms.

<sup>697</sup> [ ].

**Figure 7.5 Proportion of products that were on promotions in more than 50% of store-weeks in 2019<sup>698</sup>**



Source: Commission analysis of pricing and promotional data.<sup>699</sup>

### *Other complaints we have received about grocery retailers*

7.198 In addition to the complaints about promotions discussed above, we also received grocery complaints regarding the following themes:<sup>700</sup>

7.198.1 **Price inaccuracies:** These complaints describe instances where consumers paid a higher price at the till than they were led to believe would be payable due to in-store or advertising representations. We received 143 such complaints between 1 November 2020 and 31 May 2021. As noted at paragraph F160.3, we also received approximately 200 responses to our consumer survey which discussed similar concerns.

7.198.2 **High prices:** These complaints mention prices of products which they believe to be unreasonably high, or that prices of product(s) had recently been increased. Complainants allege that some products are significantly more expensive in NZ than they are overseas or that they are sold at "too high" a profit. We received 31 such complaints between 1 November 2020 and 31 May 2021.<sup>701</sup>

7.198.3 **Characteristics or quality:** These complaints concern the features of supermarket products or complaints about products not being of acceptable quality. We received 29 such complaints between 1 November 2020 and 31 May 2021.

<sup>698</sup> As with Figure 7.4, the ranges in these graphs reflect the upper and lower bounds of the two calculation methods used, due to limitations in the dataset. The true proportions likely lie within these ranges. These methods are described at paragraph E25.

<sup>699</sup> [ ].

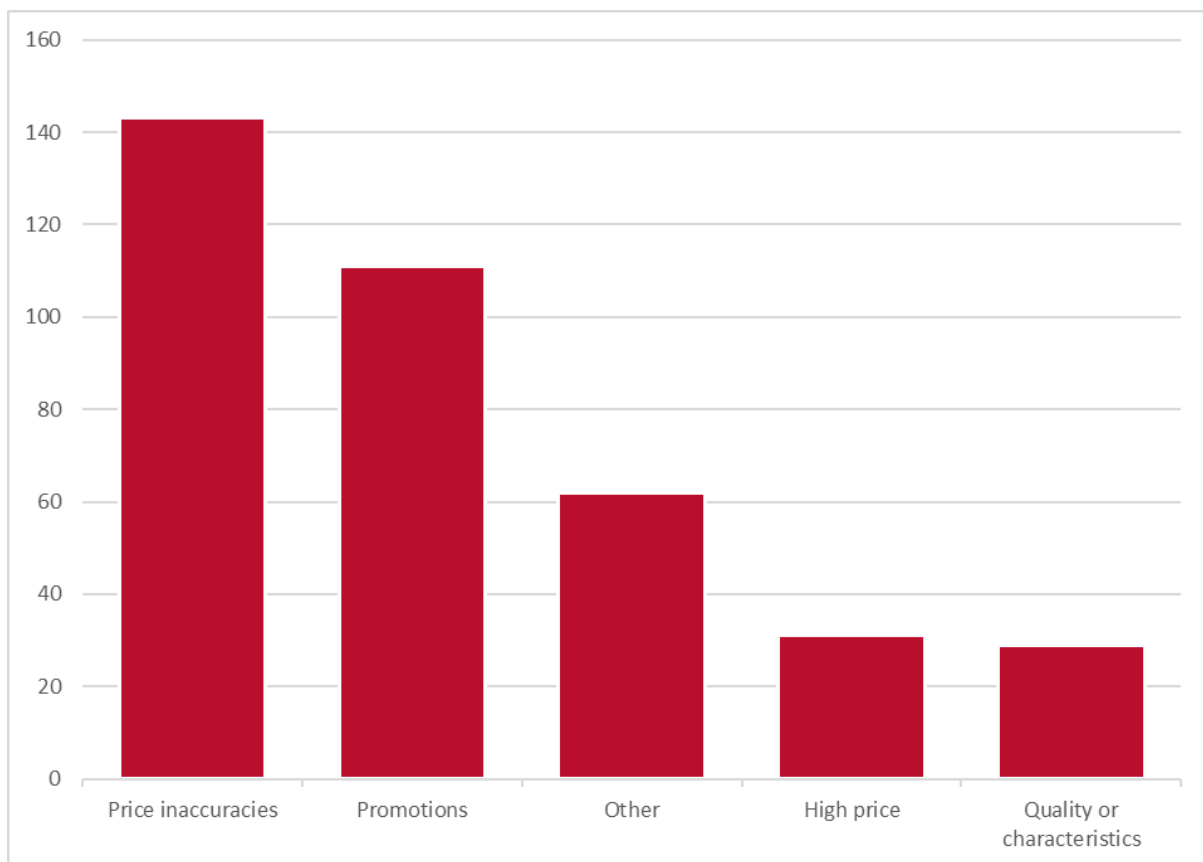
<sup>700</sup> Complaints to the Commission for the period 1 November 2020 – 31 March 2021, [ ].

<sup>701</sup> Complaints regarding high prices are discussed further at Chapter 3.

7.198.4 Supermarket complaints increased through the COVID-19 pandemic lockdowns, including complaints about alleged "price gouging" and low stock levels. During this period, MBIE established the 'Price Watch' website to enable consumers to report any price increases they had noticed.

7.199 Increased complaint levels also coincided with the launch of our market study, and the Commission's prosecution of PAK'nSAVE Mangere for discrepancies between promotional pricing displayed or advertised and the price charged at the till.<sup>702</sup>

**Figure 7.6 Supermarket complaints received by the Commission by primary issue November 2020 to March 2021**



Source: Commission analysis based on complaints data, n=306.<sup>703</sup>

<sup>702</sup> Commerce Commission "PAK'nSAVE Mangere fined \$78,000 for price discrepancies" (28 October 2021), available at: [https://comcom.govt.nz/news-and-media/media-releases/2020/paknsave-mangere-fined-\\$78,000-for-price-discrepancies](https://comcom.govt.nz/news-and-media/media-releases/2020/paknsave-mangere-fined-$78,000-for-price-discrepancies).

<sup>703</sup> [ ].

## Chapter 8 Acquisition of groceries by retailers

### Summary of preliminary findings

- Major grocery retailers are a key route to market for many suppliers. Most groceries in New Zealand are sold through the major grocery retailers' retail stores, so a supplier having its products stocked by a major grocery retailer is an important way to drive sales.
- For many suppliers there are limited alternative options available to them to sell their products other than to the major grocery retailers. With only two major grocery retailers in each island, which between them have a high estimated market share, in many instances there is only limited competition for the purchase of suppliers' products. We observe that, as a consequence, competition does not appear to be working well for suppliers to the major grocery retailers.
- Most suppliers have limited ability to negotiate with the major grocery retailers. Suppliers are typically significantly more dependent on retailers than the retailers are on suppliers. This leads to a bargaining power imbalance in many cases.
- With effective retail competition, this can result in cost savings that are passed on to consumers. However, we have heard examples which suggest that in some cases major grocery retailers are using their strong negotiating position to:
  - transfer costs and risks to suppliers, despite retailers being better placed to manage them;
  - reduce transparency and certainty over terms of supply; and
  - limit suppliers' ability or incentive to provide favourable supply terms to other grocery retailers.
- Suppliers' incentives to innovate and invest are likely to be adversely affected by this conduct in ways that ultimately harm consumers. For example, this could lead to reduced production or capacity, lower product quality and fewer new product offerings being available for New Zealand consumers. Other grocery retailers may face reduced access to supply of groceries, affecting their ability to enter or expand. There is a risk of prices rising in the future if some suppliers exit the market, reducing competition between the remaining suppliers.
- Consumers may benefit from private label products through lower prices and greater choice. However, retailers of private label products can face conflicting incentives given they are both customers and competitors of branded suppliers.
- While private label products could increase consumer choice and lower prices in the short term, there is a risk that growth of private labels could crowd out supplier-branded products. This could lead to a loss of consumer choice and higher prices over the longer term.
- The risk of private label products adversely affecting outcomes for consumers is greater when retail competition is not effective. For example, competition could be harmed by retailers giving their private label products preferential shelf space or infringing upon suppliers' intellectual property.

## Introduction

- 8.1 In this chapter we discuss how competition is working for the acquisition of groceries by retailers from suppliers and growers. We then discuss the grocery procurement practices of the major grocery retailers. We draw preliminary conclusions about the potential impact these procurement practices may have on competition and market outcomes. We identify features that may be contributing to the preliminary conclusions we have reached.
- 8.2 The major grocery retailers have between them an estimated 80-90% of the retail grocery market and are a key route to market for many suppliers. For many suppliers, there are few, if any, other parties competing to buy their products and the ability for most suppliers to transfer significant volumes to alternative sales channels is limited. In these circumstances, there is limited competitive constraint imposed on the demands which can be made by the major grocery retailers. Retailers on the other hand can generally choose between a range of suppliers for most product categories.
- 8.3 We received differing comments on the relative bargaining power of the major grocery retailers and suppliers in response to our preliminary issues paper. Submissions from the NZFGC and Horticulture NZ raised concerns about retailer conduct towards suppliers, highlighting suppliers' lack of bargaining power.<sup>704</sup> Major grocery retailers, on the other hand, submitted that they value their relationships with suppliers, and that many of their suppliers have significant bargaining power.<sup>705</sup>
- 8.4 Our preliminary view is that for the reasons described in paragraph 8.2 above, competition is not working well for suppliers to the major grocery retailers and consequently, the major grocery retailers are generally in a much stronger negotiating position than their suppliers.
- 8.5 Imbalances in bargaining power between retailers and suppliers are likely to affect the terms on which retailers acquire groceries. Suppliers may accept weaker terms than if negotiating positions were more even. This can reduce suppliers' incentives to invest and innovate, ultimately affecting the range, quality and pricing of products available to consumers.

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<sup>704</sup> NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at [9]; Horticulture NZ "Submission on retail grocery market study preliminary issues paper" (9 February 2021) at 2.

<sup>705</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 40-46; Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" at 31-32; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 21-22.

- 8.6 We have considered the perceptions of retailers and suppliers when forming our preliminary views. While we have some direct information about interactions between retailers and suppliers, many interactions occur verbally rather than in writing. It can also be challenging to gather direct evidence of how interactions between retailers and suppliers affect outcomes for consumers.
- 8.7 We also acknowledge that this chapter primarily discusses supplier perspectives conveyed to us by suppliers on condition of anonymity and through intermediaries such as the NZFGC. Many suppliers expressed concerns about the protection of commercially sensitive information and fear of retribution for contributing to our study, for example, in relation to ranging their products.<sup>706</sup> Similar concerns were raised with us in 2014 when we investigated the conduct of Progressive Enterprises. With this in mind, we appreciate that not all issues raised with us will necessarily have been raised previously with the major grocery retailers, and they may not yet have had an opportunity to comment on them.
- 8.8 For all of these reasons, we have focussed our discussion on some key themes regarding interactions between retailers and suppliers, rather than focussing on specific examples of conduct by particular retailers. We have not considered the circumstances or potential commercial rationales for each party underlying the kinds of interactions described to us. Our objective in this chapter is to share an overview of the experiences of supply relationships that suppliers reported to us, and identify the prevalence of some reported experiences.<sup>707</sup> We then consider the potential impact that experiences of that nature may have on competition.
- 8.9 While we welcome comment on all aspects of our draft report, given these parameters for our work on supplier relationships, we particularly welcome comment from the major grocery retailers and their suppliers relating to the underlying balance of bargaining power between grocery retailers and suppliers, and how this ultimately affects competition and consumers.
- 8.10 This chapter has four sections:
- 8.10.1 our approach to analysing the acquisition of groceries by retailers;
  - 8.10.2 do grocery retailers have buyer power in the acquisition of groceries?
  - 8.10.3 are retailers exercising buyer power and what is the effect?

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<sup>706</sup> Suppliers' fear of retribution has been mentioned in media articles. For example: The Detail "Sneaky, shady, shifty - supermarkets are under scrutiny" (30 November 2020) RNZ <https://www.rnz.co.nz/programmes/the-detail/story/2018774704/sneaky-shady-shifty-supermarkets-are-under-scrutiny>; Kate MacNamara "Supermarket giant faces scrutiny amid rising tension with suppliers" (5 December 2020) NZ Herald <https://www.nzherald.co.nz/business/shaky-aisles-supermarket-giant-faces-scrutiny-amid-rising-tension-with-suppliers/SRCDD63DL6N43FROEAP45TXVAA/>.

<sup>707</sup> We acknowledge that suppliers interact with retailers at different levels (eg, from in-store staff to CEO), and that retailer conduct may vary across these levels.

- 8.10.4 what effect are private label products having on competition between retailers and suppliers?

### **Our approach to analysing the acquisition of groceries by retailers**

- 8.11 This section describes the key concepts and information sources used when analysing the acquisition of groceries by retailers. Past studies and investigations into interactions between grocery retailers and suppliers are also briefly summarised. It notes that:
- 8.11.1 suppliers seek access to grocery retailers' limited shelf space;
  - 8.11.2 bargaining power and buyer power are relevant concepts when considering suppliers' relationships with retailers;
  - 8.11.3 the impact of bargaining power imbalances on outcomes for consumers depends on the circumstances;
  - 8.11.4 buyer power is a common issue considered in overseas grocery market studies;
  - 8.11.5 we previously investigated interactions between a major grocery retailer and its suppliers in 2014; and
  - 8.11.6 we undertook a survey to build our understanding of the issues facing suppliers.

### **Suppliers seek access to grocery retailers' limited shelf space**

- 8.12 Suppliers generally want to sell their products to as many customers as possible, so seek to have their products displayed in retail grocery stores. Given that most groceries are sold through retail stores, a supplier having its products 'ranged' by a major grocery retailer is an important way to drive sales.<sup>708</sup>
- 8.13 However, shelf space in retail grocery stores is limited.<sup>709</sup> Each store has a certain floor area, which in turn limits the available shelf space for displaying grocery products.

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<sup>708</sup> Our understanding is that most online grocery orders are filled by a local 'bricks-and-mortar' retail store. Therefore, although this section refers to 'shelf space', the discussion is also relevant to most online grocery sales. There are some exceptions to this such as The Honest Grocer and Supie.

<sup>709</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 40.



8.14 Grocery retailers decide the range of products displayed in their stores to best utilise this limited shelf space, to maximise their profits. Considerations when deciding which products to stock may include:<sup>710</sup>

8.14.1 meeting customers' needs;

8.14.2 sales growth;

8.14.3 product substitutability;

8.14.4 availability of supply;

8.14.5 operational ease;<sup>711</sup> and

8.14.6 ensuring the retailer's profit margin expectations are met.

8.15 Product ranging decisions can be made centrally at a retailers' head office, or in some cases by individual stores. For example, Foodstuffs' supplier website 'Foodstuffs exchange' states:<sup>712</sup>

Ranging decisions are made both at our support centres and in our stores. Our core range for each is recommended by the Category team in each region. They are responsible for reviewing the product ranges and ensuring that we are stocking products that our customers want. Local stores can also make ranging decisions which may reflect their local producers, the niche that they wish to occupy, and customer requests.

8.16 There are several key steps in the process of suppliers having their products displayed in retail grocery stores. This process is summarised in Figure 8.1 below, which is based on the supply process between major grocery retailers and suppliers in Australia. While there may be some variations for some retailers and suppliers in certain situations, this is generally consistent with what we have heard in the New Zealand context.<sup>713</sup>

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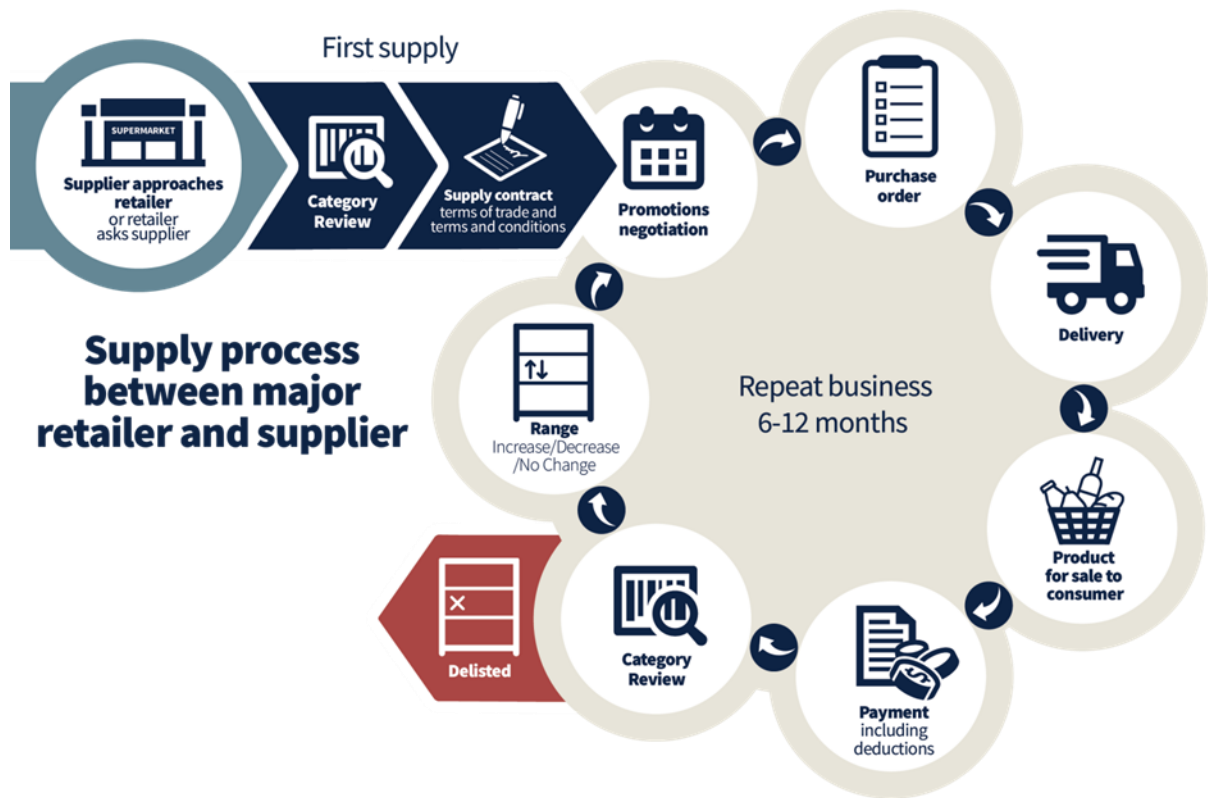
<sup>710</sup> [ ]; [ ];

<sup>711</sup> For example, ensuring enough space is allocated to each product to simplify the process of stacking the shelves (ie, enabling an entire case of each product to fit on the shelf).

<sup>712</sup> Foodstuffs Exchange "Product ranging" <https://www.foodstuffs-exchange.co.nz/become-a-supplier/product-ranging/#>.

<sup>713</sup> For example: Foodstuffs' supplier website, Foodstuffs exchange <https://suppliers.foodstuffs.co.nz/>.  
[ ];  
[ ].

**Figure 8.1 Typical supply process between major grocery retailer and supplier**



Source: Independent review of the Food and Grocery Code of Conduct by Professor Graeme Samuel<sup>714</sup>

8.17 A supplier may approach a retailer’s relevant Category Manager, or vice versa, to initiate discussions.<sup>715</sup> If agreement is reached, the supplier will typically enter into a supply contract with the retailer, reflecting the retailer’s standard terms of trade.<sup>716</sup>

8.18 The supply contract specifies the terms on which suppliers provide products to grocery retailers. For example, it may include details regarding:

8.18.1 payment or settlement terms;

<sup>714</sup> Professor Graeme Samuel “Independent Review of the Food and Grocery Code of Conduct: Final Report” (September 2018), Figure 2.2, available at <https://treasury.gov.au/sites/default/files/2019-03/Independent-review-of-the-Food-and-Grocery-Code-of-Conduct-Final-Report.pdf>.

<sup>715</sup> A category manager is a member of a retailer’s buying team that engages with suppliers in a particular product category to negotiate trading terms and conditions.

<sup>716</sup> [ ];  
[ ];  
[ ];

8.18.2 whether products are to be delivered to a distribution centre or direct to store; and

8.18.3 any discounts or rebates the supplier is to deduct off its list price.

8.19 Retailers assess supplier performance regularly as part of the category review process.<sup>717</sup> In a category review, a retailer will consider the mix of products it stocks in the product category. Changes may be made to shelf-space allocation based on the performance of existing products. Some products may be delisted to make way for new or more profitable products.

### **Bargaining power and buyer power are relevant when considering suppliers' relationships with retailers**

8.20 Retailers' relationships with suppliers can generally be considered within two main frameworks.<sup>718</sup>

8.20.1 **Market framework.** This is where there are many suppliers, and all retailers pay their suppliers a single market price for the product.

8.20.2 **Bargaining framework.** This is where retailers have relatively fewer suppliers in a product category, with prices and other terms being negotiated bilaterally between retailers and suppliers.

8.21 Most retailer-supplier relationships within the grocery sector fit within a bargaining framework. Grocery retailers and their suppliers typically enter into bilateral supply agreements, which detail the specific terms on which products will be supplied. Bargaining power and buyer power are key concepts within this bargaining framework.

8.22 Bargaining power refers to the ability of parties in a negotiation to exert influence over each other. The extent of any bargaining power imbalances between grocery retailers and their suppliers will depend on the relative negotiating positions when entering bilateral negotiations.

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<sup>717</sup> Foodstuffs NI stated "Shelf space is a finite resource in our stores, FSNI follows a constant range review process to ensure we are offering a range that meets our customers' needs"

[ ];

[ ];

[ ].

<sup>718</sup> Paul W. Dobson & Ratula Chakraborty "Buyer Power in the U.K. Groceries Market" *The Antitrust Bulletin: Vol. 53, No. 2/Summer 2008* at 337, [ ].

- 8.23 Outside options available to suppliers and retailers are a key factor in determining their relative bargaining positions. An outside option is the best option that either the seller or buyer can achieve if they walk away from the negotiations.<sup>719</sup>
- 8.24 Buyer power occurs where retailers have a stronger bargaining position than suppliers, allowing them to extract better terms (such as lower prices) than would be expected in a competitive market. This could occur where a retailer has better outside options than a supplier. In economic terms Noll (2005) describes buyer power as:<sup>720</sup>
- ... the circumstance in which the demand side of a market is sufficiently concentrated that buyers can exercise market power over sellers. A buyer has market power if the buyer can force sellers to reduce price below the level that would emerge in a competitive market.
- 8.25 While Noll's definition focusses on the ability of a buyer to reduce prices below those in a competitive market, prices are just one dimension of competition in a market. A buyer's ability to exercise market power over sellers in other ways is also relevant. For example, this could include influencing the quality of goods or the allocation of risk.
- 8.26 The relative bargaining power held by grocery retailers and their suppliers is likely to be a key driver of the terms on which retailers acquire grocery products. Retailer buyer power could mean that suppliers accept different terms than they would if negotiating positions were more even.

### **The impact of bargaining power imbalances depends on the circumstances**

- 8.27 Buyer power can be a driver of efficiency and good outcomes for consumers. If there is an imbalance in bargaining power, grocery retailers may be able to obtain better purchasing terms (for example, lower prices) than if suppliers had alternative means of selling their goods in New Zealand.
- 8.28 Consumers would benefit if these better wholesale purchasing terms lead to lower retail prices and improved quality or variety. This relies on retailers flowing better wholesale terms through to their retail offering, often referred to as 'pass-through' of cost savings. The extent to which consumers benefit depends on the strength of competition between grocery retailers.

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<sup>719</sup> ACCC "Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries" (July 2008) at 312, available at:

<https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf>.

<sup>720</sup> Roger G. Noll "'Buyer power' and economic policy" *SIEPR Discussion Paper No. 04-08* (March 2005) at 589, available at:

[https://www.researchgate.net/publication/254130874\\_Buyer\\_Power\\_and\\_Economic\\_Policy](https://www.researchgate.net/publication/254130874_Buyer_Power_and_Economic_Policy).

- 8.29 There is also the potential for consumers to benefit if powerful buyers develop long-term relationships with suppliers and invest jointly with them.<sup>721</sup>
- 8.30 However, even with strong retail competition, it is possible that too much buyer power in the hands of retailers could lead to worse outcomes for consumers.
- 8.30.1 Buyer power might suppress investment by suppliers in process and product innovation, if lower prices paid by retailers or the transfer of excessive risks reduce suppliers' expected returns from this investment. This could lead to reduced choice and quality for consumers.<sup>722</sup>
- 8.30.2 A retailer may seek to use its strong bargaining position to enter into restrictive supply arrangements, which limit a supplier's ability to sell its products via other retailers. This could reduce retail competition, ultimately leading to higher prices, less choice and lower product quality for consumers.
- 8.31 The more effective competition is at the retail level, the less likely it is that retailers having significant buyer power will ultimately harm consumers. A more competitive retail market will increase the likelihood of any benefits retailers obtain from buyer power being passed through to consumers. Conversely, if retail competition is relatively weak, buyer power might result in higher profitability for grocery retailers and worse outcomes for suppliers and consumers.
- 8.32 In addition, the more competition there is at the retail level of the grocery market, the less likely it is that retailers will have significant buyer power. This is because more retailers operating in a market provides additional options for a supplier to sell its products to, improving its negotiating position.<sup>723</sup>

### **Buyer power is a common issue considered in overseas grocery market studies**

- 8.33 Retailer buyer power has previously been considered in overseas grocery market studies. This issue has been highlighted in studies undertaken in the UK, Australia, South Africa, Spain and Portugal.

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<sup>721</sup> ACCC "Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries" (July 2008) at 319, available at: <https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf>.

<sup>722</sup> Paul W. Dobson & Ratula Chakraborty "Buyer Power in the U.K. Groceries Market" *The Antitrust Bulletin: Vol. 53, No. 2/Summer 2008* at 344-345, [ ].

<sup>723</sup> This focuses on the balance of bargaining power between retailers and suppliers. Greater retail competition could also be expected to lead to lower retail prices, and therefore downwards pressure on wholesale prices.

- 8.34 The UK Competition Commission was concerned about the transfer of excessive risk and unexpected costs by grocery retailers to their suppliers through various supply chain practices. It noted that if unchecked, this will have an adverse effect on investment and innovation in the supply chain, and ultimately on consumers.<sup>724</sup>
- 8.35 The ACCC noted in its 2008 grocery market inquiry that competition was not sufficiently strong at the retail level to ensure that consumers always benefitted from buyer power in the form of lower retail prices. However, it found that there was little evidence to substantiate anecdotal allegations of buyer power being exercised in an anticompetitive or unconscionable manner.<sup>725</sup>
- 8.36 In the ACCC's subsequent perishable agriculture goods inquiry, it identified a range of potentially harmful practices associated with bargaining power imbalances and market failures. This included contract terms that inefficiently allocate risk and supermarkets requiring cost offsets. The ACCC noted that while hard bargaining between retailers and suppliers is an inherent aspect of commercial dealings, it has concerns where behaviours move beyond this to create potentially harmful impacts on markets.<sup>726</sup>
- 8.37 The South African Competition Commission noted that national retail chains have used their buyer power to demand rebates to cover the costs of certain retail store-level activities, such as merchandising, store openings and refurbishment, advertising and promotion, access to shelf space and category management. These rebates were not available to wholesalers and independent buying groups servicing independent retailers, placing them at a material competitive disadvantage.<sup>727</sup>

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<sup>724</sup> UK Competition Commission "The supply of groceries in the UK market investigation" (30 April 2008) at [3], available at:

[https://webarchive.nationalarchives.gov.uk/20140402235418/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep\\_pub/reports/2008/fulltext/538.pdf](https://webarchive.nationalarchives.gov.uk/20140402235418/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/538.pdf).

<sup>725</sup> ACCC "Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries" (July 2008) at 325, available at:

<https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf>.

<sup>726</sup> ACCC "Perishable agricultural goods inquiry" (November 2020) at x and xiii, available at:

<https://www.accc.gov.au/system/files/Perishable%20Agricultural%20Goods%20Inquiry%20-%20Final%20Report%20-%20December%202020.pdf>.

<sup>727</sup> South African Competition Commission "The grocery retail market inquiry" (25 November 2019) at [66], available at: <http://www.compcom.co.za/wp-content/uploads/2019/12/GRMI-Non-Confidential-Report.pdf>.

8.38 The Spanish and Portuguese Competition Authorities also highlighted several areas of concerns regarding buyer power.

8.38.1 The Spanish Competition Authority referred to: 1) unpredictable commercial payments, 2) not putting contract terms and conditions in writing, 3) requiring suppliers to provide excessive information regarding new products, 4) MFN clauses, and 5) retailers demanding information on suppliers interactions with other retailers.<sup>728</sup>

8.38.2 The Portuguese Competition Authority referred to: 1) the unilateral imposition of terms and conditions, 2) discounts and related mechanisms, 3) penalties and 4) payment terms.<sup>729</sup>

8.39 Buyer power is likely to be greater in markets with fewer retailers, as suppliers have fewer options for selling their products. Given that suppliers generally have fewer large retailers to sell to in New Zealand than the countries referred to above, it is possible that New Zealand's major grocery retailers possess greater buyer power than in these overseas studies.<sup>730</sup>

#### **We investigated interactions between a grocery retailer and its suppliers in 2014**

8.40 We previously considered interactions between Progressive Enterprises (now Woolworths NZ) and its suppliers in a 2014 investigation. However, this was not in the context of a market study. Rather, this investigation considered whether Progressive Enterprises breached either the FTA or the Act through some of its business practices.

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<sup>728</sup> Comisión Nacional de la Competencia "Report on the relations between manufacturers and retailers in the food sector" (October 2011) at 133-134, available at: [https://www.cnmc.es/sites/default/files/1186012\\_7.pdf](https://www.cnmc.es/sites/default/files/1186012_7.pdf).

<sup>729</sup> Portuguese Competition Authority "Final Report on Commercial Relations Between the Large Retail Groups and their Suppliers (Abridged English Version)" (October 2010) at 6, available at: [http://www.concorrenca.pt/SiteCollectionDocuments/Estudos\\_e\\_Publicacoes/Outros/AdC\\_Relatorio\\_Final\\_Distribuicao\\_Fornecedores\\_Outubro\\_2010\\_en.pdf](http://www.concorrenca.pt/SiteCollectionDocuments/Estudos_e_Publicacoes/Outros/AdC_Relatorio_Final_Distribuicao_Fornecedores_Outubro_2010_en.pdf).

<sup>730</sup> As noted in paragraph 8.48, most estimates of the combined shares of supply for New Zealand's major grocery retailers are between 80% and 90%. In comparison, the combined market shares of the two largest retailers reported in the overseas studies were: 42% in the 2008 UK Competition Commission study, 54% in the 2008 ACCC study, 65% in the 2020 ACCC perishable agricultural goods study, 46% in the 2011 Spanish study, and 45% in the 2010 Portuguese study. The 2019 South African study noted that the top 5 largest retailers had a combined market share of 64%.

[ ]

- 8.41 We investigated five matters, concluding in each case that the conduct was unlikely to be unlawful. The five matters we investigated were whether Progressive Enterprises:<sup>731</sup>
- 8.41.1 sought payments and/or improved performance from some suppliers to compensate Progressive Enterprises for lack of profits in the previous year under improper threat of commercial sanction;
  - 8.41.2 dealt with suppliers in a misleading or deceptive manner by making deductions from supplier invoices or seeking payments to which Progressive Enterprises was not entitled under its contracts with suppliers, or otherwise misrepresenting its entitlement to do so;
  - 8.41.3 sought or received information about the future pricing and promotional intentions of its competitors, or otherwise engaged in conduct that might reduce competition with other retailers;
  - 8.41.4 used improper threats of commercial sanction or took advantage of a substantial degree of market power by refusing to accept wholesale price increases; or
  - 8.41.5 favoured its transportation subsidiary over other transportation providers to gain a competitive advantage.
- 8.42 While our view was that Progressive Enterprises' conduct was not likely to be unlawful, we identified two areas where we reminded parties to take particular care.<sup>732</sup>
- 8.42.1 The first was that parties should avoid ambiguity in communications and written terms of trade (especially standard form documents). Precision and clarity of meaning, purpose, and intention avoids ambiguity that can have the potential to mislead.
  - 8.42.2 The second was exchanging information about future competitor behaviour, or discussing supplier interactions with a competitor. These types of exchanges create an environment in which anticompetitive agreements or conduct can easily emerge.

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<sup>731</sup> Commerce Commission "Progressive Enterprises Limited: investigation closure report" (20 November 2014) at [10], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf).

<sup>732</sup> Commerce Commission "Progressive Enterprises Limited: investigation closure report" (20 November 2014) at [29], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf).



### **We undertook a survey to build our understanding of the issues facing suppliers**

- 8.43 As part of our study, we undertook a survey of suppliers (our supplier survey) to seek their views on the New Zealand grocery market. We particularly sought views on suppliers' trading relationships with grocery retailers.
- 8.44 The survey enabled us to seek the views of a wide range of suppliers and identify common themes. We received 126 responses to our supplier survey.<sup>733</sup> These respondents:
- 8.44.1 supply across a wide range of grocery retailers, wholesalers and product categories; and
  - 8.44.2 vary significantly in size, as measured by the number of products (SKUs) they supply and sales revenues in New Zealand.
- 8.45 Other key sources of information we have relied on when assessing the acquisition of groceries by major grocery retailers are listed below.
- 8.45.1 We held meetings with over 25 suppliers and supplier associations.<sup>734</sup> Meetings were held with a range of organisations we contacted to seek views, and organisations which pro-actively contacted us. We also held meetings with some respondents to our supplier survey to seek further details regarding comments made.
  - 8.45.2 Information provided by retailers regarding their grocery procurement practices in response to our information requests. This includes strategy documents and copies of supply agreements between major grocery retailers and their suppliers.
  - 8.45.3 Information about interactions between retailers and suppliers provided to us by industry participants.<sup>735</sup>
  - 8.45.4 Submissions on our preliminary issues paper, including surveys undertaken by the NZFGC and Horticulture NZ.
- 8.46 Further information on our supplier survey is contained in Attachment G.

### **Do grocery retailers have buyer power in the acquisition of groceries?**

- 8.47 This section considers the relative bargaining power between New Zealand grocery retailers and their suppliers, particularly whether retailers have market power in the acquisition of groceries. It notes that:
- 8.47.1 major grocery retailers are a key route to market for many suppliers;

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<sup>733</sup> See Attachment G for further details regarding our supplier survey.

<sup>734</sup> [ ].

<sup>735</sup> [ ].

- 8.47.2 some suppliers have stronger relative bargaining power than others;
- 8.47.3 suppliers generally have limited ability to negotiate with the major grocery retailers; and
- 8.47.4 there appears to be little recourse for suppliers who encounter difficulties with retailers.

### **Major grocery retailers are a key route to market for many suppliers**

- 8.48 Suppliers are often dependent on major grocery retailers as their main route for selling their products to consumers. The majority of grocery products purchased by New Zealand consumers are sold by the major grocery retailers. As discussed in Chapter 5, most estimates of the combined shares of supply for the major grocery retailers are between 80% and 90% for 2015 to 2019.<sup>736</sup>
- 8.49 Many suppliers we heard from indicated that they are dependent on the major grocery retailers for sales of their products. Although our supplier survey is not representative, suppliers' dependence on the major grocery retailers was highlighted in the responses we received.<sup>737</sup> This is consistent with what we heard in meetings we held with suppliers.<sup>738</sup>
- 8.50 Alternative sales channels are available for some suppliers. The alternative sales channels may include:
- 8.50.1 specialist grocery stores;
  - 8.50.2 convenience stores;
  - 8.50.3 meal kit providers;
  - 8.50.4 foodservice wholesalers;
  - 8.50.5 exports to overseas markets; and
  - 8.50.6 direct to customer sales.
- 8.51 These alternative channels are likely to be more viable for some suppliers than others. For example, suppliers of snack foods and soft drinks may be able to sell significant volumes of their products through convenience stores.

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<sup>736</sup> Some estimates are slightly lower, see paragraphs 5.89 to 5.93 for further details.

<sup>737</sup> [

<sup>738</sup> [

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- 8.52 However, the ability for most suppliers to transfer significant volumes to alternative sales channels or to diversify their customer base is limited by the structure of the retail grocery sector. As discussed in Chapter 4 and Chapter 5, other grocery retailers typically have modest volumes because they target specific customers rather than competing directly with the major grocery retailers. They are also generally perceived by consumers to have limited geographic coverage and be more expensive than the major grocery retailers for some products.<sup>739</sup>
- 8.53 Given that the majority of grocery products are sold by the major grocery retailers, alternative channels are unlikely to generate sufficient sales for most suppliers to operate profitably. In addition, there may be timing challenges if a supplier sought to significantly grow its sales through alternative channels.<sup>740</sup>
- 8.54 In our supplier survey and in meetings with some suppliers, we asked suppliers what they would do if the major grocery retailers they supply were no longer able or willing to stock their products. While some suppliers indicated that they would look to develop alternative sales channels, the majority indicated that their business would be unsustainable and they would be likely to exit the New Zealand market.<sup>741</sup>

#### **Some suppliers have stronger relative bargaining power than others**

- 8.55 The major grocery retailers submitted that many suppliers have countervailing power when dealing with retailers.<sup>742</sup>
- 8.56 We agree that this is true for some suppliers, and more generally consider there are a range of factors which can potentially affect a supplier's bargaining position. These include:<sup>743</sup>
- 8.56.1 **Ability to export:** 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 is an example, where a large proportion of production from New Zealand suppliers is sold into overseas markets.<sup>744</sup>

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<sup>739</sup> See paragraphs 4.22 and 5.39 to 5.60.

<sup>740</sup> [ ].

<sup>741</sup> [ ].

<sup>742</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2020) at 33; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 21; Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2020) at 42-43.

<sup>743</sup> These are possible examples of factors which may affect retailers' and suppliers' relative bargaining positions. In practice, the balance of bargaining power will depend on the specific circumstances regarding the product or supplier in question.

<sup>744</sup> [ ].

- 8.56.2 **Availability of other domestic sales channels:** Suppliers of products with a significant proportion of sales through other domestic channels may also be in a stronger position when negotiating with grocery retailers. Examples of these alternative channels may include foodservice wholesalers, convenience stores, or direct to customer sales (for example via a supplier’s own website).
- 8.56.3 **Strength of a supplier’s brand:** Suppliers of products carrying well-known brands, which consumers consider to be ‘must have’, may have a stronger negotiating position. Retailers’ outside options may be weaker, given the limited ability to substitute these brands with other products.
- 8.56.4 **Number of suppliers in a product category:** Retailers will be more dependent on certain suppliers in product categories where there are limited alternative suppliers available.
- 8.56.5 **Product perishability:** Suppliers of some perishable products appear to be particularly vulnerable when dealing with grocery retailers. Suppliers of highly perishable products have limited ability to delay or withhold supply while seeking to negotiate better supply terms.<sup>745</sup>
- 8.57 The vulnerability of suppliers of perishable products was highlighted in submissions on our preliminary issues paper. Horticulture NZ referred to the power differential between supermarkets and growers suggesting that retailers earn higher margins on fresh vegetables than other product categories.<sup>746</sup> T&G Fresh submitted that:<sup>747</sup>

When fresh produce is grown, it must be sold quickly because of its perishability. Unlike other industries, in fresh produce you can’t pause production because demand is low or pricing isn’t so good. You are at the mercy of mother nature, the market, and prices change daily due to supply and consumer demand.

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<sup>745</sup> ACCC “Perishable agricultural goods inquiry” (November 2020) at 55, available at: <https://www.accc.gov.au/system/files/Perishable%20Agricultural%20Goods%20Inquiry%20-%20Final%20Report%20-%20December%202020.pdf>.

<sup>746</sup> Horticulture NZ “Submission on retail grocery market study preliminary issues paper” (9 February 2021) at 2.

<sup>747</sup> T&G Fresh “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 2.

- 8.58 Our preliminary view is that, in most cases, there appears to be an imbalance of bargaining power in favour of the major grocery retailers. While some suppliers – particularly large suppliers of well-known brands – will be in a relatively strong bargaining position compared to other suppliers, this is relatively rare.<sup>748</sup> Even large suppliers with strong brands are dependent on supermarkets to access New Zealand consumers.<sup>749</sup>
- 8.59 Suppliers with better bargaining positions could be expected to have greater ability to negotiate terms of supply which differ from a retailer’s standard terms of trade. When requesting copies of supply agreements from the major grocery retailers, we asked them to identify those which vary significantly from their standard terms. A very small number of these agreements were identified, relative to the overall number of suppliers.<sup>750</sup>

### **Suppliers generally have limited ability to negotiate with the major grocery retailers**

- 8.60 Major grocery retailers have lots of suppliers, but the majority are small. For example, Woolworths NZ noted that it partners with over 1,400 suppliers, with more than 900 being small suppliers with retail sales in Countdown of less than \$1m per annum.<sup>751</sup> Foodstuffs NI and Foodstuffs SI combined have trading relationships with over 3,500 product suppliers.<sup>752</sup>
- 8.61 In many cases suppliers are likely to be more dependent on the major grocery retailers than the retailers are on particular suppliers. As noted above, the strength of relative bargaining positions depends on the value of each party’s outside options.
- 8.61.1 For suppliers with few outside options other than to supply to major grocery retailers, the cost of walking away from negotiations with a supermarket is high – significant lost sales.
- 8.61.2 In contrast, the cost to a major grocery retailer of walking away from negotiations with most suppliers is relatively low unless there are no other suppliers of those products to deal with.<sup>753</sup>

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<sup>748</sup> Woolworths NZ noted: [ ], Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 42-43. [ ]

<sup>749</sup> Consumers International “The relationship between supermarkets and suppliers: What are the implications for consumers?” (July 2012) at 3, [ ]

<sup>750</sup> [ ]. As noted in paragraph 8.60 below, the major grocery retailers have thousands of suppliers.

<sup>751</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 1, 41.

<sup>752</sup> Foodstuffs NI “Becoming a Supplier” <https://supplierhelp.foodstuffs.co.nz/en/article/becoming-a-supplier>.

<sup>753</sup> As discussed in paragraphs 8.55 to 8.59 above, some suppliers have stronger outside options than others.

8.62 Dobson and Chakraborty (2008) describe retailers' and suppliers' relative dependence on each other as follows.<sup>754</sup>

...in terms of relative bargaining power, the leading retailers may find it straightforward and inexpensive to switch suppliers (especially for commodity/private-label goods, but more generally where shelf space can be reallocated across product categories without losing significant custom), and thus switching costs in these circumstances may be expected to be relatively low as long as alternative suppliers exist with sufficient capacity. In contrast, were a supplier to lose its contract with one of the major retailers, it would normally be quite difficult in the short term to replace that lost volume with other retailers (given that these retailers would be unlikely to take on additional supplies significantly over and above their existing contracts), meaning that its own switching costs could be relatively high.

8.63 Nevo and Van den Bergh (2017) refer to large retailers as a potential bottleneck which can hinder suppliers' access to consumers.<sup>755</sup>

In modern retailing markets, large retailers may occupy a 'bottleneck' position that allows them to control the interaction of brands. In upstream markets, where manufacturers sell to retailers, the latter may use their superior bargaining position to extract favourable contract terms from the former. In downstream markets, where retailers sell to end-consumers, vertically integrated supermarkets may prioritize their private labels to the detriment of branded goods. In extreme cases, powerful retailers may refuse access to the 'bottleneck', thus hindering the access of brand manufacturers to end-consumers.

8.64 Suppliers' lack of ability to negotiate with retailers was a key theme in responses to our supplier survey.<sup>756</sup> Examples of comments we received are listed below.

8.64.1 "We have two choices 1) sell to them under their terms 2) don't sell to them at all".<sup>757</sup>

8.64.2 "No ability to negotiate. We are price takers."<sup>758</sup>

8.64.3 "It's pretty much sign this document, or don't supply".<sup>759</sup>

8.64.4 "Negotiations are one sided, as the retailers have all the power to either delete or keep our products on shelf. It is a very competitive market and the supplier who gives them the most, gains the most, even if product quality suffers."<sup>760</sup>

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<sup>754</sup> Paul W. Dobson & Ratula Chakraborty "Buyer Power in the U.K. Groceries Market" *The Antitrust Bulletin: Vol. 53, No. 2/Summer 2008* at 341-342.

<sup>755</sup> Nevo, Hila & Van den Bergh, Roger "Private Labels: Challenges for Competition Law and Economics" *World Competition* 40, no. 2 (2017) at 272, [ ].

<sup>756</sup> [ ].

<sup>757</sup> [ ].

<sup>758</sup> [ ].

<sup>759</sup> [ ].

<sup>760</sup> [ ].

- 8.65 Small suppliers may be more likely to be disadvantaged in terms of the resources and sophistication they can bring to negotiations with retailers. They may be more likely to settle for less favourable terms than suppliers with more resources.
- 8.66 Suppliers who lack the ability to negotiate may effectively be offered ‘take it or leave it’ contracts that enable retailers to extract almost all of the value of the trading relationship. Suppliers have little option other than to accept these terms or walk away.

**There appears to be little recourse for suppliers who encounter difficulties with retailers**

- 8.67 Suppliers who encounter difficulties when trading with the major grocery retailers appear to have limited ability to resolve disputes. While the major grocery retailers have charters containing principles for how they interact with suppliers, suppliers have told us that these do not appear to be effective.<sup>761</sup>
- 8.68 The major grocery retailers highlighted the supplier charters they have implemented in submissions on our preliminary issues paper.<sup>762</sup> For example:
- 8.68.1 Woolworths NZ said that its supplier charter cements its “commitment to working with our suppliers fairly, honestly, and transparently”;<sup>763</sup>
- 8.68.2 Foodstuffs NI stated that it “values its supplier relationships, invests time and endeavours to always act consistently with the Supplier Relationship Charter”;<sup>764</sup> and
- 8.68.3 Foodstuffs SI stated that it “values its supplier relationships and acts consistently with the Supplier Relationship Charter”.<sup>765</sup>

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<sup>761</sup> [ ].

<sup>762</sup> Foodstuffs NZ “Supplier Relationship Charter”, available at: [https://suppliers.foodstuffs.co.nz/assets/documents/Supplier\\_relationship\\_charter.pdf](https://suppliers.foodstuffs.co.nz/assets/documents/Supplier_relationship_charter.pdf); Woolworths NZ “Woolworths New Zealand Supplier Charter”, available at: <https://www.countdown.co.nz/media/9959/wwnz-supplier-charter-180618.pdf>.

<sup>763</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 41-42.

<sup>764</sup> Foodstuffs NI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 32.

<sup>765</sup> Foodstuffs SI “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 22.

- 8.69 The NZFGC, on the other hand, submitted that the major grocery retailers' supplier charters are "largely symbolic":<sup>766</sup>

The supplier community does not view the charters as living documents providing robust frameworks to deal with business relationships.

...

The charters are not seen to be honoured or carried out in practice. Suppliers do not feel able to use them or have faith that even if they do it will result in a fair outcome. For example, in the case of Foodstuffs suppliers are expected to contact the CEOs or the Foodstuffs lawyer. This is a daunting prospect for particularly small suppliers who will never have had the opportunity to meet them before and then be expected to make contact about a complaint.

- 8.70 We understand that relatively few complaints are made under these charters.<sup>767</sup> While this could be because suppliers encounter few issues when dealing with retailers, this seems unlikely given the wide range of concerns about retailer conduct that we have heard from suppliers during our study.

- 8.71 Some suppliers may be reluctant to raise complaints or enforce their rights due to fear of retribution, where complaints are required to be made directly to the retailer itself.<sup>768</sup>

8.71.1 Under the Foodstuffs charter, complaints are to be raised with the relevant Category Manager, Business Category Manager, or usual contact in the first instance. Complaints can be escalated to the General Manager of Merchandise, then the relevant CEO, if unresolved.<sup>769</sup>

8.71.2 Under the Woolworths NZ charter, the supplier is first required to try to resolve a dispute with the category team at Woolworths NZ. Unresolved disputes can then be sent to the Managing Director.<sup>770</sup>

### **Are retailers exercising buyer power and what is the effect?**

- 8.72 This section considers whether New Zealand's grocery retailers are exercising buyer power, and if so, the effect this has on outcomes for consumers. It notes that:

8.72.1 we have heard examples of positive feedback from suppliers on retailers;

8.72.2 retailer behaviour varies by retail banner, store, and over time;

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<sup>766</sup> NZFGC "Comments on submissions on preliminary issues paper" (12 April 2021) at [6.5]-[6.6].

<sup>767</sup> [ ];

[ ];

<sup>768</sup> [ ].

<sup>769</sup> Foodstuffs NZ "Supplier Relationship Charter" at 3, available at: [https://suppliers.foodstuffs.co.nz/assets/documents/Supplier\\_relationship\\_charter.pdf](https://suppliers.foodstuffs.co.nz/assets/documents/Supplier_relationship_charter.pdf).

<sup>770</sup> Woolworths NZ "Woolworths New Zealand Supplier Charter" at [5.3]-[5.4], available at: <https://www.countdown.co.nz/media/9959/wnnz-supplier-charter-180618.pdf>.



- 8.72.3 suppliers are concerned about the threat of having their products delisted by retailers;
- 8.72.4 we have categorised potentially harmful conduct by retailers into three main themes:
  - 8.72.4.1 transfer of costs and risks from retailers to suppliers;
  - 8.72.4.2 lack of transparency and certainty over terms of supply; and
  - 8.72.4.3 retailers limiting suppliers' ability or incentive to provide favourable supply terms to other retailers; and
- 8.72.5 there appears to be limited pass-through of cost reductions to consumers.

### **We have heard examples of positive feedback from suppliers about retailers**

- 8.73 We heard many examples from suppliers of the major grocery retailers positively affecting their businesses, and we acknowledge that many suppliers have good relationships with the retailers they supply. Examples of the themes we heard include retailers:<sup>771</sup>
  - 8.73.1 providing greater product exposure by supporting promotions and displays;
  - 8.73.2 ranging new products and supporting innovative ideas;
  - 8.73.3 helping to grow supplier businesses through common strategies and joint business plans; and
  - 8.73.4 using insights from shopper data to identify customer demand and sales patterns.<sup>772</sup>
- 8.74 The major grocery retailers have noted that they value their supplier relationships, referring to the time they invest in them.<sup>773</sup>

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<sup>771</sup> [ ].

<sup>772</sup> For example, a supplier noted that purchasing these data could enable it to help understand consumer behaviour such as switching, [ ]. Another supplier noted it had not purchased any of these insights as it is "really expensive". [ ].

<sup>773</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 32; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 22; Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 40-46.

8.75 Another theme is that suppliers generally speak positively of their trading relationships with smaller grocery retailers such as Farro Fresh, Moore Wilson’s and Commonsense Organics.<sup>774</sup> A supplier told us that this is because there is less power imbalance between suppliers and these smaller grocery retailers.<sup>775</sup>

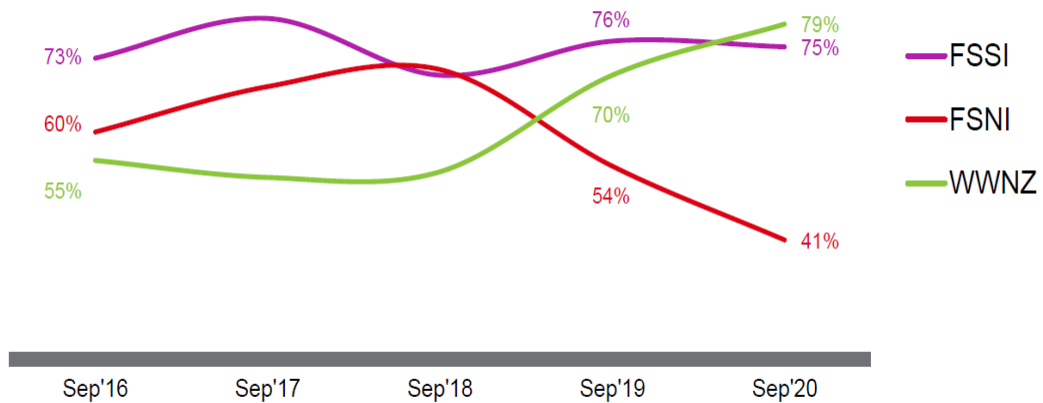
**Retailer behaviour varies by retail banner, store, and over time**

8.76 The majority of feedback we received from suppliers has focussed on potentially harmful conduct undertaken by retailers.<sup>776</sup> The range of complaints we received varies by different retail banners and sometimes individual stores.

8.77 Retailer behaviour also changes over time. Certain companies may be the focus of supplier complaints at any given time.

8.78 The 2020 Nielsen Retail Barometer survey, which measures supplier sentiment, highlights changes in suppliers’ trading relationships with the major grocery retailers over time. The percentage of survey respondents who rated their overall trading relationship with each retailer as ‘good’ or ‘excellent’ is shown in Figure 8.2 below.<sup>777</sup>

**Figure 8.2 Overall trading relationship by retailer – Good and excellent**



Source: Nielsen Retail Barometer 2020.<sup>778</sup>

<sup>774</sup> [ ].  
<sup>775</sup> [ ].  
<sup>776</sup> We sought views on both positive and negative experiences suppliers have had with the retailers and wholesalers they supply. As noted in paragraphs 8.73 to 8.74 above, we also heard examples of positive experiences. [ ].  
<sup>777</sup> This survey includes a 5-point scale of poor, below average, average, good and excellent.  
<sup>778</sup> [ ].

- 8.79 Of the respondents to the NZFGC’s members survey, nine in 10 relate commercial dealing ‘challenges’ with Foodstuffs NI.<sup>779</sup> Foodstuffs NI is currently implementing a new centralised buying model, which has raised concerns for many suppliers.<sup>780</sup> These changes may have been prominent in the minds of respondents. However, we also acknowledge that some suppliers have positive relationships with Foodstuffs NI.<sup>781</sup>
- 8.80 Previously concerns had been raised about Countdown’s business practices when dealing with some suppliers. These concerns were considered in our 2014 Progressive Enterprises investigation.<sup>782</sup>

### **Suppliers are concerned about the threat of having their products delisted by retailers**

- 8.81 Given many suppliers’ dependence on grocery retailers for sales of their products, the possibility of having products delisted appears to be a major risk to their businesses. The threat of delisting a supplier’s products is a possible way a retailer could use its bargaining power to encourage a supplier to agree to its terms.
- 8.82 Retailers delisting products is not a problem in itself. It is reasonable for a retailer to seek to delist poorly performing products, where this is based on genuine commercial reasons.<sup>783</sup> However, threats of delisting are potentially an issue where they are used to encourage suppliers to agree to terms which could reduce competition, either between retailers or suppliers.
- 8.83 Threats of delisting suppliers’ products appear to be very common. The NZFGC’s survey of its members found that 82% of respondents have been threatened with deletion for not agreeing to a retailer’s terms or margins.<sup>784</sup>
- 8.84 We have heard examples of suppliers allegedly being threatened with delisting of their products by the major grocery retailers, or facing other consequences, where:<sup>785</sup>
- 8.84.1 a supplier is refusing to agree to changes to a supply contract proposed by a retailer;

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<sup>779</sup> Blackmarket Research “Project: NZFGC, Hexis Quadrant: NZFGC members survey” (February 2021), slide 15. 159 NZFGC members responded to the survey.

<sup>780</sup> [ ]; [ ].

<sup>781</sup> For example, 77% of exhibitors who completed an online survey after the 2021 Foodstuffs Expo reported a positive relationship with Foodstuffs NI. [ ].

<sup>782</sup> Commerce Commission “Progressive Enterprises Limited: investigation closure report” (20 November 2014), available at: [https://comcom.govt.nz/data/assets/pdf\\_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf](https://comcom.govt.nz/data/assets/pdf_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf). See paragraphs 8.40 to 8.42 above for further discussion.

<sup>783</sup> For example, this could include failure to meet agreed quality or quantity requirements, failure to meet agreed commercial sales or profitability targets, or persistent failure to agreed delivery requirements.

<sup>784</sup> Blackmarket Research “Project: NZFGC, Hexis Quadrant: NZFGC members survey” (February 2021), slide 23, 35. We were not consulted in the design of this survey, given it was undertaken on behalf of the NZFGC.

<sup>785</sup> [ ].

- 8.84.2 a supplier's products are not meeting the retailer's margin expectations; or
  - 8.84.3 a supplier attempts to increase its prices.
- 8.85 We have been told that threats of delisting are often not expressed explicitly, but suppliers can perceive certain comments as implied threats. For example, we understand that retailers often use language such as:
- 8.85.1 "you are risking your position in the category";<sup>786</sup>
  - 8.85.2 "you have a long tail of products that look vulnerable";<sup>787</sup> or
  - 8.85.3 please contact us so we can "guide you through the full implications".<sup>788</sup>

**We have categorised potentially harmful conduct by retailers into three main themes**

- 8.86 In this study we have grouped feedback received from suppliers into themes, rather than focussing on specific examples of conduct by particular retailers. The underlying balance of bargaining power between grocery retailers and suppliers, and how this ultimately affects consumers, is of greatest interest to us in this study. As one interviewee commented, significant changes in a retailer's behaviour towards its suppliers are "just a leadership change away".<sup>789</sup>
- 8.87 We expect that retailers will negotiate hard to get the best deals they can from their suppliers. This is normal commercial practice for a business seeking to maximise its profits. It can also benefit consumers where better wholesale purchasing terms are passed through to retail prices.
- 8.88 However, we have heard examples which suggest that in some cases retailers are using their strong negotiating position (including threats of delisting) to:<sup>790</sup>
- 8.88.1 transfer retail costs and risks onto suppliers;
  - 8.88.2 reduce transparency and certainty over terms of supply; and
  - 8.88.3 limit suppliers' ability or incentive to provide favourable supply terms to other retailers.

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<sup>789</sup>

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These themes, including the potential impact on outcomes for consumers, are described in more detail in paragraphs 8.93 to 8.136 below.

- 8.89 Suppliers' incentives to innovate and invest are likely to be adversely affected by this conduct. Suppliers have highlighted the downwards pressure on their margins through their negotiations with the major grocery retailers, due to their relatively weak bargaining positions. For example, Horticulture NZ submitted:<sup>791</sup>
- The supermarket duopoly means growers have limited market opportunity for selling. This, as has been shown by our study, results in growers being unable to maintain their margins in the face of increasing costs.
- 8.90 Consumers are ultimately likely to be harmed by this conduct, for example through lower quality products and less choice. We have heard examples of:
- 8.90.1 reduced product quality, due to suppliers sourcing cheaper inputs when facing lower margins;<sup>792</sup>
  - 8.90.2 smaller pack sizes for products, due to suppliers seeking to reduce the cost per unit in response to margin pressure;<sup>793</sup>
  - 8.90.3 less choice for consumers due to lower investment by suppliers in research and development for new products;<sup>794</sup>
  - 8.90.4 factory closures leading to removal of products which were specific to the New Zealand market;<sup>795</sup> and
  - 8.90.5 products which were very popular among consumers in a product category being delisted because the supplier did not lower prices to meet a retailer's margin expectations.<sup>796</sup>
- 8.91 Some of the examples we have heard about during our study may appear relatively minor in isolation. However, our preliminary view is that when considered together, they suggest retailers are exercising buyer power in ways that are likely to ultimately harm consumers.

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<sup>791</sup> Horticulture NZ "Submission on retail grocery market study preliminary issues paper" (9 February 2021) at 2. Horticulture NZ also submitted that "the study should enquire into the margin that growers are receiving to ascertain whether anticompetitive pressures from the existing system are forcing unprofitable trading situations." Our profitability analysis (as discussed in Chapter 3 and Attachment C) focuses on grocery retailers. It is difficult to assess supplier profitability given the large number of suppliers and the wide range of products in the grocery sector.

<sup>792</sup> [ ].

<sup>793</sup> [ ].

<sup>794</sup> [ ].

<sup>795</sup> [ ].

<sup>796</sup> [ ].

8.92 Many of the examples discussed below are similar to issues raised by the NZFGC in its submission on our preliminary issues paper.<sup>797</sup> In response to this submission, Foodstuffs NI noted that it was “surprised by the allegations in the submissions, particularly given ... the range of forums designed to allow suppliers (including through the NZFGC on an anonymous basis) to raise the issues the submissions allege occur on a systemic basis”.<sup>798</sup> In this regard, as described above at paragraph 8.7, we appreciate that not all issues raised with us will necessarily have been raised previously with the major grocery retailers, and they may not yet have had an opportunity to comment on them.

### **Transfer of costs and risks from retailers to suppliers**

8.93 Appropriate risk allocation between parties is an important feature of well-functioning markets. It is normal for businesses to be exposed to risk. However, in a workably competitive market, risks tend to be allocated to the party best placed to manage them.<sup>799</sup>

8.94 Suppliers bearing costs and risks that they are not best placed to manage may adversely affect their ability to invest and innovate. This could lead to reduced capacity, reduced product quality and fewer new product offerings by suppliers.<sup>800</sup> Ultimately consumers are likely to face reduced choice and lower quality products.

8.95 Examples we have heard of retailers appearing to inefficiently transfer costs and risks onto suppliers include:

8.95.1 suppliers bearing costs and risks of retail promotional discounts, including overordering by retailers;

8.95.2 retailers expecting suppliers to pay for merchandising;

8.95.3 retailers seeking payments from suppliers for damaged, unsaleable, or lost stock that occurred while the retailers were in possession of the products; and

8.95.4 standard invoice settlement terms which include extended payment terms for retailers.

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<sup>797</sup> NZFGC “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at [174].

<sup>798</sup> Foodstuffs NI “Comments on submissions on preliminary issues paper” (12 April 2021) at 8.

<sup>799</sup> Commerce Commission “Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper” (22 December 2010) at [2.6.4] (bullet point 6), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0019/62704/EDB-GPB-Input-Methodologies-Reasons-Paper-Dec-2010.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0019/62704/EDB-GPB-Input-Methodologies-Reasons-Paper-Dec-2010.pdf).

<sup>800</sup> UK Competition Commission “The supply of groceries in the UK market investigation” (30 April 2008) at [9.5], available at: [https://webarchive.nationalarchives.gov.uk/20140402235418/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep\\_pub/reports/2008/fulltext/538.pdf](https://webarchive.nationalarchives.gov.uk/20140402235418/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/538.pdf).

*Suppliers bear the costs and risks of retail promotional discounts, including overordering by retailers*

- 8.96 Retailers and suppliers can both benefit from retail pricing promotions, because discounted prices can be expected to increase sales volumes for products on promotion.
- 8.97 Suppliers often fund retail pricing promotions. Suppliers have told us that when a retail pricing promotion is run, they can be expected to maintain the retailer's margin on the product.<sup>801</sup> However, we have also heard examples where promotional discounts are partially funded by the retailer.<sup>802</sup>
- 8.98 Supplier funding of promotions can operate in different ways. For example:
- 8.98.1 There can be a buy-in period in advance of a promotion, where the retailer purchases stock at a reduced price from the supplier. The retailer then drops its retail price during the promotional period.
- 8.98.2 Promotions can be run based on scanned volumes, where the supplier compensates the retailer for the cost of the promotion based on the actual volume of sales scanned through the checkout during the promotional period.
- 8.99 We have heard from suppliers that it is common for certain retailers to stockpile products purchased from a supplier at a reduced price during the buy-in period.<sup>803</sup> This is referred to as 'investment buying'. The retailer then earns extra margin on sales of these products after the promotional period ends, but the benefits to the supplier of increased sales volumes generated by the promotion are no longer available.<sup>804</sup>
- 8.100 Investment buying leads to significant fluctuations in volume, potentially creating supply chain inefficiencies for both suppliers and retailers.<sup>805</sup> A supplier needs to carefully manage its production facilities to ensure it is able to meet demand during peaks in order volumes.<sup>806</sup> Retailers need to store products they investment buy, reducing the space available for other products.

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801 [ ];

802 [ ].

803 [ ]; [ ].

804 Foodstuffs NI stated: "FSNI stores may forward buy products at the promotion cost price to enable stores to offer value to customers over a period longer than the specific promotion. Forward buying by a store is with the consent of the supplier and where the supplier is concerned a supplier may look to restrict the amount a store can purchase via an allocation of stock or a retrospective product cost price discount based on volume of retail sales (i.e., scan)"

805 [ ].

806 The supplier may also need to finance a lean period with reduced volumes until the next promotion.

8.101 Investment buying also potentially leads to a lack of transparency over prices paid to suppliers. We have heard of a retailer attempting to quantify the financial benefit they receive from investment buying, and then claiming an additional discount where they are not able to stock up.<sup>807</sup>

*Retailers expecting suppliers to pay for merchandising*

8.102 Some retailers appear to rely on significant merchandising support from suppliers.<sup>808</sup> Many suppliers have told us that they arrange their own merchandisers to go into retail grocery stores throughout New Zealand.

8.103 In most sectors, merchandising is a retailer’s responsibility. Key functions of merchandisers include stocking products on the shelves and preparing product displays. We have heard that in overseas grocery markets it is less common for suppliers to provide merchandising support than in New Zealand.<sup>809</sup>

8.104 We have been told that retailers rely on supplier merchandising as a way of keeping labour costs down.<sup>810</sup> Suppliers have an incentive to ensure their products are well stocked on grocery retailers’ shelves, given their businesses’ dependence on these sales volumes.

8.105 Some suppliers have told us that that they would prefer not to be involved in merchandising, as this is a retail activity that grocery retailers are able to undertake more efficiently.<sup>811</sup>

8.106 In some circumstances there may be inefficiencies in suppliers undertaking merchandising due to:<sup>812</sup>

8.106.1 the time and cost of travelling between retail grocery stores;

8.106.2 limited availability of backup staff (for example, due to illness); and

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- 8.106.3 a supplier's merchandisers dealing with a relatively narrow range of products (compared to a retailer who is able to merchandise across their full range).
- 8.107 However, other suppliers have indicated that they prefer to have their own merchandisers go into retailers' stores, because it gives them greater control over how their products are stocked and displayed. In some cases we have been told that this is due to a lack of trust in the retailer to do the merchandising well.<sup>813</sup>
- 8.108 Regardless of whether the retailer or supplier undertakes the merchandising, we understand that the supplier is often expected to meet the cost.<sup>814</sup>
- 8.108.1 Where a supplier employs or contracts its own merchandisers, the supplier will pay them directly.
- 8.108.2 Where the retailer undertakes the merchandising, the supplier may be expected to finance this (for example, through a discount or rebate).<sup>815</sup>
- 8.108.3 We are also aware of examples of retailers charging suppliers fees for not providing merchandising support.<sup>816</sup>
- 8.109 Merchandising fees charged by retailers may be high relative to the costs involved. A supplier told us that it is more affordable to undertake merchandising itself, than pay the merchandising fees expected by a retailer.<sup>817</sup>

*Retailers seeking payments from suppliers for damaged, unsaleable, or lost stock*

- 8.110 Products are sometimes damaged, unsaleable or lost in retail grocery stores. This is referred to as shrinkage and wastage.
- 8.110.1 Shrinkage refers to a loss of grocery products due to theft, other loss or accounting error.
- 8.110.2 Wastage refers to grocery products that are unfit for sale, for example due to damage.

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<sup>813</sup> [ ]; [ ]. In a workably competitive market, we would expect retailers to have strong incentives to undertake merchandising well, because otherwise they would risk losing significant sales to other retailers.

<sup>814</sup> Foodstuffs NI has stated: "In many instances suppliers and stores agree the level of Merchandising to be provided in store and where a supplier is not willing or able to meet the agreed level (this can be for various reasons) some suppliers agree to pay the stores to arrange for people to complete the Merchandising of shelves. Suppliers can choose not to enter into such agreements."

<sup>815</sup> [ ]; [ ]; [ ].

<sup>816</sup> [ ]; [ ].

<sup>817</sup> [ ].

8.111 Suppliers are often expected to meet at least part of the cost of shrinkage and wastage that occurs after the retailer has taken possession of the products.<sup>818</sup> This can occur through either:

8.111.1 a fixed percentage deduction off their invoices to retailers, which can be referred to as a 'minor damage allowance' (MDA) or 'ullage' term,<sup>819</sup> and/or

8.111.2 compensating retailers for ad hoc credit requests.

8.112 Suppliers have told us that in many cases credit requests which they consider unreasonable have been made by grocery retailers. In some cases this has occurred even when the supplier has already agreed to a MDA or ullage term.<sup>820</sup> We have heard examples of retailers making credit requests for:

8.112.1 products damaged in retailers' stores, without evidence;<sup>821</sup>

8.112.2 stock that could not be located as part of a stock count;<sup>822</sup> and

8.112.3 perishable stock which they were unable to sell.<sup>823</sup>

8.113 We are aware of allegations of suppliers being threatened with having products delisted if they refuse to compensate for credit requests they consider unreasonable.<sup>824</sup>

8.114 These examples suggest that, at least in some cases, retailers are using their strong bargaining position to transfer risks to suppliers. A supplier has little or no ability to manage the risk or shrinkage or wastage that occurs once the retailer has taken possession of products.

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<sup>818</sup> Foodstuffs NI stated that: "Shrinkage, waste and damage are funded by either the store or the supplier depending on the circumstances"

[ ].

<sup>819</sup> Foodstuffs NI stated: "MDA is designed to improve efficiencies for both suppliers and stores when dealing with minor damages and credits"

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<sup>820</sup>

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<sup>821</sup>

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[ ].

<sup>823</sup>

[ ].

<sup>824</sup>

[ ]; [ ].

*Standard invoice settlement terms which include extended payment terms for retailers*

8.115 Suppliers have told us that invoice settlement terms significantly favour large retailers. We understand that standard practice in the New Zealand grocery industry is a 2.5% settlement discount, which is deducted by the retailer for payments made by the last trading day of the month following the date of the invoice.<sup>825</sup>

8.116 Some suppliers have raised concerns that they effectively provide retailers with cheap funding due to the long standard settlement terms.<sup>826</sup> A supplier can wait up to 60 days to have an invoice paid, and the retailer will still receive the settlement discount.<sup>827</sup>

8.117 Extended payment terms push extra cost and risk onto suppliers, which may be much smaller businesses who are less able to manage this. As MBIE noted in a recent discussion paper on business-to-business payment practices:<sup>828</sup>

Good cash flow is crucial to a successful business. When customers take too long to pay it makes it harder for business to pay their own bills, increases businesses stress and forces them to waste valuable time and money chasing debts. It can keep businesses from growing; in the worst cases it can cause businesses to fail.

8.118 We understand that suppliers have the option of paying a greater settlement discount to be paid more promptly.<sup>829</sup> Different settlement terms may also apply to different product categories.<sup>830</sup> In addition, Woolworths NZ has noted that it has implemented shorter payment terms for small suppliers, offering them the ability to choose 14-day payment on standard settlement terms.<sup>831</sup>

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<sup>825</sup> Foodstuffs SI “Supplier terms of trade” (28 August 2020) at 1, available at:

<https://suppliers.foodstuffs.co.nz/assets/documents/FSSI-Charge-Through-Terms-of-Trade-August-2020.pdf>.

<sup>826</sup> [ ].

<sup>827</sup> [ ];  
[ ]

<sup>828</sup> MBIE “Discussion paper: Improving business-to-business payment practices in New Zealand”

(February 2020) at 6, available at: <https://www.mbie.govt.nz/dmsdocument/11212-discussion-paper-improving-business-to-business-payment-practices>.

<sup>829</sup> [ ].

In theory, if a supplier was paid more quickly it would have lower working capital requirement and therefore could offer a discount. However, the discounts required by grocery retailers (on an annualised basis) appear to be high relative to WACC.

<sup>830</sup> Foodstuffs NI stated that “Different standards will apply across different categories with a number of categories being settled on 7-day terms eg, fresh suppliers are typically paid on shorter terms. In addition, the business has supported a number of small and local suppliers over the COVID-19 lockdowns and continues to do so”

[ ].

<sup>831</sup> This applies to New Zealand suppliers which Woolworths NZ purchases less than \$250,000 of goods from each year and whose annual turnover is less than \$1m per annum. Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 42.

### Lack of transparency and certainty over terms of supply

- 8.119 In well-functioning markets, market participants are able to make informed decisions. Suppliers or consumers not having enough information to make informed decisions can lead to inefficient outcomes.<sup>832</sup> This is because they may make production or consumption decisions which are not in their best interests.<sup>833</sup>
- 8.120 We are aware of examples which suggest that in some cases major grocery retailers are reducing transparency over price and non-price terms of supply, placing undue uncertainty on suppliers. Examples include retailers:
- 8.120.1 not providing notice or clear justification for delisting products;
  - 8.120.2 taking a long time to respond to supplier requests for price increases;
  - 8.120.3 setting off amounts against supplier's invoices without prior consent; and
  - 8.120.4 not committing to provide suppliers with promotional displays.
- 8.121 The uncertainty arising from this lack of transparency regarding terms of supply makes it difficult for suppliers to run their businesses. This is likely to affect suppliers' ability to make efficient investment decisions, affecting the quality and range of grocery products available for consumers.

#### *Retailers not providing notice or clear justification for delisting products*

- 8.122 We have consistently heard of major grocery retailers delisting products with no (or very short) notice, or without clear justification.<sup>834</sup> We have also heard of retailers accepting new products with agreed performance criteria, then delisting the products months later citing different performance criteria.<sup>835</sup>
- 8.123 A supplier indicated that in some cases it is unsure of the thresholds required to have their products ranged by retailers, even after asking. It noted that there are "clear rules on paper" regarding whether ranging should be accepted, but it has seen many examples where ranging is refused without commercial justification.<sup>836</sup>

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<sup>832</sup> In particular, there could be a loss of allocative and productive efficiency.

<sup>833</sup> ACCC "Perishable agricultural goods inquiry" (November 2020) at 9, available at: <https://www.accc.gov.au/system/files/Perishable%20Agricultural%20Goods%20Inquiry%20-%20Final%20Report%20-%20December%202020.pdf>.

<sup>834</sup> [ ];

[ ].

<sup>835</sup> [ ].

<sup>836</sup> [ ].

8.124 Unexpected product deletions and ranging decisions, which do not reflect genuine commercial reasons, could.<sup>837</sup>

8.124.1 prevent efficient utilisation of supplier manufacturing facilities, which could reduce suppliers' competitiveness (and, in some cases, could cause suppliers to exit the market);

8.124.2 inhibit entry and expansion by suppliers; and

8.124.3 reduce consumer choice, by limiting the range of products available on the shelves of retail grocery stores.

*Retailers taking a long time to respond to supplier requests for price increases*

8.125 Suppliers have raised concerns about the process for increasing the prices they charge retailers. We have heard examples of:

8.125.1 price increases being rejected by retailers, despite suppliers facing significant cost increases;<sup>838</sup> and

8.125.2 significant delays in retailers responding to requests for price increases, with the process sometimes taking months.<sup>839</sup>

8.126 Lengthy delays in responding to requests for price increases cause unnecessary uncertainty and cost for suppliers.

8.127 Suppliers being unable to raise prices to reflect legitimate cost increases, which do not reflect supplier inefficiency, could potentially affect product quality.<sup>840</sup> For example, suppliers may seek to use lower quality inputs or reduce pack sizes.<sup>841</sup> Otherwise, the viability of a supplier's business may be at risk.

*Retailers setting off amounts against supplier's invoices without prior consent*

8.128 We have heard concerns about grocery retailers setting off amounts against supplier invoices without prior consent.<sup>842</sup> Set-off is where a retailer deducts any amounts it is owed by a supplier when paying a supplier's invoice. This can occur where a retailer takes rebates which are not already deducted from the supplier's invoice.

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<sup>837</sup> [ ]. As noted in footnote 783, genuine commercial reasons could include failure to meet agreed quality or quantity requirements, failure to meet agreed commercial sales or profitability targets, or persistent failure to agreed delivery requirements.

<sup>838</sup> [ ].

<sup>839</sup> [ ];

[ ].

<sup>840</sup> Retailers resisting price increases caused by supplier inefficiency could benefit consumers and enhance competition at the supplier level.

<sup>841</sup> [ ];

[ ].

<sup>842</sup> [ ].

8.129 Concerns have been raised about retailers automatically deducting rebates off their payments to suppliers.<sup>843</sup> The supplier then needs to request a credit note from the retailer to check that the correct deductions have been made, which can take some time. If the supplier disagrees with the deduction the retailer has made, it then needs to try to get its money back.<sup>844</sup>

8.130 We have been told that this approach to set-offs in the New Zealand grocery sector is relatively unusual compared to other industries (where set-offs are less common), potentially reflecting the balance of power between grocery retailers and their suppliers.<sup>845</sup>

*Retailers not committing to provide suppliers with promotional displays*

8.131 Concerns have been raised about suppliers paying for access to in-store displays, without any guarantee of receiving them. In particular, this can occur where suppliers pay for promotional displays through a fixed percentage of their retail sales.

8.132 We understand that suppliers paying for displays based on a fixed percentage of retail sales often do not receive any commitment for a certain number of displays.<sup>846</sup> Some suppliers have told us they are receiving significantly fewer displays under this model, despite paying a similar amount to what they did for guaranteed displays in the past.<sup>847</sup>

8.133 Suppliers have told us they fear they will have their products delisted, or face other consequences, if they do not agree to this model.<sup>848</sup>

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843 [ ]  
844 [ ].  
845 [ ].  
846 [ ]; Foodstuffs NI noted that  
"Approximately 60% of displays are arranged through FSNI with the balance of displays recommended to stores enabling efficiency gains through less visits to stores, less time negotiating each display, significant reduction in administration time. These benefits flow to both the supplier and FSNI,  
[ ].  
847 [ ];  
[ ].  
848 [ ];  
[ ];  
[ ].

### **Retailers limiting suppliers' ability or incentive to provide favourable supply terms to other retailers**

8.134 We have heard examples of retailers appearing to seek to limit the ability of their suppliers to deal with other retailers. Several examples are discussed in Chapter 6, including:<sup>849</sup>

8.134.1 retailers applying pressure for suppliers to not supply competing retail stores due to low retail pricing;

8.134.2 best price guarantee clauses in supply agreements potentially reducing competition between retailers; and

8.134.3 exclusive supply arrangements limiting other retailers' access to certain brands of products.

8.135 These examples may reflect the strong bargaining position of retailers. Our understanding is that in some cases suppliers have agreed to terms which limit their ability to supply other retailers because they feel they have no choice.<sup>850</sup> This is due to the dependence on the volumes sold through certain retailers.<sup>851</sup>

8.136 As discussed in Chapter 6, retailers seeking to limit suppliers' ability to deal with other retailers in these ways potentially raises barriers to entry and expansion in the retail market. This is of particular concern given the New Zealand retail grocery market is highly concentrated.<sup>852</sup>

### **There appears to be limited pass-through of cost reductions to consumers**

8.137 For retailer buyer power to benefit consumers, better purchasing terms obtained by retailers would need to flow through to lower prices or other benefits (eg, increased range or product quality) for consumers of grocery products.

8.138 There is limited evidence of retailers passing through cost reductions to consumers. As discussed in Attachment E, analysis we have undertaken indicates that most retailers have a substantial proportion of products with estimated pass-through rates significantly less than 100%.

8.139 Our analysis of price-cost relationships described in Attachment E also indicates that there is some evidence of higher pass-through of:

8.139.1 cost increases compared to cost decreases; and

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<sup>849</sup> See paragraphs 6.161 to 6.176 for further discussion of these examples.

<sup>850</sup> [

<sup>851</sup> [

[

].

];

].

<sup>852</sup> See Chapter 5 for further discussion of the level of concentration in New Zealand's retail grocery market.

8.139.2 cost changes (both increases and decreases) which affect two retailers rather than only one retailer.

### **What effect are private label products having on competition between retailers and suppliers?**

- 8.140 This section discusses the effect that private label products are having on competition in the New Zealand grocery market. It notes that:
- 8.140.1 private label products are provided by suppliers for sale under a retailer's own brand;
  - 8.140.2 private label sales in New Zealand are growing, but are relatively low compared to overseas markets;
  - 8.140.3 consumers can benefit from private labels, through lower prices and greater choice;
  - 8.140.4 private labels can also distort competition from suppliers; and
  - 8.140.5 the overall long-term impact of private labels on outcomes for New Zealand consumers is unclear, but some aspects could harm competition.

#### **Private label products are provided by suppliers for sale under a retailer's own brand**

- 8.141 Private label grocery products (also known as home brands, own brands, store brands or generics) are products manufactured or provided by a company for sale under a retailer's brand. Private label products are generally produced by existing suppliers, who win the private label contract through a tender process.
- 8.142 The major grocery retailers offer their own private label products in their stores. For example, Foodstuffs' private label brands include the Pams, Pams Superfoods, Pams Finest and Value ranges, and Woolworths NZ's private label brands include its Essentials, Countdown and Macro branded products. Woolworths NZ has noted that it offers more than 3,000 private label products across more than 250 sub-categories.<sup>853</sup>
- 8.143 A supplier of private label products may also produce products under its own brand (supplier-branded products) in competition with private labels. Therefore, retailers selling private label products are both customers and competitors of branded suppliers. This can potentially lead to competition concerns where grocery retailers selling private label products possess market power.

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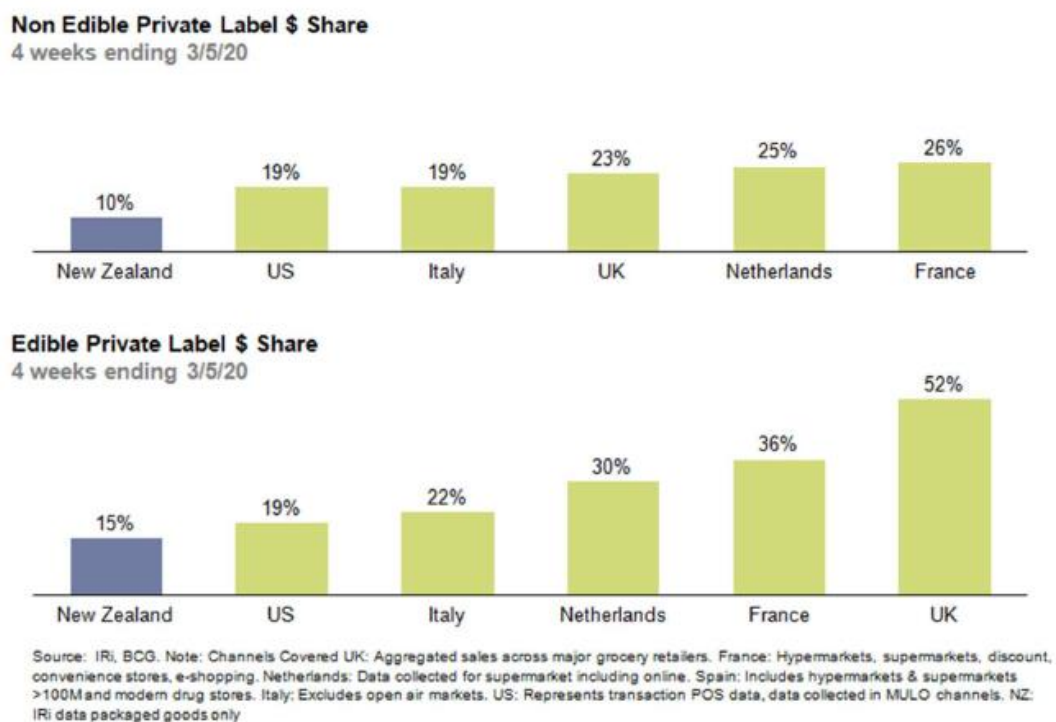
<sup>853</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 64.



### Private label sales in New Zealand are growing, but are relatively low compared to overseas markets

- 8.144 The proportion of sales of private label products in New Zealand appears to be growing, but slowly.<sup>854</sup>
- 8.145 The penetration of private label products is relatively low in New Zealand compared to other jurisdictions. Boston Consulting Group and IRI data referred to by Woolworths NZ in its submission on our preliminary issues paper suggests private label penetration in New Zealand is 15% for edible goods and 10% for non-edible goods.<sup>855</sup> This is lower than the other countries shown in Figure 8.3 below.<sup>856</sup>

**Figure 8.3 Penetration of private label products by jurisdiction**



Source: Woolworths NZ submission on our preliminary issues paper.<sup>857</sup>

- 8.146 Penetration of private label products varies by product category. Some products, such as milk and baking needs (eg, flour) appear to have a relatively high proportion of private label sales.<sup>858</sup>

<sup>854</sup> [ ]  
<sup>855</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 66.  
<sup>856</sup> IRI reports that private-label brands in Australia have a 16.4% share. IRI “Market Moves 2020 Food & Grocery” (2021) at 40, available at: <https://www.iriworldwide.com/IRI/media/IRI-Clients/International/au/2020-MM-F-G-Presentation.pdf>.  
<sup>857</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 66.  
<sup>858</sup> [ ]; [ ]

## Consumers can benefit from private labels, through lower prices and greater choice

- 8.147 Consumers may benefit from private label products through lower prices and greater choice. Ipsos found that many consumers welcome private labels “as an addition to their shop because they were more accessible for those on a set-budget and provided additional choice”.<sup>859</sup>
- 8.148 Traditionally private labels were low priced, lower quality, alternatives to supplier-branded products. For example, analysis based on European markets published in 2012 found that prices of private label products were on average 30% less than equivalent national brands.<sup>860</sup>
- 8.149 However, private labels are increasingly also providing higher quality products for consumers than they did in the past.<sup>861</sup> Doyle and Murgatroyd (2011) note that while private labels initially expanded the market by introducing “value” or low-end alternatives, more recently they have engaged in head-on competition with supplier-branded products.<sup>862</sup> For example, in the New Zealand context:
- 8.149.1 Foodstuffs has its ‘Pams Finest’ range of products which are described as “gourmet and artisan”, “containing only the finest natural ingredients and no artificial colours or flavours”;<sup>863</sup> and
- 8.149.2 Woolworths NZ has its ‘Macro’ range of products, which it notes have “introduced new organic and wholesome product offerings across a range of categories”.<sup>864</sup>
- 8.150 Retailers selling private label products could be considered a form of vertical integration, which could generate benefits by reducing transaction costs and aligning incentives. To the extent that suppliers have market power in a product category, private labels could reduce double marginalisation by reducing the extent to which the supplier and retailer both separately add mark-ups to their respective costs.<sup>865</sup>

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<sup>859</sup> Ipsos “Consumer behaviour and preferences in the New Zealand retail grocery sector: Consumer study report” (July 2021) at 12.

<sup>860</sup> SymphonyIRIGroup “Private Label in Europe 2012: Is there a limit to growth?” (October 2012), [ ].

<sup>861</sup> Nevo, Hila & Van den Bergh, Roger “Private Labels: Challenges for Competition Law and Economics” (2017) *World Competition* 40, no. 2 at 274, [ ].

<sup>862</sup> Chris Doyle & Richard Murgatroyd “The role of private labels in antitrust” (July 2011) *Journal of Competition Law & Economics*, 7(3) at 632, [ ].

<sup>863</sup> “Pams Finest” <https://www.pams.co.nz/discover/pams-finest>.

<sup>864</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 65.

<sup>865</sup> Nevo, Hila & Van den Bergh, Roger “Private Labels: Challenges for Competition Law and Economics” (2017) *World Competition* 40, no. 2 at 282, [ ]; Marc Sachon & Victor Martinez de Albeniz “Private label introduction: Does it benefit the supply chain?” *IESE Business School Working Paper WP-832* (November 2009) at 2, [ ]; and Philippe Bontems, Sylvette Monier-Dilhan and Vincent Requillart “Strategic effects of private labels” *European Review of Agricultural Economics* Vol 26(2) (1999) at 147, [ ].

- 8.151 Private label products can also promote competition, facilitating entry or expansion by suppliers due to the large volumes these products can generate. For example, an existing supplier adding private label products to its manufacturing portfolio can potentially generate manufacturing efficiencies through the additional volumes produced in its factories.
- 8.152 Submissions from the major grocery retailers referred to private label products having a positive impact on competition. Woolworths NZ noted that private label products:<sup>866</sup>
- 8.152.1 are priced very competitively, providing great value and increased choice for New Zealand consumers;
  - 8.152.2 provide a value benchmark that suppliers need to be cognisant of when pricing their own products and, therefore, enhance price competition;
  - 8.152.3 enhance competition on innovation, quality, and variety between suppliers; and
  - 8.152.4 create growth opportunities for new suppliers to enter or expand by producing private label products on its behalf.
- 8.153 Foodstuffs NI and Foodstuffs SI stated that the development and supply of private label products enhances competition at the supplier level and is an important way retailers can respond to the market power of major global suppliers.<sup>867</sup>

#### **Private labels can also distort competition from suppliers**

- 8.154 Private label products also have the potential to negatively affect competition from suppliers. Given that retailers selling private label products are both customers and competitors of suppliers, the retailers may have incentives to ensure their private labels receive preferential treatment to supplier-branded products.
- 8.155 Nevo and Van den Bergh (2017) note that vertically integrated retailers selling private label products weakens suppliers' bargaining positions, for two reasons:<sup>868</sup>
- 8.155.1 At the supplier level, private labels give retailers additional outside options. In the food retailing industry, the bargaining power of retailers is positively correlated to a larger market share of their own-brand products.

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<sup>866</sup> Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 64-65.

<sup>867</sup> Foodstuffs NI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 30; Foodstuffs SI "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 20.

<sup>868</sup> Nevo, Hila & Van den Bergh, Roger "Private Labels: Challenges for Competition Law and Economics" (2017) *World Competition* 40, no. 2 at 280, [ ].

8.155.2 Private labels turn retailers into competitors of supplier-branded products in the retail market. If the retail market is concentrated, large retailers may become a 'bottleneck' for supplier-branded products whose position has already been weakened in the upstream market.

8.156 Nevo and Van den Bergh (2017) note that there a range of ways retailers may seek to use their strong bargaining position against suppliers:<sup>869</sup>

Major supermarkets may exploit the asymmetric dependency of brand manufacturers in several ways. A powerful retailer may utilize a broad range of practices to this end, from restrictive contractual obligations (e.g. access fee payments in exchange for entering a supermarket's product listing) to simply blocking access to its store. If branded products are de-listed, product variety will decline and price competition may dampen.

8.157 Similarly, Doyle and Murgatroyd (2011) refer to the potential for retailers to encourage consumers to purchase private labels over supplier-branded products:<sup>870</sup>

Since retailers control the final sale of all products to consumers, branded and private label alike, they have the ability to "distort" their offerings so as to encourage consumers to purchase one product over another, for example by giving their private labels increased or preferential shelf-space, increased in-store promotion, raising the retail price of branded products, or ultimately by destocking brands altogether. Furthermore, in the case of private labels they may also have the incentive to do this because of the potentially higher margins available on such products, as the retailer earns both the upstream and downstream margins on their sale. Such distortions may serve to reduce inter-brand competition, with consumers facing a reduced range of products or higher prices, and manufacturers potentially having reduced incentives to invest in product quality and innovation.

8.158 We have heard several concerns about the impact of private label products in the New Zealand market during our study. These include:

8.158.1 retailers promoting their private labels in preference to supplier brands;

8.158.2 lower consumer awareness of suppliers' brands which reduces incentives for suppliers to invest and innovate; and

8.158.3 retailers leveraging information obtained through private label tenders when negotiating with suppliers.

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<sup>869</sup> Nevo, Hila & Van den Bergh, Roger "Private Labels: Challenges for Competition Law and Economics" (2017) *World Competition* 40, no. 2 at 280, [ ].

<sup>870</sup> Chris Doyle & Richard Murgatroyd "The role of private labels in antitrust" (July 2011) *Journal of Competition Law & Economics*, 7(3) (July 2011) at 641, [ ].

*Retailers promoting their private labels in preference to supplier brands*

- 8.159 A retailer selling private labels may have the ability and incentive to increase sales of its own branded products, by reducing competition from supplier-branded products. For example, this could occur if a retailer seeks to reduce sales of supplier-branded products by limiting consumers' access to them.<sup>871</sup> This risk is greater where the retailer has market power at the retail level, limiting suppliers' ability to switch to sell their products via other retailers.
- 8.160 Suppliers have raised concerns about private label products receiving preferential treatment compared to supplier-branded products. For example, we have heard examples of private label products receiving:
- 8.160.1 a disproportionate amount of shelf space relative to their market share in the product category;<sup>872</sup> and
- 8.160.2 prime shelf locations and end of aisle displays ahead of supplier-branded products.<sup>873</sup>
- 8.161 Consumers have also raised concerns about retailers placing greater emphasis on private label products by reducing the range of supplier-branded products they stock (range consolidation). Ipsos stated:<sup>874</sup>
- A few participants felt that store brands could be pushing out other suppliers, and if only the home brand is available, then it is about pricing out competitors. They worried that in the future they might lack choice and indicated that they did not want to be pushed to purchase only the store-brand product.
- 8.162 Range consolidation can potentially lead to a significant reduction in the number of supplier-branded products competing with retailer's private labels.<sup>875</sup>
- 8.163 Retailers placing greater emphasis on private label products, while significantly reducing the number of supplier-branded products, is likely to reduce consumer choice. This could reduce competition at the supplier level of the market, ultimately leading to higher prices and lower quality products for consumers in the longer term.

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<sup>871</sup> This is referred to as 'customer foreclosure'. The incentive for customer foreclosure arises due to the nature of the vertical relationships between retailers and suppliers, where private labels turn retailers into competitors of supplier branded products in the retail market.

<sup>872</sup> [ ]; [ ];

[ ].

<sup>873</sup> [ ].

<sup>874</sup> Ipsos "Consumer behaviour and preferences in the New Zealand retail grocery sector: Consumer study report" (July 2021) at 51.

<sup>875</sup> [ ];

[ ].

8.164 There is also the potential for retailers to increase (or refuse to decrease) prices for supplier-branded products to encourage consumers to purchase their private label products. Alternatively, a retailer may keep prices for supplier-branded products volatile, to indicate sustainability and predictability of the private label choice.<sup>876</sup> We have heard an example of a retailer refusing a proposed retail price reduction for a supplier's products because of the potential impact on sales of their private label products.<sup>877</sup>

*Lower consumer awareness of suppliers' brands reducing incentives for suppliers to invest and innovate*

8.165 Supplier-branded products tend to drive innovation and investment, with private labels seeking to replicate successful products.<sup>878</sup> This raises concerns about the potential for retailers to copy or transfer suppliers' intellectual property for private label products.<sup>879</sup>

8.166 Suppliers can seek to recover the cost of new product development through future sales of products carrying their brands. However, this relies on consumers being aware of, and attributing value to, suppliers' brands.

8.167 Some suppliers of fresh produce have told us about being required to provide their products as private labels, despite wanting to supply under their own brand.<sup>880</sup> Horticulture NZ submitted:<sup>881</sup>

We have specific cases where growers have developed their own retail brands. Supermarkets have then forced these growers to relinquish their brands and pack into house branded packs. This maintains the ability of the supermarkets to "switch out" packers and rides over both grower IP development and competitive outcomes.

8.168 Requiring products to be provided as private labels in this way potentially reduces consumer awareness of supplier-branded products. We have heard this reduces suppliers' incentives to innovate and invest, which could ultimately lead to reduced choice and quality for consumers.<sup>882</sup>

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<sup>876</sup> Nevo, Hila & Van den Bergh, Roger "Private Labels: Challenges for Competition Law and Economics" (2017) *World Competition* 40, no. 2 at 275, [ ].

<sup>877</sup> [ ].  
As noted in paragraphs 0 to 8.98 above, suppliers typically fund retail pricing promotions.

<sup>878</sup> [ ];  
[ ]

[ ].

<sup>879</sup> [ ].  
<sup>880</sup> [ ]; [ ].

<sup>881</sup> Horticulture NZ "Submission on retail grocery market study preliminary issues paper" (9 February 2021) at 4. [ ].

<sup>882</sup> [ ].

*Retailers leveraging information obtained through private label tenders when negotiating with suppliers*

- 8.169 Retailers can potentially use information gained through hard fought tender processes for private label products to seek lower prices for supplier-branded products. Woolworths NZ has noted that private label products “provide a value benchmark that suppliers need to be cognisant of when pricing their own products and, therefore, enhance price competition”.<sup>883</sup>
- 8.170 We agree with Woolworths NZ that private label products can enhance price competition between suppliers. For example, this could occur where retailers:
- 8.170.1 gather pricing information from private label tenders received from suppliers for a particular product; and
  - 8.170.2 use this pricing information revealed during the private label tender process to subsequently negotiate down prices for supplier-branded products.
- 8.171 However, when combined with retail market power, there is a risk that suppliers sell at lower prices to retailers without these price reductions being passed through to consumers. Retailers’ margins would increase while retail prices remain relatively stable.<sup>884</sup> This transfer of margins from suppliers to retailers could negatively affect suppliers’ investment incentives, if suppliers’ expected returns are reduced below the level expected under workable competition.<sup>885</sup>

**The overall long-term impact of private labels on outcomes for New Zealand consumers is unclear, but some aspects could harm competition**

- 8.172 It is difficult to predict the overall impact of private label products on New Zealand consumers.
- 8.173 The proportion of sales of private label products in New Zealand appears to be growing slowly.<sup>886</sup> Some retailers appear to be placing greater emphasis on private label products, through consolidation of the range of grocery products they stock.

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<sup>883</sup> Woolworths NZ “Submission on retail grocery market study preliminary issues paper” (4 February 2021) at 64.

<sup>884</sup> As discussed in Attachment E, there is limited evidence that lower prices from suppliers are passed through to consumers as lower retail prices. See paragraphs E44 to E53 for further details.

<sup>885</sup> For example, this could occur if the private label contract offered volume certainty that reduced manufacturing costs, but this volume certainty was not available to other suppliers.

<sup>886</sup> See paragraph 8.143 above.

- 8.174 While the introduction of private label products could increase consumer choice and lower prices in the short term, there is a risk that growth of private labels could crowd out supplier-branded products. This could lead to a loss of consumer choice and higher prices over the longer term. Nevo and Van den Bergh (2017) noted:<sup>887</sup>

From a short term perspective, no harm can be seen if consumers prefer a private label product over a branded one, enjoy a greater selection of products and profit from better prices. From a long term perspective, though, the competition effects of private labels in the downstream market are uncertain.

...

Private labels increase the bargaining power of large retailers and may broaden the scope for abuse of buyer power in upstream markets. The increasing size of discounts to be granted and the transfer of commercial risks may weaken the financial viability of manufacturers and reduce their incentives to innovate. Private labels can also be used strategically to limit competition in downstream markets (de-listing of branded goods), so that the overall price level of goods will increase in the long run. However, the empirical findings are yet indecisive in setting a clear correlation between private label and abusive buyer power. There is no significant relationship between the share of private label sales and customer choice but the likely negative impact on product innovation warrants caution.

- 8.175 The risk of private label products adversely affecting outcomes for consumers is greater when retail competition is not effective. Castalia (for the NZFGC) submitted that “if a supermarket sells a private label and reduces the range of brands available to consumers, the impact on consumers will differ according to the other supermarket options available”.<sup>888</sup>

- 8.176 At this stage, it is not clear whether the overall longer-term risks associated with private label products outweigh any potential benefits to consumers in the short term. However, there are specific ways in which retailer conduct regarding private labels is likely to harm competition, such as:

8.176.1 discriminating between own label and supplier-branded products (for example, when allocating shelf space);

8.176.2 infringing upon suppliers’ intellectual property and reducing innovation; or

8.176.3 a risk of increasing retailers’ buyer power, leading to further transfer of risks and reduced margins for suppliers.

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<sup>887</sup> Nevo, Hila & Van den Bergh, Roger “Private Labels: Challenges for Competition Law and Economics” (2017) *World Competition* 40, no. 2 at 280 and 297-298, [ ].

<sup>888</sup> NZFGC “Comments on submissions on preliminary issues paper: Attachment 1 - Castalia - Assessing retail grocery competition” (12 April 2021) at 15.



## Chapter 9 Competition may be enhanced in a number of ways

### Summary of preliminary findings

- We have identified a spectrum of options for recommendations that could address the factors that we have identified as adversely affecting competition for the acquisition and supply of retail groceries. This chapter outlines and invites comment on the options we have set out to help us to determine what, if any, recommendations to make as part of our final report.
- We consider that the best options for improving competition are likely to be those that enable an increase in the number of firms competing in the retail grocery market. In the long term, threatened and actual entry or expansion is likely to be the greatest driver of competition in grocery markets.
- The first way this could occur is through measures to improve the conditions for entry by new grocery retailers and expansion by existing retailers. These include measures to improve access to a wide range of wholesale groceries at competitive prices, and measures to make sites for grocery retailing more readily available through possible changes to planning laws and restrictions on the use of restrictive covenants.
- The second way this could occur is through measures to facilitate or create entry by further major grocery retailers. These could include direct facilitation of entry by the Government or divestment by the major grocery wholesalers of existing assets to create additional market participant(s).
- We consider that the imbalance of power between the major grocery retailers and their suppliers could be addressed by a number of measures, including a code of conduct and changes to restrictions against collective bargaining by suppliers.
- Finally, we have identified some measures directed at enhancing existing competition at the retail level of the market by improving the ability of consumers to make informed purchasing decisions. These include simplifying promotional pricing, mandatory unit pricing and disclosure of terms and conditions relating to loyalty programmes.

### Our approach

- 9.1 In this chapter we discuss a spectrum of options for recommendations that may change the features of the market we have identified as adversely affecting competition. These options identify different possible ways to improve competition and produce better long-term market outcomes for consumers, including PQRS.
- 9.2 The Act provides us with a broad power to make recommendations as part of the final report. However, we are not required to make any recommendations. We intend to make recommendations in the final report only where the information before us suggests that there may be ways to improve competition for the long-term benefit of New Zealand grocery consumers.

- 9.3 We invite comment on the options we have set out here. We also welcome suggestions of other options for recommendations that could improve competition. Like the preliminary views expressed throughout our draft report, the options are subject to further consultation during our submission and conference process, further analysis and deliberation, and may be altered or removed in the final report.<sup>889</sup>
- 9.4 When producing our draft report we have endeavoured to consider options that would most directly address the factors affecting competition that we have identified, are likely to improve competition, and are likely to be feasible. 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 of any recommended changes to the status quo. However, cost-benefit analysis falls outside the scope of our study. Policy makers may undertake that analysis while developing or giving effect to any government decision about recommendations that it may wish to take forward after considering our final report.
- 9.5 The following options take into account our preliminary views on the factors affecting competition at the wholesale and retail levels of the grocery market. They are necessarily interdependent, and we acknowledge that changes in one part of the supply chain can have implications for other parts of the supply chain. The following options, and any final recommendations, ought to be considered with reference to their interrelationship, their potential aggregate impact on the functioning of the supply chain, and their ultimate impact on competition in the grocery market.
- 9.6 Several of the options suggested are directed at industry participants who may be best placed to implement them. Other options are of a regulatory nature that the Government may consider instead of, or alongside, those industry options.
- 9.7 In the course of finalising our study we may also identify areas where we (or others) could undertake further work in the future. This may include investigation of potential breaches of competition or consumer law or proposals for further analysis.

### **Overview of our preliminary findings**

- 9.8 Our preliminary view is that competition is not working well for consumers in the retail grocery sector.

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<sup>889</sup> See paragraph 1.48 and Attachment A.

- 9.9 Most consumers buy groceries for their main shop at one grocery store and they typically prefer to use one of the major grocery retailers for their main shop. Major grocery retailers are uniquely placed to offer the convenience of a main shop at a single location. The major grocery retailers appear to be each other's closest competitors for consumers' main shop. Other grocery retailers do not provide a material constraint as they do not provide a widespread, full range, competitively priced offering of groceries.
- 9.10 The retail grocery sector can best be described as a duopoly with a fringe of other competitors. Competition tends to be weak in a duopoly unless it is easy for rivals to enter and expand to a scale sufficient to compete.
- 9.11 We have observed persistently high profits from the major grocery retailers, and this has not attracted new entry and expansion by other grocery retailers able to compete for consumers' favoured main shop. It does not appear that entry into the retail grocery market is easy partly because of the absence of wholesale options for a full range of groceries and limited availability of land for new grocery retailing sites.
- 9.12 Major grocery retailers are able to choose strategies that limit the extent to which they compete directly with each other, particularly on price. While there has been some innovation in the sector directed at product and service differentiation, it is modest by international standards. Grocery prices appear high by international standards, although it is hard to make accurate comparisons. We also consider that competition is not working well for the suppliers to the major grocery retailers. Many of these suppliers have few ways to sell their products other than to the major grocery retailers.
- 9.13 The lack of options for suppliers appears to allow the major grocery retailers to negotiate lower prices with, and push more risks and uncertainty onto suppliers than seems efficient. This can reduce suppliers' incentives to invest and innovate and can lead to suppliers exiting the market. In the long run, this can lead to lower quality goods, reduced choice, and a risk that prices will rise.
- 9.14 Finally, we consider that consumers are being provided with information in a way that makes it more difficult for them to confidently make informed decisions about which products to buy and which retailers to shop with.
- 9.15 We consider that the frequency and prevalence of the major grocery retailers' pricing and promotional practices, and the complexity of the reward structures and terms and conditions relating to their loyalty programmes can confuse consumers. This makes it more difficult for consumers to compare prices and make informed purchasing decisions and reduces the effectiveness of price competition between the major grocery retailers.

- 9.16 We also find that consumers are generally not aware of how their data is being collected and used when they sign up for loyalty programmes. Therefore, consumers with strong data use preferences cannot make fully informed choices about whether to participate in loyalty programmes, affecting competition for those consumers between major grocery retailers.

### **Overview of the options**

- 9.17 Our analysis of the factors affecting competition indicates that the structure of the grocery sector is the primary reason that competition is less effective than it could be. This leads us to a number of overarching preliminary views on potential directions for change.
- 9.18 First, we consider competition in retail grocery markets would be more effective if the major grocery retailers faced additional competitive constraints. The options for securing the most significant and durable improvements in competition (and consequent benefits for consumers) are likely to be those that enable an increase in the number of firms competing effectively in retail grocery markets. This is particularly in relation to those competing for consumers' main shop.
- 9.19 In the long term, meaningful entry or expansion (or the real threat of it) is likely to be the most significant driver of greater competition in grocery markets. This could involve entry by firms not currently involved in groceries, expansion by existing firms, or entry by firms already operating in adjacent retail markets such as general merchandise. It could also include, but is not limited to, one or more additional major grocery retailers, stronger competition from independent grocery retailers, or further online grocery offerings.
- 9.20 It is difficult to see improvements to competition occurring without some form of intervention. While we cannot be certain, in the foreseeable future we do not consider we can rely, under current competitive conditions, on market entry or expansion being sufficient to materially enhance competition with the major grocery retailers.
- 9.21 We see two primary ways that intervention could occur:
- 9.21.1 measures to improve the conditions for entry by new grocery retailers, and expansion by existing firms; and
  - 9.21.2 measures to facilitate or support entry or expansion by wholesalers or further major grocery retailers.
- 9.22 Second, we consider that the imbalance of power between the major grocery retailers and their suppliers could be addressed through a number of measures, including a code of conduct. This might improve long-term outcomes for consumers, including by promoting investment and innovation by grocery suppliers.

- 9.23 Finally, we consider there are some options available that may improve the ability of consumers to make more informed purchasing decisions, thereby enhancing competition at the retail level of the market.
- 9.24 We invite comment on the options below, and on others that you believe might better promote competition for the long-term benefit of New Zealand grocery consumers.

### **Options to promote entry or expansion into the retail grocery sector**

- 9.25 As discussed in Chapter 6, in the last 20 years there has been only one attempt at large-scale entry into the retail grocery sector. That attempt was by The Warehouse Group in 2006. It was ultimately unsuccessful and The Warehouse Group exited the market. Since then, there has been some small-scale entry by a number of different firms, including online entry. Small-scale entry has not provided a widespread, full range, competitively priced offering. Costco has indicated it intends to open a single store in Auckland, and it has been speculated that it may also be looking for sites in Wellington and Christchurch.
- 9.26 We have spoken to a number of firms that we have identified as potential entrants or firms that could expand into grocery retailing. Commercial investments of this kind are typically confidential during their planning stages. While we cannot be certain, we consider that, under current competitive conditions, it appears unlikely that entry or expansion will occur in the foreseeable future that will provide a sufficient competitive constraint on the major grocery retailers.
- 9.27 As a consequence, for most consumers, competition for their regular, main shop will continue to be focussed on the rivalry between the two major grocery retailers. A range of other grocery retailers exist in some areas and the major grocery retailers do occasionally make quality and range improvements where these other firms are present. However, these firms face significant difficulties should they attempt to expand significantly. These difficulties mean other grocery retailers have not attempted significant expansion and are unlikely to do so under current competitive conditions. Unless these entry and expansion conditions change, price competition between the major grocery retailers is likely to continue to be weak.
- 9.28 We have identified two significant factors that may hinder or prevent entry and expansion in the retail grocery sector and consequentially affect competition. These are:
- 9.28.1 wholesale access to competitively priced grocery products necessary to compete effectively with the major grocery retailers at a retail level; and
  - 9.28.2 access to suitable sites for grocery retailing to use to compete against the existing store networks.

- 9.29 The conditions for entry and expansion may vary between different businesses, but all will require access to competitively priced groceries. Vertically integrated firms will need access to suppliers. Non-vertically integrated firms would require a competitive wholesale market. A stronger wholesale market may also provide an additional channel for suppliers.
- 9.30 There is no guarantee that additional firms will enter or expand if these potential barriers are removed or lowered. However, even if they do not, the greater potential for entry and expansion could be expected to influence the two major grocery retailers and lead to enhanced competition between them. The level and type of demand for wholesale supplied grocery products may influence the question of which of the options we have identified is most feasible and most likely to improve competition.
- 9.31 If additional entry or expansion, or the threat of such entry, possibly together with other changes, did not result in more effective retail competition, more direct intervention in the retail grocery market may be necessary.

### **Access to products at the wholesale level**

- 9.32 A grocery retailer cannot provide a widespread, full range, competitively priced offering without first obtaining groceries at competitive prices from either a range of suppliers or a grocery wholesaler.
- 9.33 Our preliminary view is that the absence of an independent grocery wholesaler supplying many products on competitive terms may limit the ability of existing independent retailers and new entrants to obtain the full range of competitively priced grocery products needed for them to provide a competitive offering comparable to the major grocery retailers.
- 9.34 There does not appear to be any large independent wholesale options for a full range of competitively priced grocery products in the New Zealand grocery sector. The major grocery retailers each own firms which perform wholesale functions. Wholesale Distributors Limited, which is owned by Woolworths, supplies FreshChoice and SuperValue, but does not appear to supply other New Zealand grocery retailers on a large scale. Foodstuffs NI owns Trents, and Gilmours store owners are part of the Foodstuffs NI group. Gilmours and Trents are primarily foodservice wholesalers but they also supply some convenience stores and other grocery retailers.
- 9.35 There is a range of potential options for improving access for existing and new entrant grocery retailers to a full range of competitively priced grocery products, including:
- 9.35.1 improved supply through existing wholesale grocery channels, such as by:
- 9.35.1.1 voluntary commercial arrangements under which the major grocery retailers could supply grocery products to third parties on competitive terms; or

- 9.35.1.2 an enforceable access undertaking given by the major grocery retailers; or
  - 9.35.1.3 a regulatory access regime; or
  - 9.35.2 the structural separation of the major grocery retailers' wholesale and retail businesses; or
  - 9.35.3 the facilitation of entry by an independent grocery wholesaler.
- 9.36 Greater access to products at the wholesale level could result in a range of market responses, for example:
- 9.36.1 There could be retail entry by firms who are not currently involved in grocery markets, including those who operate in adjacent retail markets such as general merchandising. There could also be expansion by existing firms;
  - 9.36.2 Entry or expansion could take a number of different forms including, but not limited to, an additional major grocery retailer, stronger competition from independent grocery retailers, or one or more online grocery offerings;
  - 9.36.3 Firms would be able to differentiate their retail offering, offering PQRS closely comparable to one of the current retail banners, or differentiated in some respects, or with a different offering entirely.
- 9.37 We acknowledge that large new entrants may choose to vertically integrate as the major grocery retailers have. Improved access to products at the wholesale level may nevertheless provide a platform for entry for some firms. Avoiding the need to enter both the wholesale and retail markets at the point of entry may make entry more likely.
- 9.38 We also acknowledge that the level of demand for increased access to wholesale groceries is, at this stage, uncertain. The level of demand may influence the question of which of the options, if any, we have identified is most feasible and most likely to improve competition.

#### **Improved supply through existing wholesale grocery channels**

- 9.39 In workably competitive markets, it is not unusual for vertically integrated firms to provide wholesale supply to firms they compete with in the retail market. Where there is limited wholesale or retail competition, however, the position is likely to be different. This is because:
- 9.39.1 a vertically integrated firm facing limited competition has little incentive to supply potential retail competitors if that will cause it to lose retail sales; and

- 9.39.2 retailers may be reluctant to rely on a rival for wholesale supply given:
- 9.39.2.1 their supplier may be incentivised to provide supply on terms, including wholesale prices, that may limit their ability to compete in the retail market;
  - 9.39.2.2 it may be uncertain when wholesale supply would be available, and on what terms, and whether supply may, in the future, be withdrawn or limited; and
  - 9.39.2.3 their supplier could use information on quantity, range and price of goods ordered to inform its own retail strategy.
- 9.40 We observe that the major grocery retailers appear to already have the systems in place to provide wholesale grocery supply, either through their subsidiaries or directly. We are not aware of any supply-side or regulatory issues that would prevent these wholesale arrangements being extended to include supply to other retailers on competitive terms.
- 9.41 Although independent grocery retailers may have concerns about relying on the major grocery stores for their wholesale supply, it is possible that commercially negotiated contractual arrangements could adequately protect their interests. However, as noted above, where a vertically integrated firm faces limited retail competition, it is likely to have limited incentive to supply potential retail competitors. Given the incentives involved, and the potential imbalance in power between the parties, it is unlikely that the major grocery retailers would agree to supply on competitive terms absent the prospect of intervention.
- 9.42 We are not aware of any firms likely to enter or expand into wholesale grocery supply in the foreseeable future. We have not identified any way in which conditions for such entry or expansion could be improved. There appears to be a “chicken-and-egg” sequencing problem, where entry into wholesale supply requires clarity over there being sufficient demand, and building demand requires clarity over the availability of wholesale supply. This sequencing problem seems unlikely to be solved without some form of intervention.

*Enforceable access undertakings*

- 9.43 Firms are likely to require a high degree of confidence in their wholesale supply arrangements before they will make the investments necessary to enter or expand into retail grocery markets. Reliance on a purely commercial relationship may not provide sufficient certainty for the investment to occur.
- 9.44 Nevertheless, negotiation of commercial contractual arrangements will generally involve lower costs than achieving the same outcome by economic regulation. In some other regulatory regimes enforceable access undertakings have been provided as a way to achieve many of the benefits of access regulation at a lower cost.



- 9.45 An access undertaking is a written statement from an access provider to the Government or a regulatory agency setting out the provider's arrangements for providing access to one or more of their services. Once accepted, it governs the way the provider will work with access seekers.
- 9.46 Before accepting an access undertaking, the acceptor would need to consider the extent to which the terms of the undertaking were likely to achieve similar outcomes to regulation. This is likely to include consideration of the concerns of access seekers, the incentives on the access provider, and many of the design issues that would be addressed in any regulation of access.
- 9.47 At present there is no statutory scheme available that enables the Government or a regulatory agency to accept undertakings of this kind.<sup>890</sup>

*Economic regulation of access*

- 9.48 Access regulation is a form of economic regulation designed to provide access to an essential input to facilitate competition in downstream or related markets. Access regulation comes in many forms. It can be detailed regulation that seeks to base access terms on the access provider's costs and an allowable return on its investments. Alternatively, it can be regulation that avoids price or earnings control and instead aims to increase the viability of actual and potential competitors.<sup>891</sup>
- 9.49 We consider that the latter form of regulation is more likely to be appropriate in relation to wholesale grocery markets. We anticipate that a successful wholesale grocery regulatory regime of that kind would likely include:
- 9.49.1 An obligation to publish, or to provide on request, standard terms for the supply of products. This could include certain minimum terms, including dispute resolution and termination.
- 9.49.2 An obligation to provide supply to any member of a class of businesses that meets certain minimum criteria. This could include, for example, creditworthiness and meeting any applicable regulatory standards.
- 9.49.3 An obligation to keep confidential the information provided by independent grocery retailers and, in particular, not to provide that information to staff involved in the retail operations of the major grocery retailers or their related firms.

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<sup>890</sup> We note, however, that Schedule 3A of the Telecommunications Act 2001 was inserted to permit the use of undertakings to avoid the need for a proposed regulatory change in that sector.

<sup>891</sup> For more discussion of Light Handed Pro-competitive (LHPC) regulation, see Rogerson and Shelanski "Antitrust Enforcement, Regulation, and Digital Platforms" *University of Pennsylvania Law Review* Vol 168, No.7 (2020) at 1911-1940, available at: [https://www.pennlawreview.com/wp-content/uploads/2021/01/Rogerson-Shelanski\\_final.pdf](https://www.pennlawreview.com/wp-content/uploads/2021/01/Rogerson-Shelanski_final.pdf).

- 9.49.4 An obligation to provide supply on non-discriminatory terms – that is, terms that are in substance equivalent to those provided to its own retail businesses (or the retail businesses of related firms).
- 9.50 At this stage of our study, we do not consider direct regulation of wholesale pricing to be desirable. The large number of products involved in the market means price regulation would likely be costly and difficult. Vertically integrated firms are already incentivised to supply their retail arms efficiently and we consider that the supply of goods to competing retailers on non-discriminatory terms would be likely to promote competition at a lower cost.
- 9.51 We consider that to be effective, the design of access regulation would need to consider and address several factors including:
- 9.51.1 Who should be entitled to access?
- 9.51.2 What should the terms of access be?
- 9.51.3 Should access be to the distribution centre, to delivered goods, or both?
- 9.51.4 Which products should be covered - all products, key products, or only some product lines? How should private label goods be addressed?
- 9.51.5 What will happen if there is a supply shortage?
- 9.51.6 How should disputes in relation to the access regime be dealt with?
- 9.51.7 How would the costs of the regulatory regime be funded?

*Operational separation*

- 9.52 As noted above, firms require sufficient certainty to make the investments necessary to enter or expand into retail grocery markets, and to sustain innovation in the long term. It may be that access regulation in the grocery market could not deliver that certainty without additional protections being put in place.
- 9.53 These protections could include operational separation of the major grocery retailers' wholesale and retail businesses, thus providing for separate management, employees, and information systems in each. Information systems may, in any event, need to be altered to accommodate any dealings with access seekers of the kind discussed above. The scale of the changes needed will depend in part on the systems that the major grocery retailers already have in place to provide wholesale grocery supply.

*Administering access undertakings, access regulation or operational separation*

- 9.54 Any of the above options would be likely to need some degree of external monitoring and independent audit to ensure ongoing compliance. A form of information disclosure regime could be used to achieve this purpose. The cost involved in administering any wholesale regime is likely to vary depending on its nature. Responsibility for monitoring a regime and enforcing compliance with it would need to be allocated to an appropriate agency.
- 9.55 Access regulation and operational separation would result in both set-up and ongoing costs, including for industry participants, and could impact on the efficiency of the vertically integrated firms. Access regulation could also create unforeseen consequences. For example, firms might be incentivised to move to a greater use of private label products if these were left unregulated.
- 9.56 As noted above, the industry demand for increased access to wholesale groceries is, at this stage, uncertain. An access regime may be the more appropriate option if industry demand is below the levels needed to sustain an independent wholesaler. Any of these options could also be brought to an end at the time that new entry or expansion meant it was no longer required.

**Vertical separation**

- 9.57 An alternative option would be to require existing market participants to structurally separate their wholesale businesses from their retail grocery businesses. This would likely require legislative intervention.
- 9.58 Structural separation would go further than operational separation and involve the movement of the wholesale business unit into a separate corporate entity with its own board of directors. We note that if this is done then:
- 9.58.1 Cross shareholding may be acceptable, provided that the separated firms are operated on an arms-length basis and are required to act in the best interests of the company, rather than shareholders.
- 9.58.2 Alternatively, the restructured business could be wholly or partially divested.
- 9.59 The Commission's Merger and Acquisition Guidelines provide some guidance on the factors that are likely to influence the viability of a divestment.<sup>892</sup>
- 9.60 A successful divestment of assets would require a purchaser with the necessary experience and financial backing to operate the business. While our conclusions on the profitability of the industry may be helpful, there remains some uncertainty over the availability of an appropriate purchaser.

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Commerce Commission "Merger and Acquisition Guidelines" (July 2019) at Attachment F.

- 9.61 A purchaser may be concerned at the potential for the major grocery retailers to re-enter the wholesale market, taking trade away from the divested wholesale business. While it is possible that this risk could be dealt with through commercial arrangements, absent authorisation or a statutory exemption, such an agreement not to compete might risk contravening the Commerce Act. Statutory line-of-business restrictions could be used as an alternative. In either case, measures to address this concern may be required for a period after divestment.
- 9.62 The composition of divested assets would need to be both attractive to the potential purchaser and sufficient to operate as a viable and competitive entity. Identifying the appropriate package of assets for divestment is not always straightforward. Even if an existing business unit is able to be divested, a degree of back-office support, at least on a transitional basis, is frequently required to manage supplier relationships, marketing, personnel, finance and accounting, IT systems and an online presence.
- 9.63 If this option was to progress, the risk that the competitive effectiveness of the assets deteriorated during the divestment process would need to be considered.
- 9.64 We appreciate that structural separation of a wholesale business unit and potential divestiture would be a substantial undertaking, involve significant costs, and that careful consideration of the risks involved would be required. This would include considering risks beyond the grocery market, including distortion of investment incentives. There is also a significantly greater risk, compared with an access regime, of lost efficiencies resulting from the loss of vertical integration caused by separation. We expect that structural separation would only be considered if other options were not feasible, had proved ineffective, or did not appear likely to improve competition within the desired timeframe.

### **Facilitation of entry**

- 9.65 It is possible that the focus of our study, and our findings in relation to industry profitability, may encourage entry into the wholesale grocery market. However, it is difficult to identify where entry would come from. As noted above we are not aware of any firms likely to enter or expand into wholesale grocery supply, and there are reasons to think it is unlikely to happen without some form of intervention.
- 9.66 Another alternative option would be for the Government to facilitate entry by a grocery wholesaler who was independent of the major grocery retailers. Such a firm would likely need to establish its own facilities for storage and distribution of groceries including temperature-controlled groceries. However, some suppliers may be able to deliver directly.
- 9.67 We envisage it would not be difficult for a new grocery wholesaler to build relationships with suppliers, provided that:
- 9.67.1 there was sufficient retail demand; and

- 9.67.2 suppliers were not prevented from dealing with the grocery wholesaler by the potential loss of volumes to the major grocery retailers. This topic is discussed further in relation to the options to improve competition for the acquisition of grocery products.
- 9.68 There are a wide range of options available if the Government wished to facilitate entry into the wholesale grocery market. It could provide direct support following a contestable procurement process. This could include one-off funding of a project or longer-term support. Alternatively, the Government could invest as a joint venture partner, with a view to exiting once competition is established. The Government could instead retain a longer-term stake using a mixed ownership model.
- 9.69 The cost of facilitating entry would be significant but vary depending on the model adopted and the contribution of other partners. While we have not quantified it, we believe the costs would likely be significantly greater than the costs of access regulation, at least in the short to medium term. Careful consideration would need to be given to the merits of intervention, and if it is preferred, also ensuring that it has clear objectives aligned with the promotion of competition. Careful consideration would also be needed to ensure that any intervention is implemented in a manner that does not unfairly distort market outcomes in the long term.
- 9.70 The successful entry of an independent wholesale supplier would require the firm to obtain sufficient sales to reach a viable scale. As noted previously, industry demand for increased access to wholesale groceries is, at this stage, uncertain.
- 9.71 If intervention is to progress, consideration would also need to be given to whether the intervention should be solely at the wholesale level or whether, having regard to the costs, risks and expected benefits, intervention to establish an integrated third major grocery retailer would be preferable. We discuss this later in this chapter.
- 9.72 Once established, an independent grocery wholesaler may have a degree of market power against retailers if it was the only such wholesaler. If the owners included some grocery suppliers or grocery retailers, they may have the ability and incentive to discriminate against suppliers or retailers respectively. Any Government arrangements to facilitate entry may need to consider including measures to address these potential issues.
- 9.73 Entry of an independent grocery wholesaler would provide suppliers with an additional channel to market. This would reduce their dependence on supply to the major grocery retailers and improve the imbalance in bargaining power between them which we have identified. However, there would likely remain some imbalance in bargaining power. We envisage that entry would not remove the need for a supplier code (see below). We note that the Food and Grocery Code in Australia applies to wholesalers. It is likely that any code introduced in New Zealand may also need to apply to independent wholesalers.

## Improving access to suitable sites

9.74 As noted in Chapter 6, we identified two factors that appear to be impairing access to suitable sites for grocery retailing:

9.74.1 difficulties in getting planning permission to develop potential sites; and

9.74.2 the use of restrictive covenants and exclusivity covenants in leases, which prevent the use of potential sites.

## Potential changes to planning law

9.75 As we discussed in Chapter 6, compliance with planning laws is a necessary pre-requisite to any entry or expansion in retail grocery. We note that the Government recently undertook a full review of the Resource Management Act 1991 (RMA), and intends to undertake significant reform.<sup>893, 894</sup>

9.76 Disputes between the major grocery retailers under the RMA have been common. Partially in response to this, Part 11A of the RMA was inserted to limit trade competitors' use of the objection process under the RMA.<sup>895</sup> While Part 11A has placed some limits on such disputes, the information we have gathered suggests there is reason to believe grocery retailers continue to face significant RMA barriers when developing retail grocery stores.

9.77 We consider that the policy makers developing the replacement for the RMA should consider the potential for:

9.77.1 planning rules to significantly reduce the number of suitable sites available for retail grocery stores;

9.77.2 trade competitors to use planning law to hinder competitors' access to suitable development sites, as acknowledged in the enactment of Part 11A of the RMA; and

9.77.3 rule setting, notification and consenting processes to cause delay and uncertainty in the establishment or expansion of retail grocery stores or supporting operations (such as distribution facilities).

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<sup>893</sup> Ministry for the Environment "New Directions for Resource Management in New Zealand" (June 2020) <https://www.mfe.govt.nz/publications/rma/new-directions-resource-management-new-zealand>.

<sup>894</sup> Hon David Parker "RMA to be repealed and replaced" (10 February 2021) <https://www.beehive.govt.nz/release/rma-be-repealed-and-replaced>.

<sup>895</sup> *General Distributors Ltd v Foodstuffs Properties (Wellington) Ltd* [2011] NZEnvC 212; (2011) 16 ELRNZ 573 [2012] NZRMA 215.

- 9.78 All of these matters raise the cost of, and potentially discourage, entry and expansion. This limits the ability of the major grocery retailers to compete with each other in some areas and limits the constraints they face from potential or actual entry or expansion by other grocery retailers. While our study is limited to factors affecting competition in the supply and acquisition of groceries, these points may also be of general application in other industry sectors.
- 9.79 A review of determined RMA applications, in relation to retail grocery stores, suggests that applicants and decision makers are not consistently taking into account, or placing significant weight on, the benefits to consumers that arise from increased actual or potential competition, perhaps because the RMA prohibits consideration of the effects on “trade competition” and “trade competitors”.<sup>896</sup>
- 9.80 The proposed Natural and Built Environments Act could include mechanisms for ensuring the potential benefits of competition are a relevant consideration. This is a potential option to enable weight to be put on the benefits for consumers that arise from increased actual or potential competition.
- 9.81 The Government is currently consulting on the Natural and Built Environments Bill Exposure Draft. Competition considerations could be integrated into the framework set out by the Exposure Draft in a number of ways:
- 9.81.1 Competition, and the benefits it delivers, supports the economic well-being of people and communities, and could be included as an environmental outcome to be promoted by the National Planning Framework;<sup>897</sup>
- 9.81.2 Given the opportunity for the implementation of the National Planning Framework to promote competition, and the risk that it could limit competition, the preservation and promotion of competition could be included as an implementation principle;<sup>898</sup>
- 9.81.3 For substantially the same reasons, the benefits of preserving and promoting competition could also be a matter included in natural and built environment plans or be a consideration relevant to planning committee decisions under those plans.<sup>899</sup>
- 9.82 There may be some cost involved in assessing the potential benefits of competition. Our experience in assessing such matters in our authorisation proceedings suggests the costs could be material in some cases.

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<sup>896</sup> See for example sections 95D and 104 of the RMA. Our understanding is that these provisions were intended to prevent arguments that increased competition resulted in negative effects that should weigh against an application.

<sup>897</sup> Natural and Built Environments Bill Exposure Draft (**Exposure Draft**), Clause 8.

<sup>898</sup> Exposure Draft, Clause 18.

<sup>899</sup> Exposure Draft, Clauses 22 and 24.

### Options for reducing the impact of restrictive and exclusivity covenants

- 9.83 A restrictive covenant is a promise not to do something that is registered against land and imposes restrictions on how that land can be developed or used. Restrictive covenants are commonly used when land is developed to provide greater certainty over how land will be used, or secure existing use. They can also be used to promote environmental or public amenity outcomes. While restrictive covenants are not unusual, in some circumstances they can restrict competition.
- 9.84 Exclusivity covenants are promises contained in lease agreements and continue for the duration of the lease. They will be binding on subsequent tenants or landlords where the existing lease is assigned.
- 9.85 In Chapter 6 we explained that we have identified a large number of restrictive covenants and exclusivity covenants on sites that could be used to prevent parties from selling groceries. Such covenants may reduce market participants' ability to access suitable land and may hinder entry and expansion and raise entry and expansion costs. This is particularly so in developed urban areas where the cost of land is high and the number of greenfield sites where resource consent could readily be obtained is low.
- 9.86 We currently consider that the use of these covenants is likely to restrict retail competition and that changes to the practice of lodging covenants restricting the development of supermarket or other food retail businesses may improve the conditions for entry in these areas.
- 9.87 The effects of covenants, and whether they are beneficial, will depend on the circumstances in which they are used. It is not readily apparent what legitimate purpose restrictive covenants and exclusivity covenants may have in the retail grocery industry. Absent such justification their frequent and widespread use appears, on the information before us, unjustified and likely to limit competition.
- 9.88 We consider that restrictive covenants and exclusivity covenants are particularly likely to unjustifiably limit competition where:
- 9.88.1 they are used in areas where there is a shortage of land appropriate for retail grocery use;
  - 9.88.2 they prevent former retail grocery sites from being used for that purpose;
  - 9.88.3 they prevent undeveloped land in major urban areas and their fringes from being developed into a retail grocery site, but would permit other retail uses; or
  - 9.88.4 they are used to maximise the profitability of a supermarket by restricting its exposure to competition.



- 9.89 We encourage the major grocery retailers to consider whether there is pro-competitive justification for the imposition of such covenants in the future, and to avoid them where they may adversely affect competition. We also encourage the major grocery retailers to release any existing covenants that limit competition and are not justified by some other specific rationale.
- 9.90 We acknowledge, however, that there may be significant difficulties in the major grocery retailers removing existing land covenants. We note that:
- 9.90.1 Even where records have been kept of existing covenants, removing them would require the support of other affected parties, such as the current owner. Proceedings under the Property Law Act 2007 may be required; and
- 9.90.2 The major grocery retailers may not be incentivised to unilaterally change their behaviour. If one of the major grocery retailers continued to engage in this conduct, the other could be left at a significant disadvantage if it did not also engage in it.
- 9.91 In any case, to the extent such covenants increase the profitability of the major grocery retailers and may be currently lawful, there is no reason to expect that they will be removed.
- 9.92 A regulatory intervention may therefore be necessary in order to free up sites currently subject to restrictive covenants. Any such prohibition of covenants would need to be carefully drafted. On the one hand, a narrow provision might be easily avoided and insufficiently flexible to deal with changing market conditions. On the other, a broad provision might have the unintended consequence of prohibiting covenants unrelated to the concerns the provision would aim to address.
- 9.93 The timing of any regulatory prohibition would need to be considered. Affected parties would need time to ensure compliance. Potential entry might also be facilitated if advance notice was given that sites for grocery retailing were likely to become available for use.
- 9.94 Alternatively, section 28 of the Act already prohibits covenants with the effect, likely effect or purpose of substantially lessening competition. It may be that, now that the Commission and industry have greater awareness of the issue, industry participants could assist in achieving a change of behaviour. The Commission will consider what further action may be required utilising our compliance and enforcement functions and powers in relation to this issue.

- 9.95 We note, however, that private and public enforcement has real limitations, as follows:
- 9.95.1 The entry into such covenants is not easy to detect by either the major grocery retailers, new entrants or any regulatory agency. The use of confidentiality and arbitration clauses may prevent disputes from coming to the attention of us or the public.<sup>900</sup>
- 9.95.2 Establishing breach would require an assessment of local competition conditions on a case by case basis, in each relevant geographic market. A new entrant attempting to achieve scale would need access to sites for grocery retailing in multiple locations, and proceedings to obtain appropriate sites would add significant cost, while introducing additional delay and uncertainty.
- 9.96 Changes could be made to section 28 of the Act to reduce the cost of private or public enforcement. This could include increasing the transparency of restrictive covenants and exclusivity covenants through notification or registration. It would also be possible to shift the burden of proof in relation to certain covenants, making them presumptively unlawful.
- 9.97 As noted in Chapter 6, we do not currently see evidence of significant use of long-term land banking for anticompetitive purposes. This may become more likely if the use of restrictive covenants and exclusive leases was reduced. Future monitoring of this issue may be desirable.

### **Options to directly improve retail competition in grocery markets**

- 9.98 The measures we have referred to above are directed at enhancing competition by making retail entry or expansion easier, including by improving wholesale supply. This may improve competition in the longer term but may not provide substantial enduring change in the short to medium term.
- 9.99 It would also be possible for Government to take more direct action to facilitate entry by further major grocery retailers. This could include divestiture of retail brands.

### **Facilitation of entry**

- 9.100 The comments we have made above about the potential for the Government to facilitate entry into wholesale apply equally to entry in retail grocery markets, and to integrated entry in both wholesale and retail.

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<sup>900</sup> *Wai-iti Developments Limited and Foodstuffs North Island Limited v General Distributors Limited and Woolworths New Zealand Limited* [2019] NZHC 1656.

- 9.101 Any measures to facilitate entry will, in part, be contingent on whether there have been changes to the wholesale market. It is possible that a combined intervention may result in a vertically integrated entrant that operates in both the wholesale and retail markets. Alternatively, if there has been wholesale market entry, or if access is available to wholesale grocery supply through other measures, then a firm may choose to enter at retail level only.
- 9.102 The costs and risks involved in Government intervention are again likely to be significant. We therefore anticipate that these measures are only likely to be appropriate where the costs, risks and expected benefits have been considered, and other options, particularly in relation to the wholesale market, have either proven ineffective, or did not appear feasible and likely to improve competition within the desired timeframe.

### **Divestiture of existing retail stores**

- 9.103 An alternative to new entry would be to require one or more existing market participants to divest part of their retail business. This may be necessary if it was thought that improved access to sites for grocery retailing and wholesale groceries would not be sufficient to encourage entry.
- 9.104 As noted above, the Commission's Merger and Acquisition Guidelines provide some guidance on the factors that are likely to influence the viability of a divestment.<sup>901</sup> These include ensuring that:
- 9.104.1 there will be an available purchaser with the necessary experience and financial backing to operate the business;
  - 9.104.2 the composition of the divested assets is attractive to the potential purchaser, and sufficient to operate as a viable competitor; and
  - 9.104.3 the competitive effectiveness of the assets does not deteriorate during the divestment process.
- 9.105 Identifying the appropriate package of assets for divestment would be more difficult than divestiture of a wholesale grocery business. A successful divestment would be likely to require at least:
- 9.105.1 a network of retail stores that provided sufficient scale for efficient operation;
  - 9.105.2 a wholesale supply business, or access to wholesale supply on competitive terms;
  - 9.105.3 a distribution business, or access to logistics services on competitive terms; and

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<sup>901</sup> Commerce Commission "Merger and Acquisition Guidelines" (July 2019) at Attachment F.

9.105.4 back-office support, at least on a transitional basis, to manage supplier relationships, marketing, personnel, finance and accounting, IT systems and an online presence.

9.106 Our comments in relation to the costs, risks and benefits of separation of the wholesale business equally apply to retail. Again, we anticipate that these measures would only be considered if 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.

### **Options to improve competition for the acquisition of grocery products**

9.107 As noted above, a grocery retailer cannot provide a widespread, full range, competitively priced offering without first obtaining groceries at competitive prices. Suppliers can also drive product quality and innovation. Where suppliers are unable to provide competitive supply, or unable to innovate, this will ultimately impact on consumers and may limit competition.

9.108 As we note in Chapter 8, it appears that (with a few exceptions) the major grocery retailers are generally in a much stronger negotiating position than their suppliers. This can result in cost savings that could be passed to consumers. We have, however, heard examples which suggest that in some cases grocery retailers appear to be using their strong negotiating position to:

9.108.1 limit suppliers' ability or incentive to provide competitive supply terms to other retailers. This may make it harder for those other retailers to enter or expand as they cannot provide a full range, competitively priced offering;

9.108.2 transfer costs and risks to suppliers, despite retailers being better placed to manage them. This may reduce efficiency, resulting in higher costs that are ultimately passed on to consumers; and

9.108.3 reduce transparency and certainty over terms of supply. This harms suppliers' ability to innovate and invest, reducing consumer choice in the longer term.

9.109 Suppliers' incentives to innovate and invest may be adversely affected by this conduct in ways that ultimately harm consumers. For example, this could lead to reduced production, reduced capacity, reduced product quality and fewer new product offerings. In some cases, other retailers may face reduced access to supply of groceries, affecting their ability to enter or expand.

- 9.110 We have heard submissions and evidence that supports the introduction of a code of conduct regulating the relationship between major grocery retailers and their suppliers.<sup>902</sup> Submitters have drawn our attention to the UK Groceries Supply Code of Practice and the Australian Food and Grocery Code of Conduct.
- 9.111 Another method of addressing any power imbalance would be the introduction of collective bargaining on behalf of suppliers, which may require an exemption from the Commerce Act. The ACCC has recently introduced a class exemption in respect of collective bargaining by small firms that would permit collective bargaining by firms with a collective annual turnover of less than \$10 million.
- 9.112 We acknowledge that changes to facilitate the entry of additional major grocery retailers may, in time, improve the position of suppliers. We consider that other measures may nevertheless be desirable even with additional retail entry. We note that in the UK a grocery code continues to be considered necessary even in the face of a greater number of grocery retailers.

#### **Potential arrangements for a code of conduct**

- 9.113 Our preliminary view is that a code would be beneficial. The effectiveness of any code of conduct in the grocery industry would depend on a number of factors.
- 9.114 A code of conduct may need to be mandatory, to ensure sufficiently wide coverage across grocery retailers in New Zealand. If a code was voluntary, there is a risk that one or more of the major grocery retailers, or any new entrants, may not sign up to it. This would likely undermine the effectiveness of a code. We acknowledge it is possible that market participants, including new entrants, may respond to enhanced competition by seeking to apply greater pressure to suppliers.
- 9.115 A code of conduct may need to be determined by Government, rather than industry self-regulation. Industry led arrangements can offer real advantages.<sup>903</sup> We have heard, however that suppliers lack confidence in the current supplier charters, which were negotiated by industry. To the extent there is a significant power imbalance, there is a real risk that the outcome of industry negotiations would reflect any power imbalance and represent a minimal improvement on the current position.

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<sup>902</sup> NZFGC "Submission on retail grocery market study preliminary issues paper" (4 February 2021).

<sup>903</sup> ACCC "Guidelines for developing effective voluntary industry codes of conduct" (July 2011).

- 9.116 A code of conduct would need to include an accessible and affordable dispute resolution mechanism, and it is likely that an independent decision maker would be needed for disputes. This could be an agency, a specialist provider of dispute resolution services, or a Government-appointed Ombudsman or adjudicator, similar to the UK's Grocery Code Adjudicator (GCA). Where an industry is characterised by significant power imbalances, and there is the potential for retaliation against suppliers to make complaints, it may be necessary for the decision maker to have an inquisitorial mandate, rather than a purely adjudicative one.
- 9.117 To the extent that self-enforcement is not considered sufficient, it may also be necessary to provide an agency with appropriate powers and resources to monitor compliance and undertake enforcement action where appropriate. Compliance with a code of conduct is likely to be improved by appropriate enforcement mechanisms. This could include civil pecuniary penalties to deter breaches of the code, and the ability to order payment of compensation to those affected by any breach of the code. Reliance solely on self-enforcement may not be realistic given the high costs of civil litigation in New Zealand, the concentrated market, and the disparity of resources between some suppliers and major grocery retailers.
- 9.118 A code of conduct will need to provide for periodic review to ensure the effectiveness of the code over time. The relationship between suppliers and major grocery retailers may change over time, and new issues may arise that should properly be included in a code.
- 9.119 In our fuel market study we recommended the enactment of a generic regulatory regime in the Commerce Act for the adoption and enforcement of industry codes, like Part IVB of the Australian Competition and Consumer Act 2010 (Cth) (CCA). This recommendation has not been adopted at this time. We remain of the view that a regime of this type may produce more consistent and predictable outcomes over time than the development of one-off regulatory regimes for different sectors.

#### **Potential content of a code of conduct**

- 9.120 Many of the concerns raised by suppliers with the Commission have been covered in Australia through provisions in the Food and Grocery Code.<sup>904</sup> One of our major grocery retailers, and a number of suppliers, operate in both markets. If a code is to be adopted in New Zealand, in our view consideration should be given to the potential benefits from alignment between New Zealand and Australia.

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<sup>904</sup> Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015, as amended.

- 9.121 A code could set minimum standards for the setting and variation of terms of supply. Examples of potential content of a code include:
- 9.121.1 A requirement that all agreements between major grocery retailers and suppliers, including any variations, must be:
    - 9.121.1.1 recorded in writing; and
    - 9.121.1.2 written in clear and concise language.
  - 9.121.2 Matters that must be covered, which might include:
    - 9.121.2.1 quantity and quality standards;
    - 9.121.2.2 delivery requirements;
    - 9.121.2.3 when groceries may be rejected;
    - 9.121.2.4 the maximum period for payment;
    - 9.121.2.5 circumstances when payment may be withheld, or deductions made; and
    - 9.121.2.6 the term of the agreement.
  - 9.121.3 Limits on retrospective variations of the terms of supply.
  - 9.121.4 Limits on unilateral variations of the terms of supply.
- 9.122 As noted in Chapter 6, some suppliers are sufficiently concerned about the response of existing retailers that they may decline to supply potential entrants. Even when supply is provided, it is likely to be on terms that are less favourable, due to the possible response from the major grocery retailers. In the current competitive conditions, where entry and expansion are unlikely, only limited pressure from the major grocery retailers may achieve this effect.
- 9.123 There is a real risk that the major grocery retailers' incentives would change, however, if entry or expansion in the wholesale or retail grocery markets was likely. Exclusive supply arrangements, or conduct disincentivising suppliers from supplying competitors, might become more common. This could hinder or prevent entry or expansion.
- 9.124 To mitigate this, a code could also address conduct that, directly or indirectly, places pressure on suppliers to refuse supply to other grocery wholesalers and retailers, or to supply only on less favourable terms. While such conduct may also substantially lessen competition, and therefore breach the Commerce Act, a specific prohibition may prove easier to enforce if an anticompetitive effect is presumed.

- 9.125 A key concern for suppliers would be the circumstances in which a major grocery retailer can delist a supplier's products. Concerns will also arise with other unfavourable treatment, less than delisting, that may nevertheless be used to discipline suppliers. A code of conduct would likely address both the circumstances in which these may occur, and the process that should be followed.
- 9.126 A code could also place restrictions on the use of own (private label) brands in a manner that is likely to harm suppliers in the long term. For example, a code could prohibit infringement of suppliers' intellectual property through the use of own brands.<sup>905</sup> Major grocery retailers could also be prohibited from discriminating in favour of own-brand products in ranging and space allocation decisions.<sup>906</sup>
- 9.127 A code may also identify other specific behaviours that should not occur or should occur only in defined circumstances. This could include payments for the major grocery retailers' business activities or costs, funding for promotions and promotional space, or sign-on payments.

### **Collective bargaining by suppliers**

- 9.128 Collective bargaining in this context involves two or more competitors jointly negotiating with a common supplier or customer about terms and conditions of supply, which may include price. This may involve appointing a single representative, such as an industry association, to act on their behalf in negotiations.
- 9.129 Small businesses can sometimes be better off negotiating as a group. They may be able to negotiate more efficiently with larger businesses and may be able to achieve better terms and conditions, than they can on their own. Larger businesses may also benefit from collective bargaining, particularly where it reduces their costs in dealing with individual suppliers.
- 9.130 Without limiting the potential use of collective bargaining by suppliers, we envisage it may be particularly efficient where major grocery retailers intend to modify non-price terms and conditions that are common to many suppliers. We note that collective bargaining is also relatively common in relation to groups of fresh produce suppliers.
- 9.131 As collective bargaining by suppliers involves an agreement between competitors, there is a risk that any such agreement may breach competition laws. Such agreements can, and have, been authorised by the Commission where they are likely to be of net public benefit. There are, however, significant costs in obtaining an authorisation and these costs may discourage small businesses from individually applying.

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<sup>905</sup> Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015, Clause 24(3).

<sup>906</sup> Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015, Clause 26(5).



- 9.132 Collective bargaining by small suppliers could be authorised, or provided a statutory exception, on a class basis. Any such authorisation or exception would need to ensure:
- 9.132.1 The collective bargaining was limited to the businesses, and circumstances, where it was likely to be beneficial. This would likely include a maximum size for any business involved in collective bargaining.
  - 9.132.2 The collective bargaining did not permit, or facilitate, additional conduct that would be likely to harm competition. This would include, but not be limited to, cartel conduct.
  - 9.132.3 It was transparent when collective bargaining was occurring, so that the effect of any authorisation or exemption could be monitored. A public notification of collective bargaining may be appropriate.
  - 9.132.4 It can be tailored to circumstances as they arise. It would be desirable if the authorisation or exemption was able to be amended, to reflect any identified concerns, unforeseen issues or changes in circumstances.
- 9.133 Collective bargaining by suppliers may not be sufficient, on its own, to overcome a significant imbalance between suppliers and major grocery retailers. Collective bargaining may, however, support some of the other options we have described.

#### **Fair Trading Amendment Bill**

- 9.134 The Commerce Commission investigated complaints of about the treatment of suppliers in the grocery sector in 2014 but concluded that there was no evidence of misleading or deceptive conduct, or coercion of suppliers in breach of the Fair Trading Act, or evidence of anticompetitive conduct in breach of the Commerce Act.<sup>907</sup> Absent misleading conduct, the relevant breach of the Fair Trading Act required physical force, harassment or coercion. It was noted that coercion required improper or illegitimate pressure, or conduct that was “in bad faith, immoral or unethical”.
- 9.135 Parliament is currently considering the Fair Trading Amendment Bill that will include a business-to-business unfair contracts regime, and a prohibition against unconscionable conduct. These reforms could potentially provide additional tools for suppliers wishing to take action against conduct of the kind reported to us during our study.

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<sup>907</sup> Commerce Commission “Progressive Enterprises Ltd: investigation closure report” (20 November 2014).

- 9.136 Assuming the Bill is passed in its current form, it will introduce a prohibition against unconscionable conduct. In Australia, the unconscionable conduct prohibition has been used with some success to deter unconscionable conduct against suppliers. The ACCC has investigated allegations of unconscionable conduct by major grocery retailers and has had some success in enforcement actions.<sup>908</sup>
- 9.137 The New Zealand unconscionable conduct prohibition will be enforceable by the Commission and private parties. It is likely that it will take a number of years to build up sufficient case law to determine the effectiveness of the unconscionable conduct prohibition in New Zealand. The scope of unconscionable conduct provisions in Australia has been the subject of debate and a number of appellate judicial decisions.<sup>909</sup>
- 9.138 The Fair Trading Bill will also introduce an unfair small trade contracts regime that will, by default, apply to all small trade contracts. These are defined as contracts involving a trading relationship with an annual value of less than \$220,000 plus GST.
- 9.139 Many suppliers to the major grocery retailers would have trading relationships in excess of \$220,000 plus GST. Regulations made under the Fair Trading Act may, however, deem a class of trade contract to be a small trade contract. This could provide suppliers with access to greater protections than at present.
- 9.140 The unfair contracts provisions of the Fair Trading Act are only able to be enforced by the Commission. We note that, if that were not the case, private enforcement of the unfair contracts provisions may work well in conjunction with permitting collective bargaining by suppliers.
- 9.141 The principle-based nature of the unfair contracts and unconscionability provisions means they are potentially of wide application but are inherently less certain than the specific provisions adopted in the UK and Australian codes of conduct. This may not provide sufficient certainty to industry to materially improve the position of suppliers. We consider that this uncertainty, together with the inability for suppliers to take private enforcement action against the use of unfair contract terms, means the regime is unlikely to be a viable alternative to a code of conduct. It may, however, support some of the code of conduct and other measures we have identified.

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<sup>908</sup> *ACCC v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405 and *ACCC v Woolworths Limited* [2016] FCA 1472.

<sup>909</sup> The decision in *Australian Securities and Investments Commission v Kobelt* [2019] HCA 18, was decided by a 4:3 majority and resulted in five separate judgments. These decisions have recently been reconciled, and the position clarified, in *ACCC v Quantum Housing Group Pty Ltd* [2021] FCAFC 40.

## Options for improving the information provided to consumers

9.142 Consumers, and the decisions they make, can drive stronger competition. We consider that major grocery retailers should simplify and improve some of the information they give to consumers. This will give consumers better tools to make more informed comparisons and purchasing decisions and improve consumer confidence. This in turn will enhance competition between the major grocery retailers.

### Simplifying pricing and promotional mechanisms

9.143 The major grocery retailers provide information to consumers to help compare offerings. Where the information provided is confusing it may make it harder for consumers to make informed decisions.

9.144 The pricing and promotional mechanisms used by the major grocery retailers appear to make it more difficult for consumers to make meaningful comparisons between offers and products. This is particularly the case where multiple pricing and promotional mechanisms are used frequently and often in combination with one another.

9.145 For example, New World and Countdown currently use at least four pricing and promotional tickets. The same style ticket may be used for both a “was/now” promotion and a “multi-buy” or an “everyday low price” offering may also be part of a multi-buy offer.<sup>910</sup> Feedback we have received from consumers suggests they find the current practices confusing, and decision making would be improved if pricing and promotional mechanisms used by the major grocery retailers were simplified.

9.146 We note the submissions that the major grocery retailers already intend to decrease promotional pricing and increase their use of “everyday low pricing”.

9.147 We consider that the major grocery retailers could also improve the clarity of their promotions and pricing practices in other ways. Our work suggests this could be done by, for example:

9.147.1 Simplifying and reducing the number of different promotional mechanisms and their use in combination.

9.147.2 Using different tickets for different mechanisms to clearly indicate the type of mechanism being used.

9.147.3 Ensuring that the usual price is accurate and consistently and clearly displayed alongside the promotional price.

9.147.4 Ensuring that member-only discounts are clearly labelled and easily distinguishable from other pricing and promotional mechanisms.

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<sup>910</sup> Further examples of these are in Table 7.1.

- 9.148 We welcome submissions on these and other potential changes the major grocery retailers should consider.
- 9.149 While the major grocery retailers appear likely to alter current industry practice, it is possible this change will not be enduring. In such circumstances additional options may be appropriate. For example, a consumer information standard introduced under the Fair Trading Act could facilitate these improvements by setting certain requirements relating to pricing displays by grocery retailers.

### **Consistent display of unit pricing**

- 9.150 As noted in Chapter 7, consistent unit pricing can help consumers compare the price of goods within retailers. To a lesser extent, as online shopping increases, consistent unit pricing may also help consumers compare the price of goods between retailers. Even when not directly comparing products and retailers, clear and accurate pricing information can help consumers to develop perceptions of value over time which in turn help them to decide where to shop to best meet their needs.
- 9.151 Where unit pricing information is not consistently available or cannot easily be assessed and acted upon by consumers, they may be less able to make informed decisions and less likely to shop around. This can result in a softening of competition between grocery retailers.
- 9.152 Unit pricing is mandated in Australia and the European Union. While unit pricing is not currently mandatory in New Zealand it is used to an extent by the major grocery retailers. It is not, however, used consistently.
- 9.153 We consider that improved unit pricing would assist consumers and improvements would appear to involve a relatively low cost, given unit pricing is widely used already. A consumer information standard under the Fair Trading Act could be published that required:
- 9.153.1 unit price to be prominently and clearly displayed both in store and online, in close proximity to the selling price including for products on promotion;
  - 9.153.2 products to display unit price using consistent units (for example, for goods sold by weight, a price per 100g);
  - 9.153.3 unit prices to be displayed in a consistent format including font style and size.

9.154 We note that the Australian Unit Pricing Code excludes a range of non-food items that, while sold at some major grocery retailers, are not grocery items.<sup>911</sup> Similar exclusions may be appropriate for any New Zealand unit pricing regime. As noted above in relation to the Food and Grocery Code, if regulation is to be adopted in New Zealand, consideration should be given to the potential benefits of alignment between New Zealand and Australia.

### **Price comparison websites**

9.155 As noted in Chapter 4, price comparison websites aggregate product information from different retailers, enabling consumers to digitally compare prices of alternative suppliers for the same or substitutable products. There is currently one price comparison website for retail grocery in New Zealand: FoodMe.

9.156 There is conflicting evidence over whether price comparison websites promote competition. Price comparison websites can reduce search costs for consumers and provide a means for consumers to shop around more easily, which provides stronger incentives for firms to improve their offerings. The effectiveness of this will likely be influenced by, for example, how easy the website is to use, and the reliability and accuracy of the comparisons being provided.

9.157 However, in some markets there is a risk that a price comparison website could facilitate coordination by increasing price transparency for firms. We consider the risk of that is likely to be low in this case, because a high degree of price monitoring is already undertaken by firms.

9.158 FoodMe does not appear to be widely used by consumers. It is unclear how useful consumers are likely to find price comparison websites in the context of grocery purchasing. The wide range of products, and requirements of different shopping missions, make price comparison considerably more difficult than markets where price comparison tools have proven useful, such as retail electricity.

9.159 Collecting pricing data directly from grocery retailers is likely to be the most accurate method for operating a grocery price comparison website. It is not clear, however, whether there would be benefits in providing access to this or other data that might be used to provide innovative services to consumers.

### **Improving disclosure of loyalty programmes terms and conditions**

9.160 As noted in Chapter 7, our preliminary view is that competition may be affected by consumers' lack of understanding of the terms and conditions of the loyalty programmes they subscribe to.

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<sup>911</sup> For example, books, magazines and stationery, electrical items, furniture, hardware, manchester, telecommunications, computer and AV equipment, sports and camping equipment, and clothing.

- 9.161 Our preliminary view is that most consumers do not have a good understanding of how loyalty programmes such as the Onecard and Clubcard work, particularly regarding rates at which benefits or points can be earned by consumers and redeemed for various rewards.<sup>912</sup>
- 9.162 We consider that complex rewards structures could make it harder for consumers to identify the benefits available to them, and lessen price competition by shifting consumer focus away from retail prices and towards rewards. They also make it difficult to compare the benefits offered by a loyalty programme with other discount promotions offered by the same, or other grocery retailers.
- 9.163 These effects would be mitigated if the major grocery retailers simplified and improved the presentation of the reward structures offered by their loyalty programmes to ensure that they are clear and transparent and more easily understood by consumers. For example, the major grocery retailers should:
- 9.163.1 Ensure consumers understand the difference between transaction-based benefits and accumulated rewards.
  - 9.163.2 Clearly and prominently explain the rate of reward consumers can earn through accumulating points and its value (ie, the dollar spend required to earn points and the dollar value of any corresponding reward once earned).<sup>913</sup>
  - 9.163.3 Ensure that consumers are adequately notified if their accumulated points are approaching expiry.
  - 9.163.4 Notify consumers of any changes to their rewards structures.

*Consumer data collection and use practices*

- 9.164 As noted in Chapter 7, we also consider that many consumers do not understand how their personal data is collected and used in their loyalty programmes. Consumers may not be able to make decisions about their participation in loyalty programmes that accurately reflect their data use and privacy preferences. This may inhibit competition for consumers with strong data use or privacy preferences.
- 9.165 While the major grocery retailers disclose some of these practices, their privacy policies lack specificity around who might be provided with consumer data and on what basis. In addition, the terms and conditions are lengthy, difficult for consumers to understand, and may change without consumers being informed. Consumers may therefore not be aware of what they are signing up for.

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<sup>912</sup> We have explained the types of benefits available in Table 7.2.

<sup>913</sup> We have noted in paragraph 7.175 above that the typical reward rate is relatively lower than the amount of spend required (less than 1%).

- 9.166 We consider that the major grocery retailers need to ensure that they are providing consumers with appropriate relevant information to make informed decisions. For example:
- 9.166.1 The major grocery retailers should ensure that their explanation of the nature of consumer data collection and use practices is sufficiently prominent, by:
- 9.166.1.1 Improving the accessibility, clarity and readability of privacy policies and other related terms and conditions.
  - 9.166.1.2 Clearly describing how consumer data is shared, with whom and why.
  - 9.166.1.3 Minimising information overload by prominently presenting the key aspects of their policies.
- 9.166.2 Providing consumers with timely and prominent notice of any changes to these practices and an option to cancel their membership if they do not accept the changes.
- 9.166.3 Major grocery retailers that can link consumers' payment cards to their loyalty membership to track purchasing behaviour when they do not scan their loyalty card, should disclose the potential for this clearly or consider changing their practice.
- 9.167 Our preliminary recommendation is that the major grocery retailers should voluntarily make these improvements. If they do not, regulation may be necessary to improve these practices.

### **Next steps/questions for discussion**

- 9.168 We invite comment on the options we have set out, and also welcome suggestions of other options for recommendations we may make that could enhance competition.
- 9.169 Like the preliminary views expressed throughout our draft report, the options are subject to our further consultation process, further analysis and deliberation, and we may alter or remove any option when we finalise our recommendations.

## **Attachment A                    Next steps and how you can have your say**

- A1     This attachment provides information on how you can have your say on this draft report, and details about our consultation conference.
- A2     Written comments on this draft report are due **4pm, Thursday 26 August 2021**.
- A3     We intend to hold a consultation conference in central Wellington from **Tuesday 21 September to Friday 24 September 2021** and provide further details on this below.
- A4     Further comments, including comments on matters raised at the conference and in published comments made by others, are due **4pm, Thursday 7 October 2021**.
- A5     The remaining sections in this attachment cover:
- A5.1    making written comments on this report;
  - A5.2    confidential information – disclosure of your submission;
  - A5.3    invitation to attend consultation conference; and
  - A5.4    questions on material included in this attachment.

### **Making written comments on this report**

- A6     You are welcome to provide your views to us by uploading your written comments via our website: [www.comcom.govt.nz/groceries](http://www.comcom.govt.nz/groceries).
- A7     We encourage you to provide comments that are supported by evidence. Less weight may be given to a statement or submission that cannot be supported by evidence.
- A8     Please provide submissions in both a format suitable for word processing (such as a Microsoft Word document), and a 'locked' format (such as a PDF) for publication on our website.

### **Confidential information – disclosure of your submission**

- A9     While we intend to publish submissions on our website, we understand that it is important to parties that confidential, commercially sensitive or personal information (confidential information) is not disclosed as disclosure could cause harm to the provider of the information or a third party.
- A10    Where your submission includes confidential information, we request that you provide us with a confidential and a public version of your submission. We will publish the public versions of submissions on our website. We note that responsibility for ensuring that confidential information is not included in a public version rests on the party providing the submission.



- A11 Where confidential information is included in submissions:
- A11.1 the information should be clearly marked and highlighted in yellow; and
  - A11.2 both confidential and public versions of submissions should be provided by 4pm on the due date.
- A12 If your submission contains information which is considered confidential, a schedule must be provided which identifies each piece of information over which confidentiality is claimed and the reason why the information is confidential (preferably with reference to the Official Information Act 1982 (OIA)).
- A13 We will not disclose any confidential or commercially sensitive information in a media statement, public report, or in response to a request, unless there is a countervailing public interest in doing so in a particular case. Such cases are likely to be rare and would be discussed with you in advance of any publication.
- A14 We will consider any request from a party who wishes to keep their identity and/or the content of their submission anonymous. However, this request must be discussed with us first, before the submission is provided to us. Submitters must justify any request for anonymity by providing reasons.
- A15 We will publish on our website public versions of written comments on our draft report as soon as practicable. If, after we have published the public versions, we identify further information in written comments that may be made public, we will ask for additional public versions to be provided for publication and inform all stakeholders when they are available on our website.

### **Invitation to attend consultation conference**

- A16 We intend to hold a consultation conference from **Tuesday 21 September to Friday 24 September 2021**.
- A17 This conference is intended to inform our final report by allowing us to test our preliminary findings with stakeholders, and to clarify and test comments received on our draft report.
- A18 It will be held at a hotel in central Wellington.

### **Consultation conference format**

- A19 The conference is likely to include open sessions as well as some confidential sessions with stakeholders on specific topics.

- A20 During the conference, each topic will be introduced by us. Members of the Commission and Commission staff will ask specific questions of parties and experts. We may choose to direct some questions to experts without reference to the parties. Parties may only ask questions of us for the purpose of clarifying a question. No party will have the right to cross-examine us or any other party during the conference. We do not intend to update stakeholders with our views on matters addressed in our draft report prior to, or during, the conference.
- A21 Although there may not be an opportunity for participants to speak to their comments in general, we may allow for statements from participants on specific topics. Where this is the case, we will inform participants prior to the conference.

### **Attendance of experts at the conference**

- A22 We expect that all experts that have been advising parties will be available at the conference to respond to our questions and that experts attending the conference appear as experts in their fields rather than as an advocate for any particular party. We also expect experts to follow the guidance provided in the code of conduct for expert witnesses in the High Court Rules.<sup>914</sup>

### **Confidentiality**

- A23 Our expectation is that confidential material should be kept to a minimum during the conference in order to maintain as transparent a process as is possible. Attendance at any closed confidential session would be limited to Commission members, Commission staff, the party presenting the confidential information, and counsel and/or experts who have provided us with undertakings not to reveal the confidential information to any other party, including the persons instructing the experts.
- A24 We understand that some information you may want to discuss with us could be commercially sensitive and highly confidential. If stakeholders wish to attend the conference but have concerns or questions regarding confidentiality, please contact us at [marketstudies@comcom.govt.nz](mailto:marketstudies@comcom.govt.nz).

### **Other administrative matters**

- A25 The conference will be recorded, and a stenographer will also provide a transcript of the conference. A transcript of each day's discussion (excluding any closed confidential sessions) will be made available on our website as soon as practicable.
- A26 The conference will start at 9.30am each day, with breaks for morning and afternoon tea and lunch. Please note these will not be catered by us.
- A27 Interested media may be in attendance at public sessions.

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<sup>914</sup> Schedule 4 of the High Court Rules 2016:  
<https://www.legislation.govt.nz/regulation/public/2016/0225/latest/DLM6953324.html>.

- A28 Stakeholders are asked to register their intention to attend the conference by **4pm, Thursday 12 August 2021** by providing the following details:
- A28.1 organisation;
  - A28.2 name and role of each attendee (including experts);
  - A28.3 contact number; and
  - A28.4 email address.
- A29 At this time, stakeholders are also requested to register their interest in speaking in public sessions should this opportunity be available.
- A30 At this time, we are also interested to hear from stakeholders about topics they may consider to be important to informing the conference.
- A31 Please note that limited seating is available so the number of attendees at the conference may have to be restricted. Time constraints may also mean that we cannot accommodate all requests to speak at the conference.
- A32 We will confirm conference attendees and speakers one week prior to the conference, at the latest.
- A33 We will also confirm topics and publish an agenda for the conference prior to the conference date.

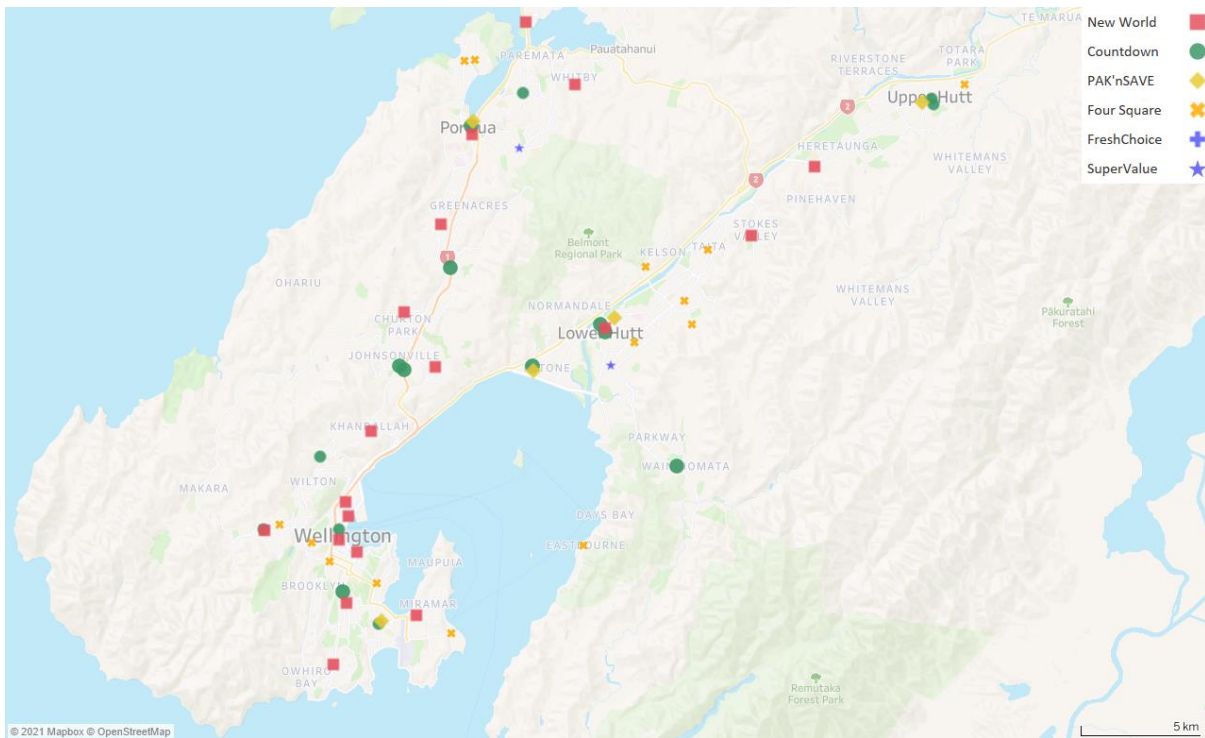
### **Questions on material included in this attachment**

- A34 If you want to register your intention to attend the conference, or have any questions or comments regarding material covered by this attachment, please contact us at: [marketstudies@comcom.govt.nz](mailto:marketstudies@comcom.govt.nz).

**Attachment B Additional maps of grocery stores**

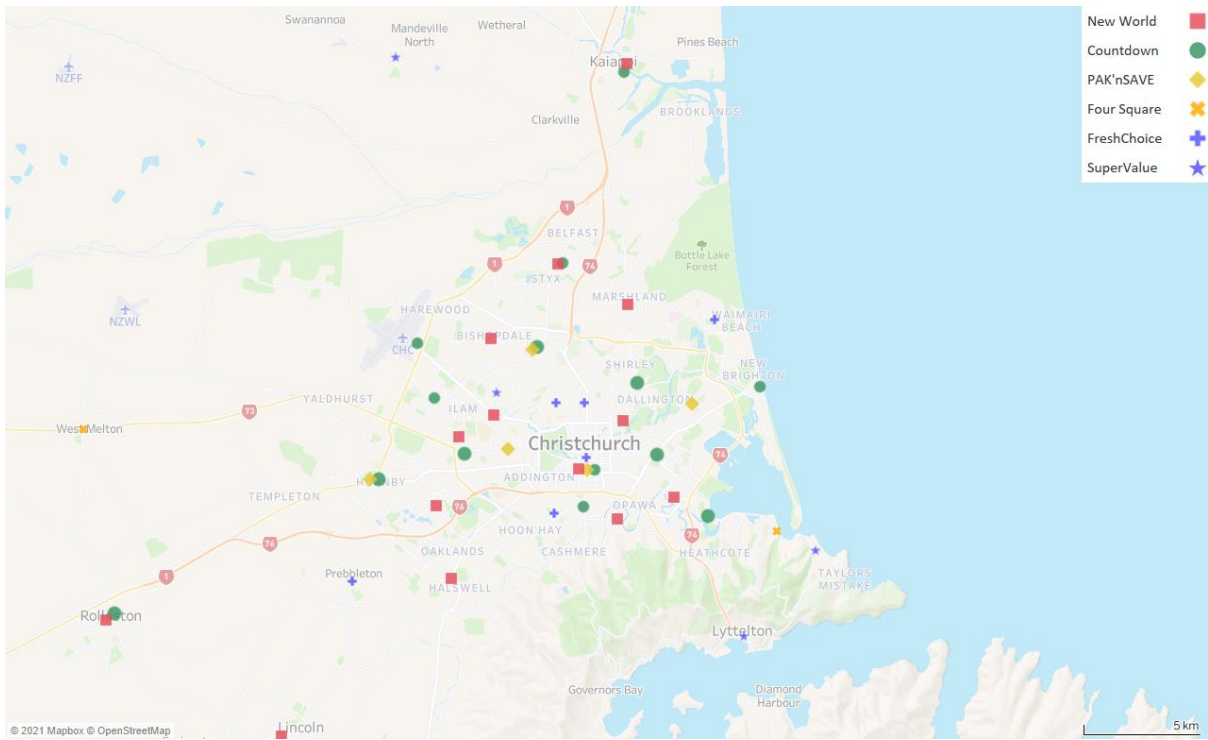
- B1 This attachment includes maps additional to those included in our draft report showing supermarket locations in New Zealand.
- B2 Figure B1 and Figure B2 show the location of major grocery retailer stores by retail banner in Wellington and Christchurch. A similar map of Auckland is included in Chapter 2 at Figure 2.4.
- B3 Figure B3 and Figure B4 show the location of major grocery retailer stores in the upper and lower North Island. A similar map of the South Island is included in Chapter 2 at Figure 2.3.
- B4 Figure B5 and Figure B6 show the location of other grocery stores in Wellington and Christchurch. Similar maps of Auckland, and regional maps of the North Island and South Island are included in Chapter 4 at Figure 4.7, Figure 4.8 and Figure 4.9.
- B5 Chapter 4 also provides more detail of which other grocery stores are included in these maps.

**Figure B1 Major grocery retailer store locations in Wellington by retail banner**



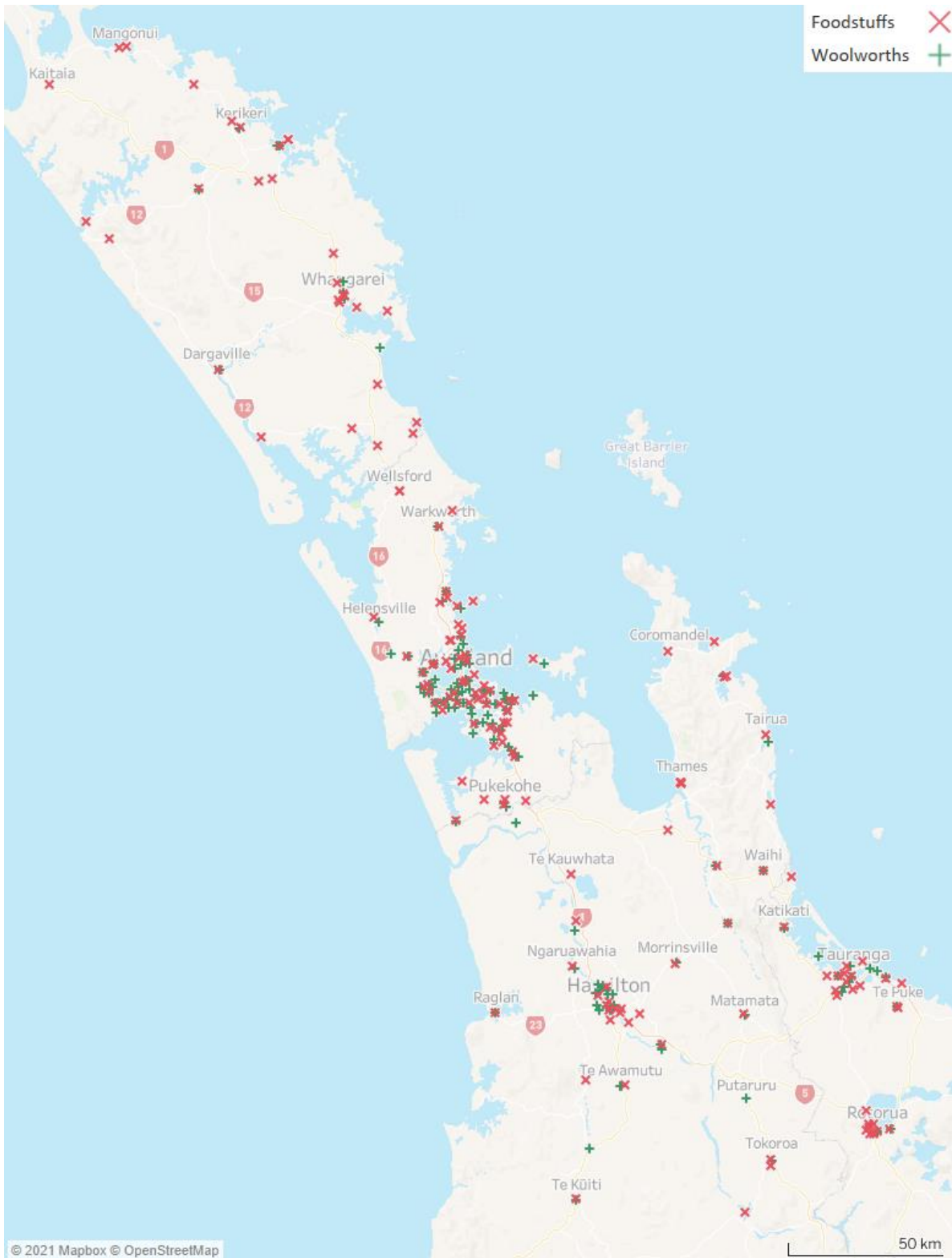
Source: Commission analysis of information provided by major grocery retailers, as at December 2020.<sup>915</sup>

**Figure B2 Major grocery retailer store locations in Christchurch by retail banner**



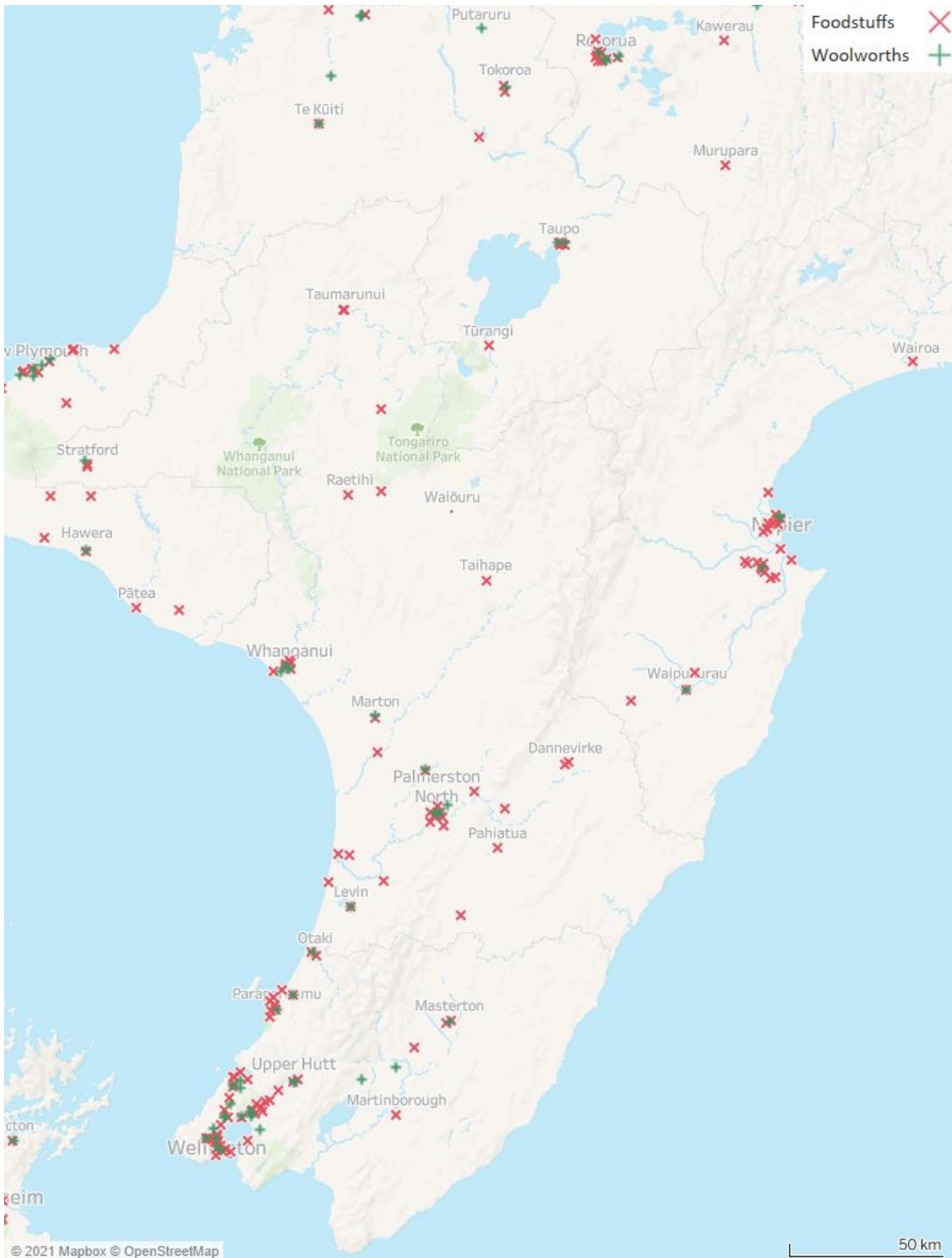
Source: Commission analysis of information provided by major grocery retailers, as at December 2020.<sup>916</sup>

**Figure B3 Major grocery retailer store locations in the upper North Island**



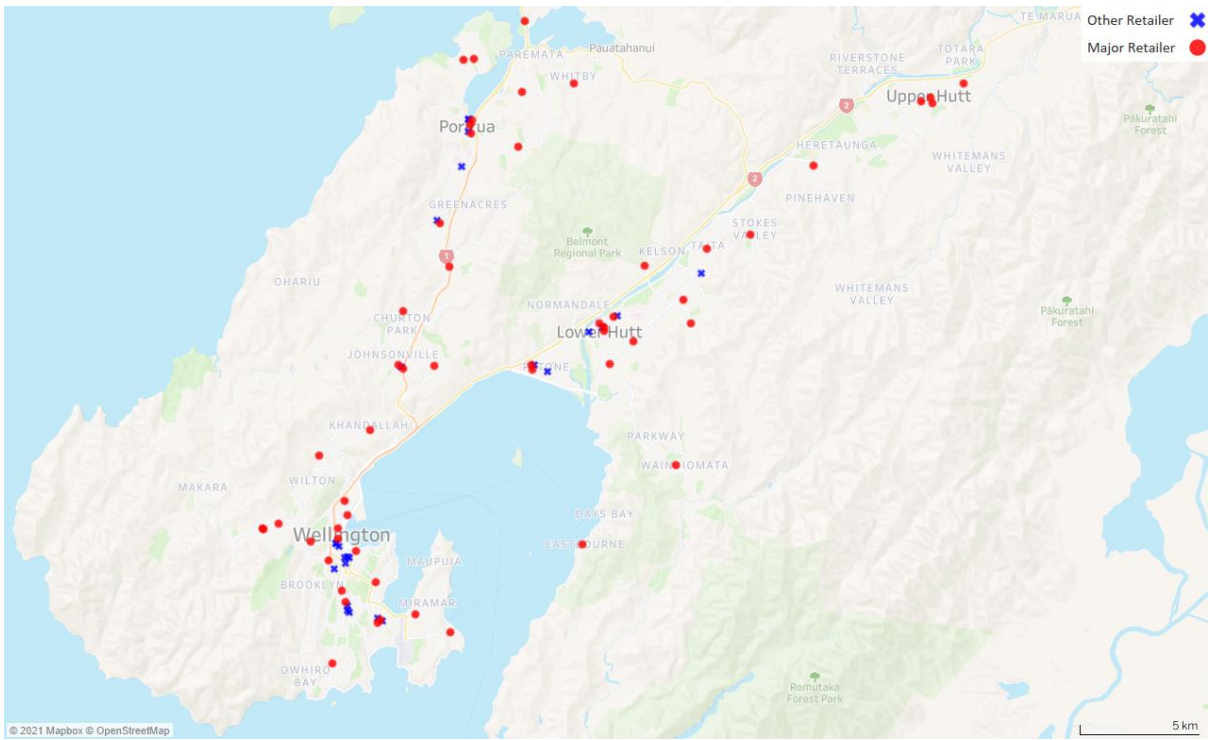
Source: Commission analysis of information provided by major grocery retailers, as at December 2020.<sup>917</sup>

Figure B4 Major grocery retailer store locations in the lower North Island



Source: Commission analysis of information provided by major grocery retailers, as at December 2020.<sup>918</sup>

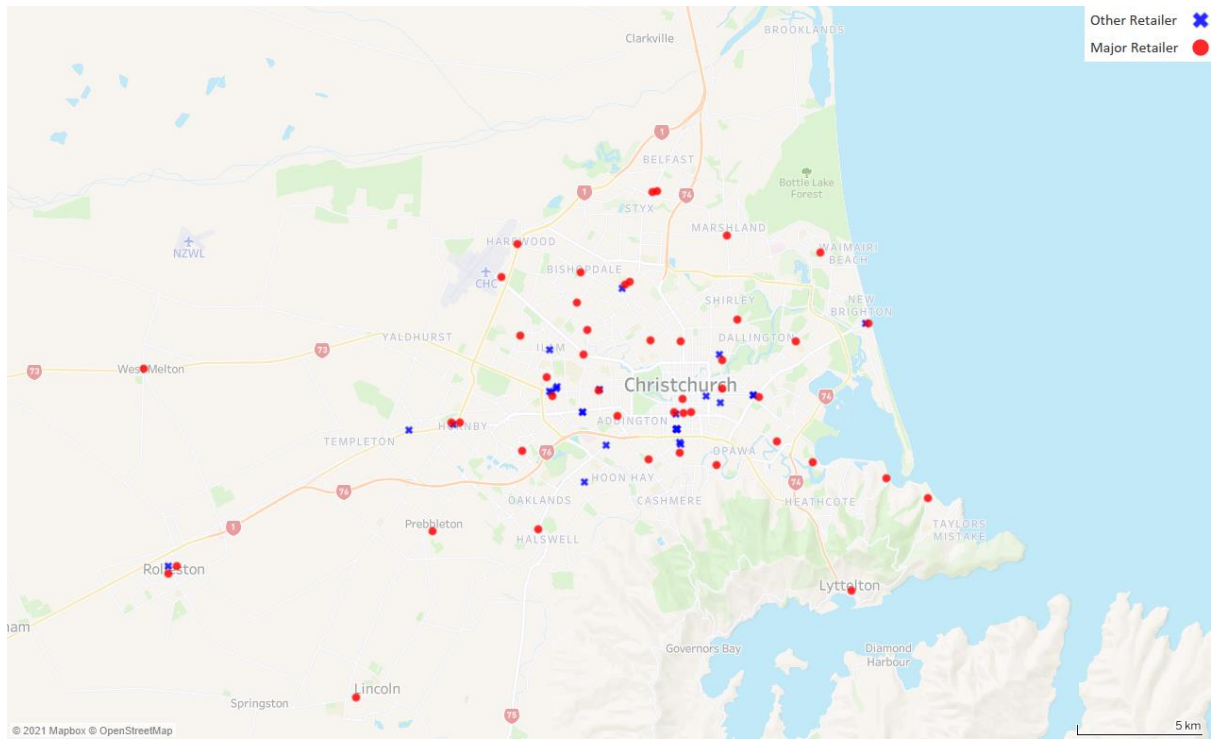
**Figure B5 Grocery store locations in Wellington**



Source: Commission analysis of information provided by major grocery retailers.<sup>919</sup>



**Figure B6 Grocery store locations in Christchurch**



Source: Commission analysis of information provided by major grocery retailers.<sup>920</sup>

## **Attachment C                    Our assessment of retail grocery profitability**

### **Introduction**

- C1     This attachment provides details about how we have assessed profitability within the retail grocery sector, the analysis we have undertaken and our preliminary findings from this analysis.
- C2     The sections in this attachment are:
- C2.1    what is profitability and why do we measure it;
  - C2.2    our approach to assessing profitability;
  - C2.3    our estimation of normal levels of profitability for grocery retailing in New Zealand;
  - C2.4    our assessment of the profitability of grocery retailers in New Zealand; and
  - C2.5    profitability summary – is there persistence of excess levels of profit.

### **What is profitability and why do we measure it**

- C3     Profitability analysis has formed part of our assessment of competition in the grocery sector.
- C4     The ability of all or most market participants to extract profits which are persistently in excess of a normal return may indicate that competition is not working effectively for the long-term benefit of consumers.
- C5     Excess levels of profitability can arise temporarily in competitive markets from pro-competitive conduct such as innovation and increasing efficiency of operations. Likewise, an absence of excess returns does not necessarily mean that competition is working effectively, as the relevant businesses may not be operating efficiently.
- C6     Similarly, there may be some market participants that make consistently high levels of profit in competitive markets because they are more efficient than their competitors, such as when they control unusually productive resources, while their less efficient or innovative competitors make relatively low levels of profitability.

- C7 Nevertheless, in a workably competitive market we would expect profitability to tend towards normal returns over time.<sup>921</sup> We would expect new entrants to be drawn to the market by excess returns, investing in capacity that increases the supply of goods and services, which in turn lowers the price of these products, and reduces the level of returns down to normal levels.
- C8 We therefore focus our assessment on whether major grocery retailers' profits are consistently (across firms) and persistently (over time) in excess of normal returns to inform our overall understanding of whether competition is working well for consumers.

### **Our approach to assessing profitability**

- C9 This section presents our approach to assessing profitability of grocery retailers in New Zealand. It includes both a conceptual discussion of our approach and a technical discussion of the specific profitability measures we have used, the issues we have encountered in their use and the ways we have addressed these.

#### **Overview of our conceptual approach**

##### *Our focus is economic profitability*

- C10 Our conceptual approach for assessing profitability is an economic one. Economic profit differs from accounting profit in that it includes the cost of capital associated with the assets used to generate the accounting profit. Assessing economic profit is different to assessing taxable profit. Each of these measurement objectives has its own data and information requirements.
- C11 Economic profit is benchmarked against the opportunity cost of investing the assets (or capital) employed elsewhere. It is calculated with reference to the economic costs of the resources used in the business. These costs are based on a price the resource would be bought and sold for in a competitive market. The economic value of the resources being used (or assets being utilised) reflects their current value to the business, or their market value.
- C12 We do this because we want to understand the true economic cost, or opportunity cost of undertaking the business activity in question. This includes understanding the return required on any capital in order for it to be employed in a given activity rather than elsewhere. In doing so, we are seeking to understand the costs that a notional firm would need to incur in order to undertake the activity.

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<sup>921</sup> *Wellington International Airport & Others v Commerce Commission* [2013] NZHC 3289 [11 December 2013], at [18]-[20], available at: <https://forms.justice.govt.nz/search/Documents/pdf/ido/53/alfresco/service/api/node/content/workspace/SpacesStore/1c117dea-b8ba-491e-ba1d-d4cd30dbe522/1c117dea-b8ba-491e-ba1d-d4cd30dbe522.pdf>.

- C13 The economic costs of resources often differ from the depreciated historical purchase price of the assets (or book value) that are shown in a company's financial statements. These valuations are usually based on accounting principles. In some cases the book value of an asset is an acceptable measure of its economic cost. However, in other cases we need to adjust the accounting value of assets to reflect their economic value.
- C14 This includes forming a view on the appropriate valuation of any land and buildings the grocery retailer owns and assessing the market valuation (or replacement cost) of other assets that the grocery retailer uses, such as store fittings and fixtures. Over time, the gap between economic and tax depreciation can widen such that the book value of assets is less than their market value.
- C15 The opposite issue can also arise. For example, some assets that are often included in commercial balance sheets would not be considered relevant to our economic estimate of capital employed if they relate to items that naturally occur through the running of a business or relate to the expectations of future earnings. As such, we have also examined the intangible (non-physical) assets of grocery retailers listed in their accounts. This includes items such as brands and licenses, which the company paid a specific amount for and represent assets the company uses in generating its earnings.
- C16 Another significant intangible is goodwill. Goodwill is the difference between what a company historically paid for another business when it was acquired, and the book value of the acquired business' assets at the time. Unless a company is in distress, it's sale value is normally based on an assessment of its future expected net cash flows rather than the book value or the scrap value of the assets being acquired. Premiums paid on acquisition (above the entry cost of acquiring the necessary assets) therefore reflect the expectation that the company will be able to make future profits above the entry cost of the necessary assets. These premiums show up as goodwill in the acquiring company's accounts and represent the premium paid for the ongoing economic rents that the company is expecting to collect.<sup>922</sup>

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<sup>922</sup> Oxera "Assessing profitability in competition policy analysis" (July 2003) at 72, available at: <https://www.oxera.com/wp-content/uploads/2018/03/OFT-Assessing-profitability-1.pdf>.

C17 For these reasons our starting position is to remove all goodwill from our profitability assessment. This approach is consistent with the approach taken in our fuel market study, and international studies and research. For example, the 2020 study into the funerals market by the Competition and Markets Authority (CMA) of the UK.<sup>923</sup> This study noted that goodwill is the value of the profits generated from running the business – above those needed to cover costs, including asset costs. Therefore it should not be included in the capital employed. Having done so, we then check that productive assets reflected in the book value are not under-valued relative to their true cost.

*Our focus is profit from grocery retailing*

C18 Our profitability assessment has focussed primarily on the retail grocery activities of the businesses we have assessed. We have therefore sought to exclude all activities unrelated to grocery retailing from our analysis.

C19 This approach has been complicated by the structure of the two Foodstuffs co-operatives, as each group of companies includes multiple legal entities performing different tasks and the co-operatives have property holdings.<sup>924</sup>

C20 Each co-operative is owned by the operators of its individual shareholder retail member stores (retail members). The co-operatives do not directly engage in grocery retailing but provide a range of different services for their retail members which are funded by those retail members in a number of ways.<sup>925</sup> Activities can be divided into the following broad categories:

C20.1 Wholesale grocery purchasing, warehousing, and distribution services associated with the supply chain are undertaken by the co-operatives and charged to their member stores. They also undertake marketing, IT, and a range of other support functions.<sup>926</sup> The operational cost of these services is recovered from the retail members.<sup>927</sup>

C20.2 The co-operatives also own many of the land and buildings that the member stores lease from the co-operative, the land and buildings for grocery wholesale and distribution activities, and IT assets. The co-operatives charge their retail members rent for these premises. Both co-operatives also redevelop premises as required.<sup>928</sup>

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<sup>923</sup> Competition and Markets Authority “Funerals Markets Investigation” (18 December 2020), Appendix S, at S22, available at: [https://assets.publishing.service.gov.uk/media/5fdb2461e90e071be1015708/Appendix\\_S\\_-\\_Profitability\\_of\\_funeral\\_directors\\_18.12.20.pdf](https://assets.publishing.service.gov.uk/media/5fdb2461e90e071be1015708/Appendix_S_-_Profitability_of_funeral_directors_18.12.20.pdf).

<sup>924</sup> [ ].

<sup>925</sup> Although we note that the co-operatives do directly own some subsidiaries that do retail groceries. For example, the co-operatives jointly own Liquorland, which retails alcohol.

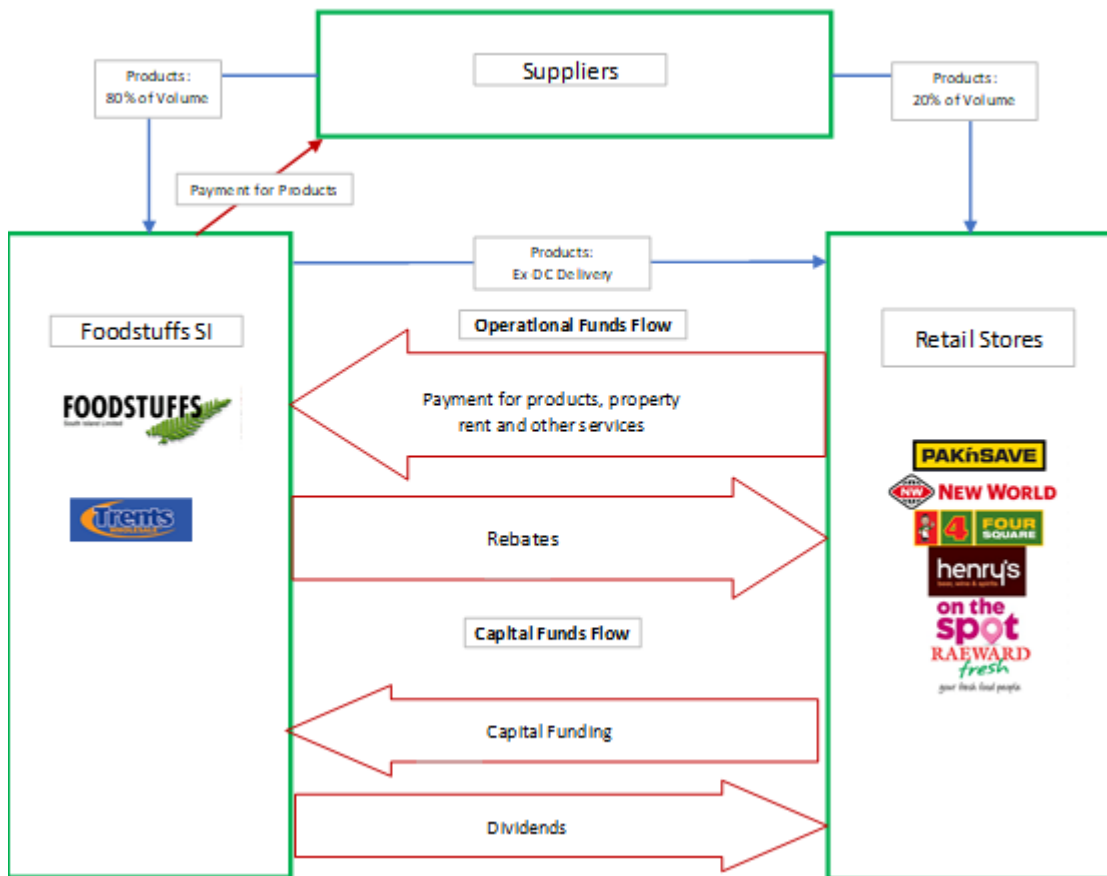
<sup>926</sup> This includes merchandising services including product sourcing, ranging and promotional planning, retail execution support, management of marketing, IT and digital systems development, developing and renting properties for owned retail stores, transactional shared services, HR and legal support.

<sup>927</sup> [ ].

<sup>928</sup> [ ].

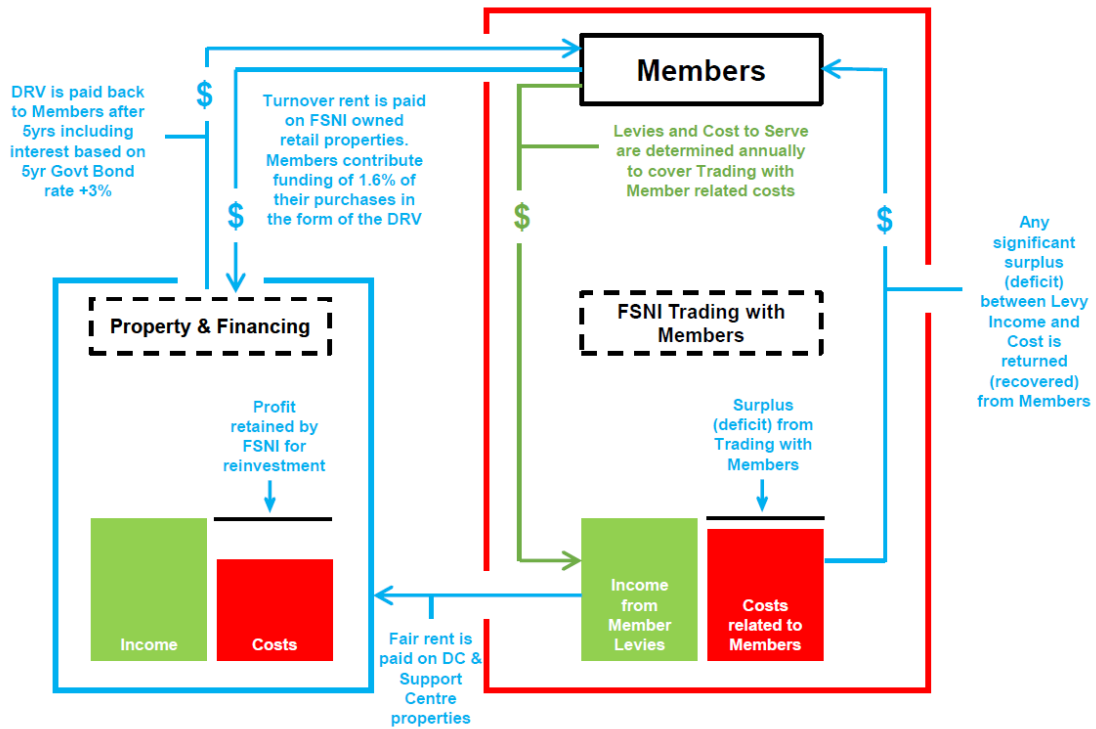
- C20.3 Capital funding is also provided between member stores and the co-operatives. This also makes assessing profitability more complex.
- C21 The store owners are shareholders or retail members in their respective co-operative. Retail members directly engage in grocery retailing. They lease the store premises from their respective co-operative and pay for the services provided by their co-operative. Retail members own the stock inventories, store fittings and fixtures for their stores.
- C22 Figure C1 shows the relationship between Foodstuffs SI and its retail members, including the flow of grocery products and operational and capital funds flow. The Foodstuffs NI operating structure as shown in Figure C2 below has some slight differences to its South Island counterpart but is broadly similar. However, we note that Foodstuffs NI treats capital funding from the retail member stores as an equity investment, whereas the Foodstuffs SI co-operative treats this as debt funding.

**Figure C1 Operating structure and flow of payments within the Foodstuffs SI co-operative**



Source: Information provided by Foodstuffs SI.<sup>929</sup>

**Figure C2 Operating structure and flow of payments within the Foodstuffs NI co-operative**



Source: Information provided by Foodstuffs NI.<sup>930</sup>

C23 Given the retail members operating the individual retail member stores are the corporate entities that are directly engaged in grocery retailing, we have focussed our profitability assessment on the retail member stores of each co-operative. In doing this, we have combined the individual Foodstuffs NI and Foodstuffs SI retail member stores into a notional entity for each co-operative and have assessed this entity’s grocery retailing profitability as a whole.

- C24 We acknowledge comments from Foodstuffs NI and Foodstuffs SI that they consider the transactions between the co-operatives and the retail member stores cannot be interpreted as independent, arm's length and economic cost reflective transactions.<sup>931, 932</sup> We have therefore sought to understand whether the costs being recovered, and the financing transactions are on a commercial footing, or whether there is some form of cross-subsidy between the co-operatives and their retail member stores. To account for this, we have made a number of adjustments and sensitivity checks. These have included assessments of rent being paid by the member stores to the co-operatives, the cost of wholesaling services, and capital funding being provided by the retail member stores to the co-operatives.
- C25 We have also examined the profitability of the co-operative companies (as distinct from the supermarkets) to gain a complete picture of the entire co-operative group. This has allowed us to test whether, for example, the co-operatives are making economic losses that disguise the true profitability of their respective retail member stores that own the co-operatives.
- C26 However, understanding the profitability of the two co-operatives has been difficult:
- C26.1 While the bulk of their operational activities can be described as grocery wholesaling and distribution, the bulk of each co-operative's assets are land and buildings.<sup>933</sup> These assets are not always regularly revalued. This makes it difficult to assess profitability in terms of the asset base and the gains they have made from holding these assets. While we have some information on the market value of land and buildings and have used this to uplift Woolworths NZ's relatively small property portfolio; applying this uplift to the co-operatives' entire portfolio of assets is challenging.

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<sup>931</sup> Foodstuffs NI and Foodstuffs SI responses to Commission information requests.  
[ ]

<sup>932</sup> Foodstuffs NI has indicated this is because, first, the levies included in the financial flows between the co-operative and the member-owned individual stores are used to raise finance as well as to recover costs. Secondly, even the cost recovery elements are imprecise and exclude any allowance for risk associated with the relevant activities (for which an arm's-length counterparty would be compensated). In Foodstuffs NI's view, the implication of these features of the transactions between the co-operatives and the individual stores is that profit margins for the co-operative can only be meaningfully calculated and benchmarked at the whole of business level. Foodstuffs SI considers the transactions between the co-operatives and the individual stores cannot be interpreted as independent, arm's length and economic cost reflective transactions as they are based on "cost recovery" only and do not reflect an economic charge for the use and risks of the wholesale business and assets (which is substantial). Without considering this effect retail store profitability is materially overstated.

<sup>933</sup> [ ];  
[ ]



- C26.2 In addition, both co-operatives hold large portfolios of land and buildings, and regularly redevelop these premises. As such, this part of the co-operatives can be considered more akin to a property holding company than engaging in grocery retailing. This means the appropriate benchmark for assessing profitability will not be the same as that used for grocery retailing. We discuss this in more detail later in this attachment.
- C27 Woolworths NZ is a more integrated business model. The majority of its business activities are directly related to grocery wholesaling and retailing, it owns a relatively small amount of land and buildings (leasing the vast majority of its stores and warehouses), and it performs its own wholesaling and distribution of groceries. We have removed the accounts for two subsidiaries that were engaged in non-grocery retailing activities from Woolworths NZ's financial accounts.
- C28 Woolworths NZ also operate a franchisee model for the SuperValue and FreshChoice stores. The costs that Woolworths NZ incurs in servicing these stores and the payments it receives for those services (ie, the profits of its wholesaling activities to these stores) are included in its profitability. However, the grocery retailing activities for these stores are excluded from Woolworths NZ as they are separate grocery retailers. We do not consider this franchisee business has a material effect on Woolworths NZ's profitability for the purposes of this study given that the franchise stores are a relatively small part of its overall business.
- C29 We have not been able to collect sufficient financial data for these individual stores in order to robustly assess their store profitability. However, it appears while the margins of individual franchisees vary, on average their profit margins are slightly lower than those of Woolworths NZ. This exclusion omits profits from around 70 retail stores.

### **Overview of our approach**

- C30 Our approach for assessing grocery retailing profitability has been to use a number of generally accepted profitability measures that we have robust data available for. These profitability measures have been drawn from various sources, including those used in our fuel market study, those used in overseas studies of grocery retailers, and those supported by generally accepted international competition policy methods.
- C31 We have compared these profitability measures to benchmarks to understand what the level of profitability suggests about the competition levels in the sector and to establish whether it is persistent.
- C32 Our primary measure for assessing retailers' profitability is the ROACE. The ROACE is comparable to our estimate of the WACC for a grocery retailer. It has also been compared to returns of international grocery retailers of similar nature, and against the wider rates of return being made by companies in New Zealand listed on the NZX50 share index.

- C33 We have also examined the historic profit margins of the major grocery retailers in New Zealand. Profit margins have been calculated as the annual level of profitability as a percentage of the annual sales turnover. These have been assessed in terms of longer-term trends and against international grocery retailers' profit margins.
- C34 We have assessed three different levels of profit margins. These are:
- C34.1 **GP margin:** GP is the profit a company makes after deducting the costs immediately associated with purchasing its products and making them ready for sale. Put another way, it is the total sales revenue the company receives, less the total cost of the goods sold. The GP margin is the total GP divided by total sales for a financial year.
- C34.2 **EBIT margin:** EBIT is the profit a company makes before the interest expenses on debt and the tax on its profit have been paid. It reflects the amount of pre-tax profit that is available to service the providers of a company's debt and equity. The EBIT margin is the total EBIT divided by total sales for a financial year.
- C34.3 **NPAT margin:** NPAT is the profit a company makes after all costs, including interest and taxation have been paid. The NPAT margin is the total NPAT divided by total sales for a financial year.
- C35 Finally, we have examined the returns that grocery retailers expect to earn from proposed new investments, and the level of financial return that the grocery retailers require for new business cases to be approved. This has been compared against the estimated WACC of the firm.
- C36 This overall approach is similar to that used in our fuel market study, which drew on a variety of assessment tools to produce as complete a picture of profitability as possible.<sup>934</sup> However, our approach has been somewhat restricted compared to that study due to the availability of data and lower number of major market participants in the sector. In addition, none of the New Zealand grocery retailers are publicly listed, which also restricts the profitability measures available to us.<sup>935</sup>
- C37 We have excluded 2020 when assessing profitability. We have done this to avoid the distortionary effects that the COVID-19 pandemic potentially had on the grocery sector and the wider economy. We also consider the inclusion of 2020 would have particularly influenced our estimate of WACC, due to recent falls in interest rates.

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<sup>934</sup> Commerce Commission New Zealand "Market study into the retail fuel sector – Final report" (5 December 2019), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0028/193915/Retail-fuel-market-study-Final-report-5-December-2019.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0028/193915/Retail-fuel-market-study-Final-report-5-December-2019.PDF).

<sup>935</sup> Woolworths Australia owns Woolworths NZ and is listed on the Australian Stock Exchange, see: <https://www2.asx.com.au/markets/company/wow>. However, we cannot use this as a proxy as its Australian operations are substantially larger than its New Zealand operations.

## Potential approaches for measuring profitability

### *Approaches for measuring profitability in competition policy*

- C38 Based on a literature review, including papers by Oxera, and our own internal knowledge developed from our fuel market study, the following measures can be used to assess profitability for competition analysis:<sup>936</sup>
- C38.1 The **Truncated Internal Rate of Return (TIRR)** calculates an investment's discount rate that makes the Net Present Value (NPV) of all cash flows equal to zero. One of the main advantages of TIRR is that it is calculated using cashflows and relies on less accounting data. We also note that in the long run this return is comparable to the WACC.
- C38.2 TIRR differs from the more well-known IRR profitability metric, which typically assesses a proposed future investment across the entirety of its expected life. The TIRR estimates a return on an investment that has already begun but not been fully completed. This allows investments to be assessed that do not neatly coincide in terms of start and finish with the time period we are assessing. As such, the cashflows used for this measure are truncated. Instead of forecasting all future cashflows associated with an investment, the current market value of the company is used as the estimate of all future values – similar to a terminal value.
- C38.3 A difficulty with the TIRR measure is the need to derive the opening and closing investment value that captures the opportunity cost of capital as opposed to historical valuations. These values are not available for the major grocery retailers.
- C38.4 **ROACE** is an annualised measure of profitability. It represents the profit made in a financial year relative to the assets used in earning that profit. It differs from TIRR, which measures profitability over multiple periods. Another distinction from the TIRR is that the ROACE measure relies more heavily on accounting data, whereas the TIRR is derived from cashflows. This means there are often a number of adjustments that need to be made to the accounting-based data when using ROACE.
- C38.5 **Profit margin analysis** at either the GP, EBIT or NPAT levels can provide an understanding of trends in profitability over time and can also be compared to overseas comparator companies from the same industry. This may provide some insight into the general state of competition. However, comparisons between companies and between international markets can be problematic given differences between business operating models and international jurisdictions. The analysis relies upon accounting data, and as such it does not provide a measure of economic profitability.

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<sup>936</sup>

See: <https://www.oxera.com/wp-content/uploads/2018/03/OFT-Assessing-profitability.pdf>.

- C38.6 **Tobin's Q** is the ratio of a firm's stock market value to the cost of replacing its assets. This measure requires the company to be listed on a stock exchange so that its market value can be measured over time, which prevents its use here. We used this profitability metric in our fuel market study as Z Energy is listed on the New Zealand Stock Exchange (NZX).
- C38.7 **Expectations of returns on new investments** can be assessed. This approach includes understanding the firm's views on industry profitability, the likelihood of new market entrants, and expectations around returns firms expect from new investment. This is the same approach we utilised in our fuel market study.
- C39 The TIRR measure is considered the most robust of the profitability measures available. The 2003 report from Oxera "Assessing profitability in competition policy analysis" provides the following summary comparison between TIRR (IRR) and ROACE (ROCE):<sup>937</sup>
- In general, the individual ROCE estimates tend not to equal the IRR of the period. The ROCE is particularly affected by accruals, ... by the choice of depreciation schedules and by uncertainties in asset values (perhaps more so than the IRR). Accruals can cause a significant wedge between actual cash inflows and outflows in a period and the costs and revenues (and hence profit levels) assigned to that period. The choice of depreciation schedule affects both the profit levels in the numerator of the ROCE calculation and the asset values in the denominator. By contrast, the IRR is estimated using actual cash flows, which are not affected by accruals or depreciation.
- With regard to asset values, any errors in valuation would affect the ROCE in each period. The IRR, however, is estimated using asset values at the start and end of the period in question only. Estimates of the IRR are relatively more dependent on cash flows than on asset values, as compared to the ROCE. Hence, the effects of any errors in asset valuation, for example, those arising from valuing intangibles... may be less severe than in the case of the ROCE.
- C40 Nevertheless, Oxera considers the average ROACE measure can still be used as a proxy for TIRR or IRR, provided asset valuations are reflective of economic costs, and changes in the value of assets are reflected in earnings.<sup>938</sup>

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<sup>937</sup> Oxera "Assessing profitability in competition policy analysis" (July 2003) at 54, available at <https://www.oxera.com/wp-content/uploads/2018/03/OFT-Assessing-profitability.pdf>.

<sup>938</sup> Oxera "Assessing profitability in competition policy analysis" (July 2003) at 54, available at: <https://www.oxera.com/wp-content/uploads/2018/03/OFT-Assessing-profitability.pdf>.

*Approaches taken in international studies of retail grocery sectors*

- C41 Several international studies on competition in retail grocery markets have measured retailer profitability using different metrics. They have tended to use profitability margin analysis, with only one study using the Return on Capital or TIRR measures.
- C41.1 The 2000 UK Competition Commission undertook a study into the UK grocery sector.<sup>939</sup> This study assessed profitability using profitability margins and ROACE measures, which were compared to similar measures for international grocery retailers. It also calculated TIRR estimates using estimates of the value of fixed assets provided by the grocery retailers. These results were compared to WACC estimates provided by the grocery retailers. The study also examined the profitability of individual stores, in particular those facing limited competition.
- C41.2 In 2008, the UK Competition Commission conducted another study into the grocery market.<sup>940</sup> This study considered the operating margins of large grocery retailers; however, it could not draw any conclusions about the relative profit margins earned by UK grocery retailers compared to those from other countries because of the significant variation in profit margins being earned by the various grocery retailers.
- C41.3 The ACCC undertook an investigation into the competitiveness of retail prices for standard groceries in 2008.<sup>941</sup> This study considered the two major grocery retailers (Woolworths Australia and Coles) in terms of total revenues and earnings, and their earnings margins including gross margins, cost of doing business margins, and EBIT margins. It compared these margins to those for overseas retailers. It also assessed gross margins for different product categories.
- C42 The more recent UK and ACCC studies did not state why they had not used ROACE and TIRR for their profitability assessment. We are not aware why this was the case.

*The profitability measures adopted in this study*

- C43 We have adopted three profitability measures for our analysis:
- C43.1 ROACE;
- C43.2 profit margin analysis; and
- C43.3 an examination of the expectations of future profitability.

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<sup>939</sup> See: [https://webarchive.nationalarchives.gov.uk/+www.competition-commission.org.uk/rep\\_pub/reports/2000/fulltext/446c8.pdf](https://webarchive.nationalarchives.gov.uk/+www.competition-commission.org.uk/rep_pub/reports/2000/fulltext/446c8.pdf).

<sup>940</sup> Office of Fair Trading "The grocery market" (May 2006), available at: <https://assets.publishing.service.gov.uk/media/555de47840f0b669c4000141/oft845.pdf>.

<sup>941</sup> See: <https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf>.

- C44 We have been unable to calculate TIRR because the information we had available to us did not contain sufficient information on cashflows for all of the major grocery retailers which are required to calculate TIRR.
- C45 We have also been unable to use Tobin's Q because this requires one or more companies to be listed on a stock exchange so that their market value can be measured. As discussed above, none of the major New Zealand grocery retailers are publicly listed as a stand-alone entity.

### Return on average capital employed

- C46 The ROACE measure compares the annual level of financial return (in this case NPAT) against the average value of assets employed to produce that return. The average value of assets employed is calculated using the value of assets at the start and the end of the financial year. We have used the formula below to calculate ROACE. This is broadly the same formula as that used in our fuel market study.<sup>942</sup>

$$\text{ROACE} = \frac{\text{Net Profit after Tax} + (\text{Net Interest Expenses} \times (1 - \text{Corporate Tax}))}{\text{Average Assets Employed}}$$

**Where:** Net Interest Expenses = Interest Expenses - Interest Income

Average Assets Employed = ( Total Assets - Goodwill - Current Liabilities + Interest Bearing Current Liabilities )  
taken at the start and end of the financial year

- C47 A benefit of the ROACE measure is that the inputs into the formula are readily available from annual reports, and these reports are generally consistent and have been audited and comply with international standards.<sup>943</sup>

### Drawbacks in using ROACE

- C48 One of the main drawbacks of using ROACE is its reliance on accounting data, which may not reflect economic costs as discussed above in our conceptual approach. The 2003 Oxera report noted this drawback and that the numerator and denominator of the ROACE formula is subject to variations in accounting practices.<sup>944</sup> ROACE also requires an ongoing annual valuation of the company's assets employed for comparisons over a particular period.

<sup>942</sup> We have not made any adjustments to capital employed for any surplus cash the grocery retailers may have held at the end of the financial year as we did in our fuel market study. We acknowledge that some grocery retailers may hold considerable cash at financial year-end, and this may increase their total assets employed. We also acknowledge feedback from the major grocery retailers that taking an opening and a closing cash balance may be unreflective of the average cash they hold throughout the year. We may examine this issue following our draft report.

<sup>943</sup> Most of the Foodstuffs retail member stores' financial accounts have been audited, however some of the smaller ones may not have been.

<sup>944</sup> Oxera "Assessing profitability in competition policy analysis" (July 2003), at [12.29], available at: <https://www.oxera.com/wp-content/uploads/2018/03/OFT-Assessing-profitability-1.pdf>.

- C49 ROACE also has a number of other drawbacks; including that estimation of average assets employed is problematic in terms of moving from an accounting-based estimate of assets to an economic one. For example, in response to the 2008 ACCC investigation, we understand that Woolworths Australia noted many of its assets were old and had been depreciated down which inflated its ROACE, and Coles noted that it leased a lot of its buildings overinflating its ROACE.<sup>945</sup>
- C50 As discussed earlier, we have made various adjustments to the book values of assets employed to reflect economic costs. We acknowledge these adjustments are not precise, but we do not consider the profitability results that we observe later in this attachment are likely to be materially impacted by measurement errors in these adjustments.

#### *Valuation of land and buildings*

- C51 Accounting value of land is often recorded at its purchase price, and buildings are often recorded at their depreciated historical cost. These valuations are based on accounting rules that are unlikely to reflect the opportunity cost of the assets that have been employed. Addressing this requires some estimation or valuation of specific land and buildings assets. This could be either in the form of a bottom-up revaluation of each asset, or a top-down adjustment made to the entire portfolio of land and building assets using a metric or proxy.
- C52 Although Woolworths NZ leases most of its land and buildings, it does own some. The 2019 book value of its land and buildings is \$366 million, which is based on the purchase price less accumulated depreciation.<sup>946</sup>
- C53 Woolworths NZ, and the Foodstuffs NI and Foodstuffs SI co-operatives provided us with market valuations of certain parcels of land and buildings they own. We used these to adjust Woolworths NZ's land and buildings to reflect their economic value. Using property valuations from all three major grocery retailers, rather than just from Woolworths NZ provided a larger sample size which is likely to be more reflective of market values.
- C54 We compared market valuation to the book value of these assets to derive a proxy weighted average uplift. We then applied this uplift as a top-down adjustment to the book value of Woolworths NZ's total land and building assets. We acknowledge this uplift adjustment will be imprecise for a number of reasons. However, we have used a sizeable sample of valuations conducted between 2018 and 2021 and consider it should be reasonably reflective of the overall increase in land and building value. We have not had to adjust the land and building valuations for the Foodstuffs NI or SI retailers because these assets are owned by their respective co-operative.

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<sup>945</sup> ACCC "Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries" (July 2021) at [111], available at: <https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf>.

<sup>946</sup> Woolworth New Zealand Group Limited "Annual Report" (30 June 2019) at 25, available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>. This includes development properties and freehold warehouse, retail and other premises.

C55 The gain in market valuation of fixed assets is recognised as income and should be included in our ROACE calculations. However, given we only have limited information on the annual incremental gain in land and property values, we have opted to exclude these gains from our ROACE assessment for this study. This will understate profitability.

*Market valuation of other fixed assets*

C56 The other large groups of fixed assets owned by Woolworths NZ and the Foodstuffs retail member stores are plant and equipment, and leasehold improvements, which we assume largely relate to store fittings and fixtures. We have tested whether the book value of these assets needs to be adjusted to reflect their market value. We have done this by comparing the purchase value for new store fittings and fixtures that are shown in various business cases provided by the major grocery retailers. For comparability, we have done this on a cost per square metre basis.

C57 The average cost per square metre has not changed significantly between the time period of 2016 to 2020.<sup>947</sup> While there is some variability between the observed replacement costs per square metre in the business cases that we have examined, this is not material. We conclude that there has been limited inflation in the replacement cost of these assets. We also note that the expected useful life for plant, equipment and fittings is between two and 10 years, which suggests to the assets are being replaced on a reasonably regular basis.<sup>948</sup>

C58 In addition, while some self-checkout technology has advanced over recent years, we consider that store fittings and fixtures have not otherwise been subject to rapid technological change and that the underlying assets required are likely to have remained broadly similar over time.

C59 We therefore consider that the book value of these assets is a suitable proxy for their market value and have made no adjustments to their value for Woolworths NZ's or Foodstuffs' member stores.

*Exclusion of goodwill*

C60 As discussed in our conceptual approach, we have removed all goodwill from the asset base of Woolworths NZ and the Foodstuffs member stores when assessing their ROACE profitability because we do not consider this represents a specific asset being employed to generate earnings.

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<sup>947</sup> Commerce Commission profitability analysis, [ ].

<sup>948</sup> Woolworth New Zealand Group Limited "Annual Report" (30 June 2019) at 15, available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>.

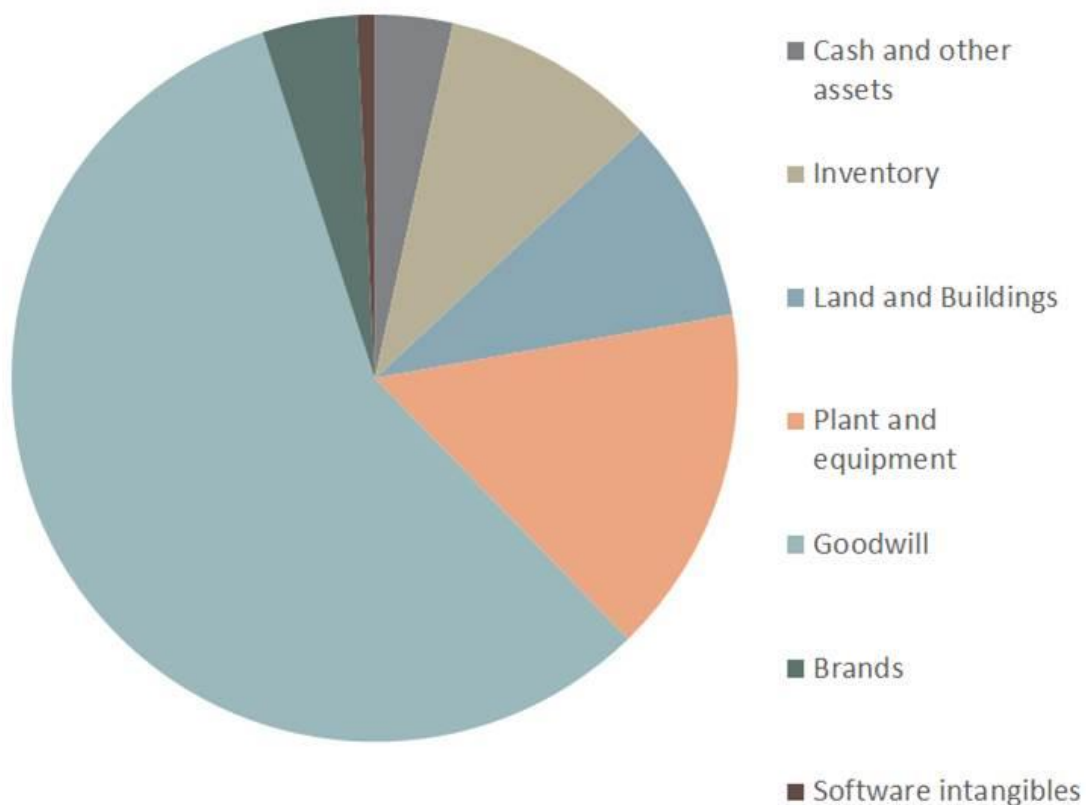


- C61 The 2003 report from Oxera “Assessing profitability in competition policy analysis” provides the following comments on why goodwill should be excluded from the assessment of profitability:<sup>949</sup>

...goodwill is normally determined by an assessment of the NPV of the company’s future net cash flows and could therefore be a reflection of the expectation that the company will be able to make excessive profits in future—i.e. it is a premium for future cash flows. In other words, including goodwill in the asset valuation may not be appropriate in a profitability analysis. In valuing the assets of the company under investigation, any goodwill on its balance sheets should normally be excluded unless it can be attributed to specific assets and associated with specific costs incurred.

- C62 Woolworths NZ has around \$2.3 billion of goodwill on its balance sheet as at 30 June 2019. This amounts to around 57% of the total book value of its asset base.<sup>950</sup> To provide some context for this amount, Figure C3 provides a breakdown of Woolworths NZ’s total assets as at 31 March 2019. Values for land and buildings in this figure do not include the increased values discussed above.

**Figure C3 Woolworths NZ’s goodwill relative to total assets**



Source: Woolworths NZ 2019 Annual Report.<sup>951</sup>

<sup>949</sup> Oxera “Assessing profitability in competition policy analysis” (July 2003) at 72, available at: <https://www.oxera.com/wp-content/uploads/2018/03/OFT-Assessing-profitability.pdf>.

<sup>950</sup> Commerce Commission profitability analysis, [ ].

<sup>951</sup> Woolworth New Zealand Group Limited “Annual Report” (30 June 2019), available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>.

- C63 The majority of Woolworths NZ's goodwill arose through Woolworths Australia's purchase of the grocery retailer Progressive Enterprises in 2005 for \$2.5 billion. The Net Book Value of Progressive Enterprise's assets and liabilities was only \$300 million. This resulted in the addition of a goodwill balancing figure of \$2.2 billion to Woolworths NZ's balance sheet as an asset.
- C64 Goodwill is not depreciated or amortised over time like most other assets. However, it is subject to an annual impairment test, which assesses whether the expected future cashflows arising from the acquisition can still support the goodwill valuation. If this is not the case, the impairment test will give rise to a write down of goodwill and the recognition of an impairment expense which will lower a company's earnings in that year. Based on our assessment of Woolworths NZ's financial statements, the goodwill associated with the acquisition of Progressive Enterprises has never been impaired.<sup>952</sup>
- C65 A number of individual Foodstuffs member stores also have goodwill and intangibles on their balance sheets. These amounts have arisen when an existing retail store has been sold to a new owner and the sales price has exceeded the value of the company's net assets at book value.
- C66 The total amount of goodwill and intangibles relative to the book value of total assets varies between the retail stores relating to the two Foodstuffs co-operatives. Overall, goodwill and intangibles comprises between approximately 20% and 25% of the total assets of the Foodstuffs NI retail stores. The Foodstuffs SI retail stores have between 10% and 15% of their total assets comprising goodwill and intangibles.<sup>953</sup> These amounts will vary between stores depending on whether they have been bought or sold.
- C67 Woolworths NZ has submitted various arguments that the goodwill from Woolworths Australia's acquisition of Progressive Enterprises represents a number of things that have legitimate value that should be included in the assets employed.<sup>954</sup> We examine and test these arguments in detail later in this attachment.

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<sup>952</sup> We note that Woolworths NZ's goodwill was impaired by \$276 million in 2016 when it wrote down the value of the goodwill associated with the investments in its subsidiary Ezibuy, which it sold in 2016.

<sup>953</sup> Commerce Commission profitability analysis, [ ].

<sup>954</sup> [ ].

*The exclusion of brand intangibles*

- C68 Woolworths NZ has around \$169 million of intangibles relating to its brands in its financial statements as at 30 June 2019.<sup>955</sup> Based on comments made in earlier Woolworths NZ annual reports, the brand intangibles relate to the acquisition of Progressive Enterprises in 2005.<sup>956</sup> Similar to the intangible of goodwill, brand intangibles are considered to have an infinite life as the company maintains the brand value through marketing campaigns. It is not depreciated or amortised. Instead it is subject to an annual impairment test.
- C69 Given the similarities to goodwill, and in keeping with our approach of removing goodwill from the assets employed, we have removed the intangible brands asset. This asset does not represent a specific asset that is being employed to generate earnings.
- C70 However, we have retained the \$33 million of software licenses as these are assets that were purchased for a specific cost and represent items the company uses in generating its earnings.<sup>957</sup>

*Removal of non-grocery business activities*

- C71 We have examined the financial accounts for Woolworths NZ and the Foodstuffs member stores to determine whether they own any material non-grocery related subsidiaries that should be removed from their accounts. Apart from Lotto outlets and some stores that sell petrol, which we consider immaterial, the accounts for the individual Foodstuffs member stores did not indicate they were engaged in any other activity.
- C72 For Woolworths NZ we have identified a number of material non-grocery related investments. These include its earlier investment in Ezibuy and its current investment in New Zealand Cellarmasters Wines Proprietary Limited. Woolworths NZ provided a revised set of financial accounts with these two subsidiaries removed. Details of these adjustments are provided later in this attachment.

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<sup>955</sup> Woolworths New Zealand Group Limited "Annual Report" (30 June 2019) at 26, note 11, available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>.

<sup>956</sup> Woolworths New Zealand Group Limited "Annual Report" (30 June 2013) at 28, note 11, available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>.

<sup>957</sup> Woolworths New Zealand Group Limited "Annual Report" (30 June 2019) at 26, note 11, available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>.

*The valuation of leases and changes to accounting standards*

- C73 Recent changes to the accounting standard NZ IFRS 16 mean there are now no distinctions between operating and finance leases. Companies are required to recognise all lease assets, and corresponding liabilities on their balance sheet – as follows:
- C73.1 the value of the lease liability is derived by discounting the remaining future lease cashflows at the cost of borrowing to obtain the present value; and
  - C73.2 the value of the lease (or right of use asset) is the same amount as the liability, plus any up-front costs.
- C74 As lease payments are made the value of the lease will reduce. Simultaneously the lease asset will depreciate. At the end of the lease there should be no liability nor asset remaining in the balance sheet. Overall, the value of the lease asset will be a close approximation to the value of the liability over time, and the two nearly cancel each other out.
- C75 Under the accounting standards, this increases the value of the assets on the balance sheet and has the effect of reducing the ROACE profitability measure.
- C76 However, we do not consider including the leases in total assets employed is appropriate when assessing economic profit:
- C76.1 These changes arise from changes in the accounting standards. As noted, we are only interested in the economic value of assets and not accounting standards.
  - C76.2 Given the value of the lease asset will always be closely matched by the value of the liability, the two tend to cancel each other out.
  - C76.3 These accounting changes did not come into effect until the 2020 year. This is outside of the time period in which we are examining profitability.
- C77 Given these characteristics we have made no adjustments to the assets employed as a result of the recent changes to accounting standard NZ IFRS 16.

*Benchmarking ROACE profitability*

- C78 The ROACE measure has been compared against the following benchmarks:
- C78.1 The most appropriate internal benchmark is the WACC measure. We have estimated this using the Capital Asset Pricing Model (CAPM), and data downloaded from Bloomberg to identify comparable international companies. This is discussed in greater detail later in this attachment.

- C78.2 The ROACE measure has also been compared against the historic ROACE of a sample of international grocery retailers. This comparison provides an indication of the relative levels of profitability between New Zealand and other jurisdictions, which will have normal levels of economic profitability to the extent they operate in competitive markets. This analysis used Bloomberg data to identify those international companies and download their financial information. These are the same comparator companies that were used for developing the asset beta and other inputs that are required for the CAPM model to determine WACC.
- C78.3 A further comparison is against the ROACE's of the New Zealand Stock Exchange's (NZX) NZX50 index of companies excluding banks. This analysis has been extracted from Bloomberg to identify the NZX50 companies and download the required data. This approach was also used in our fuel market study. This will inform us how well the grocery retailers are performing relative to a basket of large-scale companies also operating in the same economy.

### Profit margin analysis

- C79 Profit margins are the annual level of profitability as a percentage of the annual sales revenue. As described, we have assessed the historic profit margins of the three major grocery retailers in New Zealand using the following three profit margin levels:
- C79.1 **GP margin:** GP is the profit a company makes after deducting the costs associated with purchasing its products and making them ready for sale. Put another way, it is the total sales revenue the company receives, less the total cost of the goods sold. The GP margin is the total GP divided by total sales for a financial year.
- C79.2 **EBIT margin:** EBIT is the profit a company has made before the interest expenses on debt and the tax on its profit have been paid. It reflects the amount of pre-tax profit that is available to service the providers of a company's debt and equity. The EBIT margin is the total EBIT divided by total sales for a financial year.
- C79.3 **NPAT margin:** NPAT is a company's profit after all costs, including taxation have been paid. The NPAT margin is the total NPAT divided by total sales for a financial year.
- C80 The grocery retailers' profit margins have been benchmarked against those of the sample of international grocery retailers. These are the same retailers that were used to develop the WACC and the ROACE. This will provide some insight into the profitability of New Zealand grocery retailers relative to other countries, especially overseas markets that we expect will have greater levels of competition.

- C81 However, we acknowledge there are difficulties in comparing profit margins between different countries. This was pointed out by Foodstuffs NI and Foodstuffs SI in their submissions which stated this includes, amongst other things, the scope of activities the entities undertake, the average density of their population, and differences in the cost of capital.<sup>958</sup> In addition, Foodstuffs NI was formed in 2013 from the merger of Foodstuffs Auckland and Foodstuffs Wellington. This merger and subsequent restructuring may affect their profit margins.
- C82 There are also limitations to profit margin analysis and care must be exercised when drawing any inferences. It does not provide any actual estimate of economic profit. For example:
- C82.1 Rising profit margins could also be due to previous unsustainably low profit levels that needed to rise to provide a sustainable level of profit, or improvements in-store efficiency and productivity have led to an increased EBIT profit margin and competition at some stage will gradually erode these away.
- C82.2 Stable margins could suggest there is adequate competition and the market is in some form of equilibrium. It could also be that the existing competitors have reached a tacit level of co-operation or a stable equilibrium and they are extracting economic rents from consumers.
- C83 The trends in profit margins for the three major grocery retailers are complementary to our other profitability measures, as they may provide some insight into the general state of competition in the grocery sector. To give an illustration, a gradually rising profit margin may indicate rising profits as a result of a lack of competition, however this is not definitive.

### **Expectations of returns on new investments**

- C84 The expectation of profitability for existing market participants provides an insight into the expectations of forward-looking profitability. We have obtained a suite of business cases for proposed new investments from the major grocery retailers, and a number of post-investment reviews for investments that have been completed. From these we have assessed:
- C84.1 The returns firms expect to earn on new investments in new or redeveloped retail sites. This has focussed on the IRR measure, which is benchmarked against WACC.
- C84.2 The companies' hurdle rates for accepting or rejecting investments are compared to our estimated WACC.
- C84.3 Post-investment reviews have also been reviewed to assess how previous investments have performed relative to original expectations.

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<sup>958</sup> Foodstuffs NI and Foodstuffs SI responses to Commission information requests.  
[ ]

## Other issues

### *Time period for assessing profitability*

- C85 The assessment of profitability must be done over a sufficiently long time period for business cycles and one-off gains and losses to be averaged out in order to demonstrate that any excessive profits are ‘persistent’. Where possible we have sought to obtain a ten-year time series. This has not always been possible given data availability issues, which are discussed in greater detail below. As such, our focus has typically been the five-year period covering the financial years between 2014-15 and 2018-19, and we have tended to assess the average profitability across this time period and not individual years.
- C86 However, the impact of the COVID-19 pandemic on New Zealand’s and the international economy has been significant. Including what we hope is a very rare event in our ten-year time series may distort our results. This is especially true for determining WACC, given central banks around the world loosened their monetary policy and lowered interest rates.
- C87 As such the time period we have used to assess profitability specifically excludes the 2019-20 financial year. Consequently, when we do reference the 2020 year, we acknowledge that its results may not be comparable to prior years.

### *Foodstuffs’ data availability*

- C88 The Foodstuffs NI and Foodstuffs SI co-operatives have financial accounts going back many years. However, we are not primarily focussing on the profitability of the co-operatives, but instead their individual member stores.
- C89 We have used data available to conduct our analysis.<sup>959</sup> In spite of our data series being incomplete we consider we have obtained a sufficient quantity of financial accounts to form a robust data series. In most cases we have obtained all of the accounts for the stores within the larger retail banners of New World and PAK’nSAVE. We have obtained a large number of financial accounts for the Four Square retail banner, but not all of them for all years. As noted, we have not obtained any financial data for the “On the Spot” stores. However, these are all relatively small; akin to a corner dairy. We consider the omission of these smaller stores does not make a material impact on our analysis.

### *Accounting for transfer pricing*

- C90 It may be possible for the Australian-owned Woolworths NZ to engage in transfer pricing. This could take the form of Woolworths Australia sourcing wholesale products and selling these to its New Zealand subsidiary at elevated prices. This would reduce the New Zealand operation’s earnings and increase its Australian earnings.

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<sup>959</sup>

C91 However, we have no evidence of this. It also seems unlikely given the New Zealand corporate tax rate is 28% and Australia's is 30%, meaning it would expose itself to higher taxation by transferring taxable earnings to Australia, unless there are other taxation considerations. We also understand that a substantial amount of Woolworths NZ's supply is locally sourced. Therefore, we have not considered this issue any further.

## **Our estimation of normal levels of profitability for grocery retailing in New Zealand**

### **Introduction**

C92 This section explains how we have estimated a normal rate of return for firms in the New Zealand retail grocery sector. We use our estimate of a normal return as a benchmark to compare against the actual and expected levels of returns being made by New Zealand grocery retailers. We define a normal level of return to equal our estimate of the WACC.

### **The cost of capital is an estimate of a normal rate of return**

C93 A normal level of profitability allows a firm to cover all its costs, including the cost of capital, over time. The cost of capital is the expected financial return investors require from an investment given its risk. Investors have choices and will not invest in an asset unless the expected return is at least as good as the return they would expect to get from alternative investments of similar risk. The cost of capital is an estimate of that expected rate of return.

C94 If expected levels of profitability are equal to or greater than the cost of capital, investment will be attracted to the industry as the returns are equal to or greater than the returns that are available elsewhere to the investor. Conversely, if prospective returns are less than the cost of capital then investment is expected to reduce. This is how competitive markets allocate capital to its highest value use.

C95 In a competitive market, the expected rate of return will over time tend towards a normal level of profitability, that is towards the cost of capital. However, it will not necessarily equal the cost of capital. The cost of capital is an *expected* average return – actual returns may be higher or lower for reasons within and outside the firm's control at any point in time. However, if rates of return in a market are persistently above the cost of capital this may suggest that competition is not working as well as it should.

### **What is the cost of capital**

C96 Firms raise the capital they need from two main sources: debt and equity. Both have a cost. For debt, it is the future interest payments. For equity, it is the expectation of dividend payments by the firm, and where profits are retained and reinvested, the expectation of larger dividend payments by the firm at some time in the future, as well as the expected capital gain from holding the stock (or a combination of both). The WACC reflects the cost of debt and the cost of equity, and the respective portion of each that is used to fund the investment.



- C97 The cost of capital cannot be observed, and accordingly it needs to be estimated. For this study we have:
- C97.1 estimated the cost of debt with reference to the yield on publicly-traded New Zealand corporate bonds of similar credit rating to the major grocery retailers;
  - C97.2 estimated the cost of equity for a participant in the retail grocery sector using our standard methodology for estimating the cost of equity;
  - C97.3 combined the cost of debt and equity to give an estimate of the WACC; and
  - C97.4 compared this estimate of WACC against other available estimates of the cost of capital for this sector to test for reasonableness and long-term estimates of average market return.
- C98 Our approach to estimating the cost of capital has been developed since 2001 and has been formalised in the context of economic regulation through our cost of capital input methodologies. These methodologies have been consulted on heavily, with many parties over many years. They have been reviewed and accepted by the High Court.<sup>960</sup>
- C99 Our methodology for estimating the cost of capital has been applied to many sectors, including electricity lines businesses, gas pipelines, specified airport services and certain telecommunication services.<sup>961</sup> We consider that our standard methodology for estimating the cost of capital is appropriate for the current study.
- C100 We acknowledge the different businesses within the retail grocery sector. This includes the differing scale of many of the grocery retailers, and the different operations involved in grocery retailing, including grocery retailing itself and property ownership.

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<sup>960</sup> *Wellington International Airport & Others v Commerce Commission* [2013] NZHC 3289 [11 December 2013] at Part 6, available at: <https://forms.justice.govt.nz/search/Documents/pdf/jdo/53/alfresco/service/api/node/content/work-space/SpacesStore/1c117dea-b8ba-491e-ba1d-d4cd30dbe522/1c117dea-b8ba-491e-ba1d-d4cd30dbe522.pdf>.

<sup>961</sup> For example: Commerce Commission “Electricity Distribution Services Input Methodologies Determination 2012” (20 May 2020), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0017/60542/Electricity-distribution-services-input-methodologies-determination-2012-consolidated-January-2019-31-January-2019.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0017/60542/Electricity-distribution-services-input-methodologies-determination-2012-consolidated-January-2019-31-January-2019.pdf). The cost of capital input methodology was last reviewed during 2015 to 2016. For further details see: <https://comcom.govt.nz/regulated-industries/input-methodologies/projects/201516-im-review>.

C101 We note that while there are a range of participants, our main focus is on the three major grocery retailers, which we consider are broadly similar to each other. We also use the same estimate of WACC for the other grocery retailers because they undertake similar business activities and are in the same market. However, we recognise that they potentially sit towards the top of our estimated WACC range or may even sit outside our estimated WACC range given they are less internally-diversified than the three major grocery retailers.

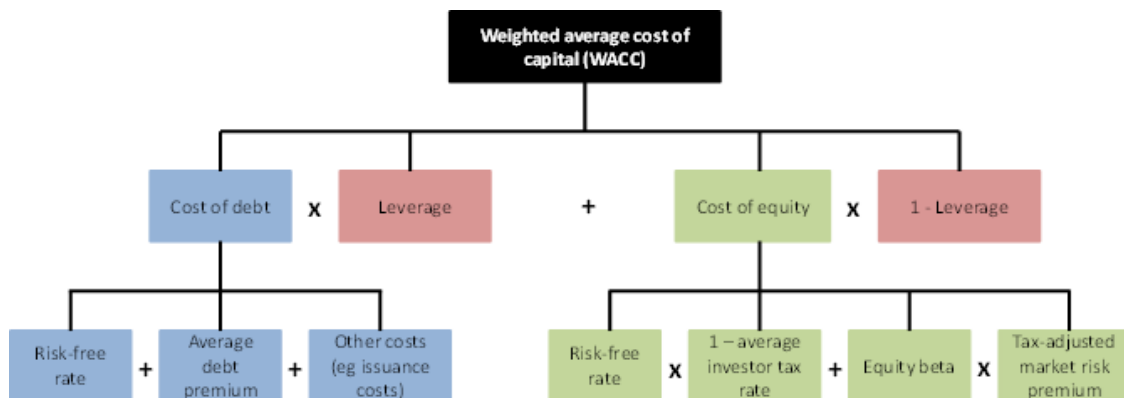
C102 Consistent with our fuel market study we have developed a range of WACC estimates. This includes a High and a Low estimate, as well as a mid-point that is our best estimate of the WACC. This is based on establishing a range for certain of the key parameters that are required for estimating the WACC.

### There are seven key parameters required to estimate the WACC

C103 The values for seven parameters are required to estimate the cost of capital. These are the risk-free rate, the debt premium, asset beta (and subsequently equity beta), tax-adjusted market risk premium, investor and corporate tax rates, and leverage. Each parameter is described in turn. Combining these produces an estimate of WACC.

C104 The key parameters for estimating a vanilla WACC, and how they feed into the calculation of the WACC, are summarised in Figure C4 below.<sup>962</sup>

**Figure C4 Components of the WACC**



Source: Fibre Input Methodologies reasons paper.<sup>963</sup>

<sup>962</sup> The parameters for estimating a post-tax WACC are the same as for the vanilla WACC, except that the cost of debt is also multiplied by  $1 - \text{the average corporate tax rate}$ .

<sup>963</sup> Commerce Commission "Fibre input methodologies: Main final decisions – reasons paper" (13 October 2020), Figure 6.1, available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0022/226507/Fibre-Input-Methodologies-Main-final-decisions-reasons-paper-13-October-2020.pdf).

*Risk-free rate*

- C105 A risk-free rate is the rate of return expected when there is no risk of default. Debt issued by the New Zealand Government and denominated in New Zealand dollars is considered to be free of default risk. The return on New Zealand Government issued debt can generally be readily observed from trading on the debt market.
- C106 Generally, the rate of return varies with the term of the investment. In regulatory contexts we choose a term of the risk-free rate that matches the length of the regulatory period, which is typically five years. However, in the context of a market study there is no regulatory term. More common commercial practice is to use a term of 10 years.
- C107 In this market study we are using our estimate of WACC in various contexts, including assessing the returns on new investment and assessing firm profitability over longer time frames.
- C107.1 Spot risk-free rates are useful when evaluating new investments, since spot rates reflect the cost of funds at the time the investment is being made.
- C107.2 However, spot rates are less useful when assessing the profitability of a firm over longer time periods since the spot rate at one point in time is unlikely to be reflective of the risk-free rate throughout the period (and investments will have been made throughout the period).
- C107.3 When assessing the profitability of an unregulated firm over time, an average risk-free rate is appropriate.
- C108 The risk-free rate is volatile and has declined materially in recent years. This is particularly true with the effects of the COVID-19 pandemic, which has seen a reduction in interest rates internationally due to central bank policies to counter the adverse economic impacts.
- C109 Given these considerations, we propose using a range for the risk-free rate based on the average New Zealand five-year and ten-year risk-free rate estimated during the years from 2015 to 2019, which is the period during which our profitability assessment is focussed. This five-year risk-free rate averaged an interest rate yield of 2.34% pa, and the ten-year risk-free rate averaged at 2.70% pa.

*Debt premium*

- C110 Companies fund part of their activities with money borrowed from others. When companies raise debt, they pay a higher rate of interest than the Government (ie, the risk-free rate), to reflect the corporate's default premium, liquidity premium and systematic risk premium. This higher rate of return on corporate debt (above the risk-free rate) is called the debt premium.

- C111 Using our standard methodology, we estimate the debt premium by looking at the yield to maturity on publicly-traded bonds in New Zealand relative to the yield to maturity on government bonds. While corporates can raise money using a wide range of debt instruments, we use publicly-traded bonds to estimate the debt premium, as information on the cost of these is publicly available. The debt premium on other debt facilities is generally not publicly known.
- C112 In our fuel market study, we used Z Energy's publicly-traded bonds to estimate the debt premium to include in our estimate of WACC. However, there is no publicly-traded debt in the New Zealand market for either of the major grocery retailers for us to directly observe.
- C113 As such, we have observed the yield to maturity on publicly-traded bonds of New Zealand companies that have a credit rating of between BBB- and BBB+. We have chosen this range because Woolworths Australia currently has three bond issues in Australia with a Standard & Poor's (S&P) rating of BBB.
- C114 The debt premium can vary between companies depending on their credit standing and scale of operations. The other retail grocery companies may incur a higher debt premium than other larger companies. However, we use the same estimate of debt premiums for the other grocery retailers because they undertake similar business activities and are in the same market, although we recognise that they potentially sit towards the top of our estimated WACC.
- C115 We estimated the average daily debt premium on publicly-traded bonds of credit rating of BBB- and BBB+ above the risk-free rate with the same remaining term to maturity for the six-monthly periods between 2015 to 2019.<sup>964</sup> For example, for a bond with a remaining term of five years we:
- C115.1 estimate its yield to maturity;
  - C115.2 estimate the risk-free rate on a government bond with an interpolated remaining term of five years;
  - C115.3 take the difference between those estimates as an estimate of the debt premium; and
  - C115.4 repeat those calculations across the years 2015 to 2019.
- C116 The resulting estimate of the debt premium on the sample of corporate bonds with the longest remaining term to maturity ranged between 161 to 176 basis points (ie, 1.61% to 1.76% pa, with a remaining term of close to five years) over this period. The average debt premium was 167 basis points. This is summarised in Table C1.

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<sup>964</sup> Estimated by linear interpolation based on the Nelson-Siegel-Svensson approach to modelling interest rate yield curves and term structures.

**Table C1 Estimated debt premium on NZ corporate bonds: BBB- to BBB+**

	2015	2016	2017	2018	2019
Five year debt premium	1.65%	1.76%	1.68%	1.66%	1.61%
<b>Average</b>	<b>1.67%</b>				

Source: Commerce Commission analysis of Bloomberg data.<sup>965</sup>

C117 Consistent with our input methodology for determining WACC, we have also included a 20 basis point (0.2%) uplift in the debt premium to reflect debt issuance costs. The 20 basis point issuance cost is based on a five-year period of debt. It may be slightly less for longer-term debt.

#### *Asset beta*

C118 The Brennan-Lally CAPM model requires an estimate of the equity beta in calculating the cost of equity. We require an equity beta estimate for the sector that we are investigating, and therefore need to use a sample of comparable companies in that sector with publicly-traded stocks.

C119 Beta is a measure of exposure to systematic risk. Systematic risk measures the extent to which the returns of a company fluctuate relative to the equity returns in the stock market as whole.<sup>966</sup>

C120 We start by estimating a sector-wide asset beta in order to strip out the effects of each firms' leverage, which impacts its equity beta. Once we have estimated the average asset beta for the sector, we can re-lever the asset beta to estimate the equity beta using our estimate of notional leverage applying to the sector.

C121 We estimate asset beta empirically by identifying publicly-listed firms that undertake activities that are broadly comparable to those undertaken by firms in the New Zealand retail grocery sector. We then estimate the relationship between the share prices of those publicly-listed firms and the market index for the country in which they are listed.

C122 We identified comparable firms from Bloomberg using the following criteria:

C122.1 listed in an OECD country, with a market capitalisation of at least \$100m US dollars (USD); and

<sup>965</sup>

[ ].

<sup>966</sup>

If an investment had no systematic risk (ie, it would show no correlation with returns on the market), its equity beta would be zero. If an investment in the equity of a company is of average risk, the equity beta will be 1. This means that the premium over the risk-free rate that equity investors expect will be the same as the average for the overall market (known as the tax-adjusted market risk premium, or TAMRP).

C122.2 in the Global Industry Classification Standard (GICS) category of Bloomberg of “Food Retail”.

C123 Of the resulting sample of companies we excluded:

C123.1 companies whose percentage of revenue from ‘supermarkets’ was less than 75%. This excluded those with more than 25% of their revenues coming from convenience store revenue, drug store and/or pharmacy store revenue;

C123.2 companies who had over 75% revenue from “hypermarkets”; and

C123.3 companies who had very little or no revenue data available in Bloomberg.

C124 This produced a sample of 30 companies, which are listed in Table C2.<sup>967</sup>

C125 We note that this sample may include some companies that are not entirely comparable to the New Zealand grocery retailers we are assessing. For example, some of the overseas retailers may have a wider range of retail products, including spirits with a higher alcohol content or retail higher volumes of fuel. In other cases, the overseas retailers may own a greater proportion of their land and buildings, as opposed to leasing the premises. Nevertheless, we still consider the sample is representative of grocery retailing given the use of Bloomberg’s GICS category of “Food Retail”.

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<sup>967</sup>

We have included Woolworths Australia in our sample because it meets our sampling criteria, despite Woolworths NZ being included in Woolworths Australia. However, Woolworths NZ is only a relatively small portion of Woolworths Australia, so we are comfortable with its inclusion. We did however test the exclusion of Woolworths Australia in the sample and it did not materially alter the results for Asset Beta or Leverage.

**Table C2 Listed comparator companies**

<b>Company Name</b>	<b>Country</b>
TESCO PLC	United Kingdom
KONINKLIJKE AHOLD DELHAIZE N	Netherlands
KROGER CO	United States
WESTON (GEORGE) LTD	Canada
METRO INC/CN	Canada
JERONIMO MARTINS	Portugal
COLRUYT SA	Belgium
EMPIRE CO LTD 'A'	Canada
SAINSBURY (J) PLC	United Kingdom
DINO POLSKA SA	Poland
BIM BIRLESIK MAGAZALAR AS	Turkey
WM MORRISON SUPERMARKETS	United Kingdom
AXFOOD AB	Sweden
GROCERY OUTLET HOLDING CORP	United States
CASINO GUICHARD PERRACHON	France
SPROUTS FARMERS MARKET INC	United States
SHUFERSAL LTD	Israel
LA COMER SAB DE CV	Mexico
WEIS MARKETS INC	United States
NORTH WEST CO INC/THE	Canada
SOK MARKETLER TICARET AS	Turkey
MIGROS TICARET A.S	Turkey
INGLES MARKETS INC-CLASS A	United States
RAMI LEVY CHAIN STORES HASHI	Israel
RALLYE SA	France
VICTORY SUPERMARKET CHAIN LT	Israel
VILLAGE SUPER MARKET-CLASS A	United States
TIV TAAM HOLDINGS 1 LTD	Israel
ADESE ALISVERIS MERKEZLERI T	Turkey
WOOLWORTHS AUSTRALIA	Australia & New Zealand

Source: Commerce Commission analysis of Bloomberg data.<sup>968</sup>

C126 Consistent with our methodology for estimating the cost of capital under Part 4 and the Telecommunications Act 2001, and our approach in our fuel market study, we estimated asset beta for the comparator companies:

C126.1 for up to 20 years (subject to the availability of data) by splitting the period into four consecutive five-year periods; and

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<sup>968</sup> [ ].

C126.2 using daily, weekly, and four-weekly data. To limit the risk of estimation error based on the choice of reference day, the weekly and four-weekly estimates are averaged over each day of each period, rather than being sourced directly from Bloomberg estimates.<sup>969</sup>

C127 The resulting sample averages for each period are shown in Table C3 below.<sup>970</sup>

**Table C3 Average comparator company asset beta**

	2000-2004	2005-2009	2010-2014	2015-2019
Number in sample	20	22	25	30
Weekly asset beta	0.37	0.42	0.43	0.46
Four-weekly asset beta	0.34	0.41	0.45	0.44
Average weekly and four-weekly asset beta for 2010-14 and 2015-19 periods				0.44

Source: Commerce Commission analysis of Bloomberg data.<sup>971</sup>

C128 Consistent with our fuel market study, we prefer to give greatest weight to weekly and four-weekly estimates, and the two more recent time periods of 2010 to 2014 and 2015 to 2019.<sup>972</sup> The average of the weekly and four-weekly results over the two five-year periods was 0.44.

C129 For the purposes of our retail grocery market study we have used a range for asset beta of 0.40 to 0.50. As shown in Table C3 above, this range captures most of the observed average asset betas shown above.

C130 Adopting a range for the asset beta input parameter also helps address estimation error and accounts for differences in the type of activities undertaken by the New Zealand grocery retailers and those in the international sample, which may give rise to differences in systematic risk between these companies.

<sup>969</sup> Commerce Commission “Input methodologies review decisions Topic paper 4: Cost of capital issues” (20 December 2016) at [291], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0021/60537/Input-methodologies-review-decisions-Topic-paper-4-Cost-of-capital-issues-20-December-2016.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0021/60537/Input-methodologies-review-decisions-Topic-paper-4-Cost-of-capital-issues-20-December-2016.pdf).

<sup>970</sup> As noted, we have excluded 2020 from our time period of analysis to remove the effects of the COVID-19 pandemic.

<sup>971</sup> [ ].

<sup>972</sup> Daily asset beta estimates can be distorted by low liquidity stocks and older estimates may have smaller sample sizes (and changes over time may mean older estimates are less relevant to the risks faced today). For further discussion, see: Commerce Commission “Input methodologies review decisions Topic paper 4: Cost of capital issues” (20 December 2016) at [297]-[307], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0021/60537/Input-methodologies-review-decisions-Topic-paper-4-Cost-of-capital-issues-20-December-2016.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0021/60537/Input-methodologies-review-decisions-Topic-paper-4-Cost-of-capital-issues-20-December-2016.pdf).



- C131 For the purpose of this market study we do not need a single point estimate of asset beta, unlike in respect of Part 4 regulation (for example, where we require a single point estimate of beta, and WACC, to set a price-quality path).<sup>973</sup>
- C132 We tested whether the exclusion of companies who had over 75% revenue from “hypermarkets” was distortionary given we have determined that New Zealand has a higher proportion of larger scale supermarkets than overseas. There were only one company in this category. Including this in the sample did not materially change the average asset beta.

*Tax-adjusted market risk premium*

- C133 The tax-adjusted market risk premium (TAMRP) is a market-wide measure which reflects the additional expected return over and above the risk-free rate required to compensate investors for holding the stock market portfolio. We use a range of TAMRP from 7.0% to 7.5%, with a mid-point of 7.25%. This range is consistent with the TAMRP we use under our Part 4 regulatory regime of 7.0% and the latest estimate under Part 6 of the Telecommunications Act is 7.5%.<sup>974</sup>
- C134 This range of TAMRP is also consistent with the previous and most recent advice from Dr Lally, an expert adviser to the Commission.<sup>975</sup>
- C135 Given our profitability assessment is primarily focussed on the period from 2015 to 2019, a 7.0% TAMRP is the more appropriate estimate of TAMRP for the retail grocery sector. Nevertheless, we have adopted the latest estimate of TAMRP to reflect the most recent research and findings that are available.

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<sup>973</sup> In the regulatory context we recognise and treat estimation risk differently. Specifically, we consider whether to apply an uplift to our mid-point estimate of WACC. Commerce Commission “Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services” (30 October 2014) at Section 5, available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0029/88517/Commerce-Commission-Amendment-to-the-WACC-percentile-for-price-quality-regulation-Reasons-Paper-30-October-2014.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0029/88517/Commerce-Commission-Amendment-to-the-WACC-percentile-for-price-quality-regulation-Reasons-Paper-30-October-2014.PDF).

<sup>974</sup> Commerce Commission “Input methodologies review decisions - Topic paper 4: Cost of capital issues” (December 2016) at Chapter 4, available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0021/60537/Input-methodologies-review-decisions-Topic-paper-4-Cost-of-capital-issues-20-December-2016.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0021/60537/Input-methodologies-review-decisions-Topic-paper-4-Cost-of-capital-issues-20-December-2016.pdf); Commerce Commission “Fibre Input Methodologies Determination 2020” (9 July 2021) at [67], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0029/259373/Fibre-Input-Methodologies-Determination-2020-consolidated-July-2021-.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0029/259373/Fibre-Input-Methodologies-Determination-2020-consolidated-July-2021-.pdf).

<sup>975</sup> Dr Martin Lally “Estimation of the TAMRP” (26 September 2019), available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0043/189889/Dr-Martin-Lally-Estimation-of-the-TAMRP-26-September-2019.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0043/189889/Dr-Martin-Lally-Estimation-of-the-TAMRP-26-September-2019.pdf).

*Investor and corporate tax rates*

C136 We assume a corporate and investor tax rate of 28%, consistent with the New Zealand company tax rate and the prescribed investor tax rate for a portfolio investment entity, respectively. Fuller reasons are set out in the Input Methodologies (IMs) reasons paper 2010.<sup>976</sup>

*Leverage*

C137 Leverage reflects the proportion of a company's total funding that is borrowed/debt financed. The international comparator companies we used in our assessment of the asset beta have an average leverage of around 20%.<sup>977</sup> We use this as our best estimate of leverage for calculating the WACC.

C138 There was some variance in the leverage within this comparator sample. Based on the variance in this sample we have used a range for leverage of 10% to 30%.

*We estimate a WACC of between 4.6% - 6.1% for the retail grocery sector*

C139 Combining these parameter values produces an estimate of WACC ranging from 4.6% to 6.1%. This is shown in Table C4.<sup>978</sup>

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<sup>976</sup> Commerce Commission "Input Methodologies (Electricity distribution and gas pipeline services) Reasons Paper" (December 2010) at [H10.5]-[H10.17], available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0019/62704/EDB-GPB-Input-Methodologies-Reasons-Paper-Dec-2010.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0019/62704/EDB-GPB-Input-Methodologies-Reasons-Paper-Dec-2010.pdf).

<sup>977</sup> The reasons for this are set out in: Commerce Commission "Input Methodologies (Electricity distribution and gas pipeline services) Reasons Paper" (December 2010) at Attachment H3, available at: [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0019/62704/EDB-GPB-Input-Methodologies-Reasons-Paper-Dec-2010.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0019/62704/EDB-GPB-Input-Methodologies-Reasons-Paper-Dec-2010.pdf).

<sup>978</sup> We also examined what the post-tax WACC would be if they were done on an annual basis across the five years. This approach used the five-year government bond rate in each year as the risk-free rate. The post-tax WACC ranged from 5.8% in 2015 through to 4.6% in 2019.

**Table C4 Our parameter inputs for our estimate of WACC**

	Low	ComCom Best Estimate	High
Risk-free rate	2.35%	2.53%	2.70%
Average debt premium	1.67%	1.67%	1.67%
Leverage	10%	20%	30%
Asset beta	0.40	0.44	0.50
TAMRP	7.00%	7.25%	7.50%
Corporate tax rate	28%	28%	28%
Debt issuance costs	0.20%	0.20%	0.20%
Cost of equity (post tax)	4.8%	5.8%	7.3%
Cost of debt	4.2%	4.4%	4.6%
Post-tax WACC	4.6%	5.3%	6.1%

Source: Commerce Commission analysis.<sup>979</sup>

#### *Our estimate of WACC compared to the supermarket's estimates*

C140 To test the reasonableness of our estimate of post-tax WACC we compared it to the estimates provided by the major grocery retailers.<sup>980</sup> These are between 1.0% and 2.0% higher than our WACC range. The key differences between our WACC estimates and those of the major grocery retailers is the choice of asset beta, which are materially higher than our estimates of 0.40 to 0.50.

#### *The risks of mis-estimating WACC*

C141 As WACC cannot be observed, there is a risk of mis-estimating WACC, which is why we provide a range of estimates above. In some contexts where a point estimate is required, we make an additional allowance for the risk of estimation error. This is especially so when there are asymmetric consequences from getting that estimate wrong.<sup>981</sup>

C142 In this study we have estimated a range of WACC which we have compared profitability against. The use of a range increases the likelihood that our estimates capture the true but unobservable level of WACC.

<sup>979</sup> [ ].

<sup>980</sup> [ ].

<sup>981</sup> In particular, we may make an allowance for estimation error when setting the maximum prices a monopoly supplier of services can charge its consumers. This is to protect consumers where we believe the consequences of under-investment are significant enough to justify the cost of a higher WACC to consumers, see: Commerce Commission "Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services" (30 October 2014) at Section 5, available at: [https://comcom.govt.nz/data/assets/pdf\\_file/0029/88517/Commerce-Commission-Amendment-to-the-WACC-percentile-for-price-quality-regulation-Reasons-Paper-30-October-2014.PDF](https://comcom.govt.nz/data/assets/pdf_file/0029/88517/Commerce-Commission-Amendment-to-the-WACC-percentile-for-price-quality-regulation-Reasons-Paper-30-October-2014.PDF).

## **Our assessment of the profitability of grocery retailers in New Zealand**

C143 As discussed earlier, we have adopted a variety of approaches measuring the profitability of grocery retailing in New Zealand. These include the following:

C143.1 ROACE;

C143.2 the returns firms expect to earn from new investments in the retail grocery sector; and

C143.3 profit margin trends over time and compared to international grocery retailers.

### **Return on average capital employed**

C144 The following sections describe our assessment of ROACE for the three major grocery retailers: Woolworths NZ, and the Foodstuffs NI and Foodstuffs SI co-operatives. These include discussions on the various adjustments and tests we have made to these ROACE. These results are benchmarked against the WACC, the sample of international grocery retailers and the companies on the NZX50.

C145 We also present the ROACE results for the Foodstuffs NI and Foodstuffs SI co-operatives. This is in order to test whether our focus on the member stores distorts our profitability estimates.

C146 We also include a ROACE assessment of three other smaller grocery retailers.

### **ROACE for Woolworths NZ**

C147 In assessing Woolworths NZ's ROACE, it is necessary to discuss certain features of its financial accounts and the adjustments we have made to its financial performance and assets employed to derive our ROACE forecasts. These include:

C147.1 removing various non-grocery related subsidiaries from Woolworths NZ's financial accounts;

C147.2 removing all of Woolworths NZ's goodwill and brand intangibles from its assets employed; and

C147.3 adjusting Woolworths NZ's land and property assets to reflect market values.

#### *Removing Woolworths NZ's non-grocery related subsidiaries*

C148 Discussions with Woolworths NZ determined that it owned two materially significant subsidiaries that were engaged in non-grocery retailing activities. These are Ezibuy and New Zealand Wine Cellars Limited.<sup>982</sup> Given our market study is focussed on grocery retailing, Woolworths NZ provided an adjusted set of financial accounts with these two entities removed for the years 2015 to 2019.

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<sup>982</sup>

Previously known as Cellar Masters Wines Proprietary Limited.

C149 The most significant aspect of removing these non-grocery activities is the removal of the material loss that Woolworths NZ incurred in its 2016 financial year from the sale of Ezibuy. This caused the write down of \$276 million in goodwill as a result of the sale of the company below what its carrying book value was.<sup>983</sup>

*Removing Woolworths NZ's goodwill and brand intangibles*

C150 As discussed in our approach section, we consider it is appropriate to remove all goodwill from Woolworths NZ's average assets employed in our ROACE assessment. This amount on Woolworths NZ's balance sheet has averaged around \$2.3 billion each year from 2010 to 2019.

C151 We have also removed the intangibles relating to brands from the average assets employed in the ROACE assessment. This has typically been around \$169 million each year on Woolworths NZ's balance sheet from 2010 to 2019.

*Adjusting Woolworths NZ's land and property assets to market values*

C152 We have adjusted Woolworths NZ's land and building assets to reflect their market, or economic value. The 2019 book value of its land and buildings of \$366 million is based on purchase price, less accumulated depreciation.<sup>984</sup>

C153 To adjust Woolworths NZ's land and building assets from their book value to a market value, we took the following steps:

C153.1 Woolworths NZ, Foodstuffs NI and Foodstuffs SI provided us with various market valuations they have undertaken between 2018 to 2021 on certain land and buildings they own. We compared each valuation to the book value of each property. This showed a weighted average valuation uplift of between 30 and 35%.

C153.2 We applied this valuation uplift to the book value of all of Woolworths NZ's land and buildings as a top-down adjustment to reflect the market value of these assets being employed.

C153.3 We did not include this capital gain in valuation of the earnings of Woolworths NZ, so this adjustment is relatively conservative in the sense it under-estimates the earnings that Woolworths NZ has made from owning these assets.

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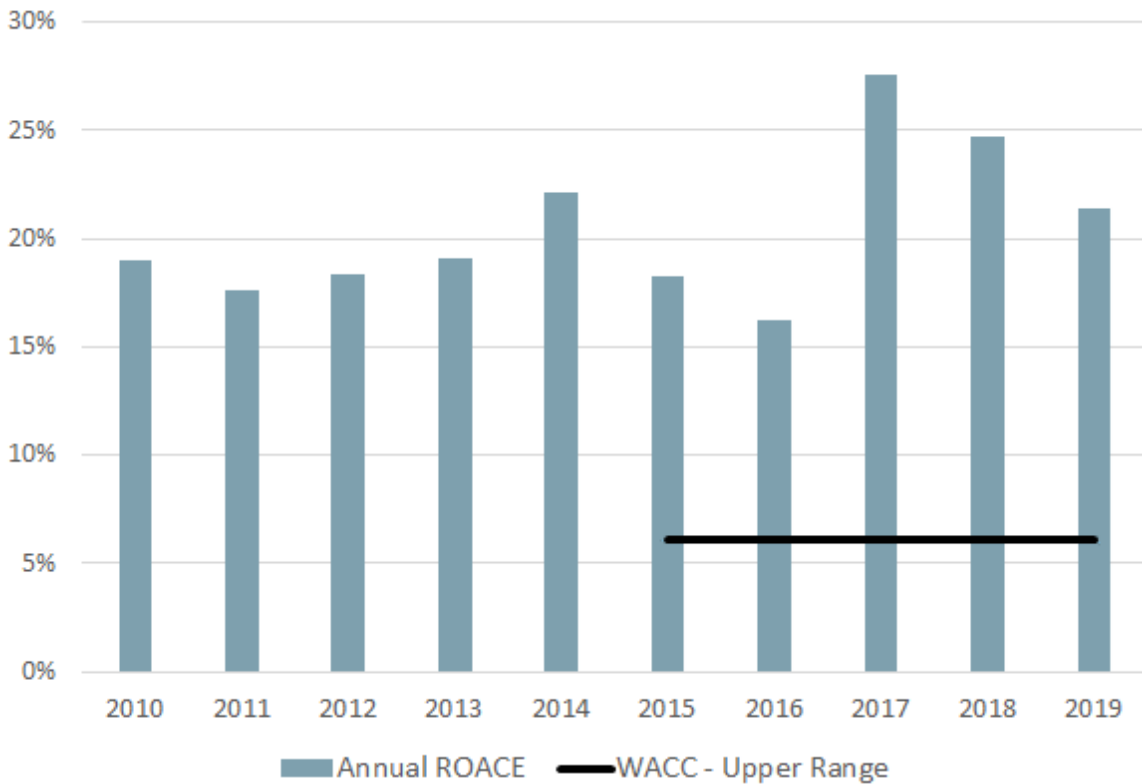
<sup>983</sup> Woolworths New Zealand Group Limited "Annual Report" (26 June 2016) at 26, available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>.

<sup>984</sup> Woolworth New Zealand Group Limited "Annual Report" (30 June 2019) at 25, available at: [https://www.woolworthsgroup.com.au/icms\\_docs/195582\\_annual-report-2019.pdf](https://www.woolworthsgroup.com.au/icms_docs/195582_annual-report-2019.pdf).

*Woolworths NZ's ROACE after adjustments*

C154 Following these three adjustments, we have determined the average ROACE for Woolworths NZ was 20.4% from 2010 to 2019, and 21.6% from 2015 to 2019. This ranged between 16% and 28%. Figure C5 shows this result for the entire period, including the upper end of our WACC range of 6.1% for the years 2015 to 2019. As shown, Woolworths NZ's profitability has been materially and consistently above our estimated WACC range. Moreover, this same conclusion would apply if we compared ROACE to the slightly higher WACC range that Woolworths NZ submitted.

**Figure C5 Woolworths NZ's ROACE: Post adjustments<sup>985</sup>**



Source: Commerce Commission profitability analysis.<sup>986</sup>

<sup>985</sup> The reduction in profitability in the 2016 year was due to a restructure in Woolworths NZ's operations which incurred various costs. Both factors reduced Woolworths NZ's profit materially for that year.  
<sup>986</sup> [ ].

*Woolworths NZ's view on goodwill and its inclusion*

C155 Woolworths NZ considers its goodwill should be retained in its assets employed when calculating the ROACE as it represents the actual cost to Woolworths NZ of entering the New Zealand market that could not be avoided.<sup>987</sup> It states that the acquisition meant it could enter the New Zealand market and avoid the full cost of replicating the business it was acquiring, but it was required to pay some measure of economic replacement cost materially above the depreciated book value of the assets.

C156 Woolworths NZ has also identified various specific sources of economic value that are not reflected individually in its balance sheet, but rather embedded in the overall goodwill value.<sup>988</sup> These include:

C156.1 Progressive Enterprises' assets were heavily depreciated at the time of the acquisition, and by inference were recorded at levels well below their replacement value. Evidence for this lies in the difference between the asset book values and Woolworths NZ's estimates of the replacement cost of these assets. For assets where replacement costs are not available, Woolworths NZ considers the historic cost is a good proxy. Woolworths NZ acknowledges there are challenges in making these estimates but considers the difference between book value and fair replacement value to be worth up to \$698 million based on the replacement cost at the time of acquisition.

C156.2 Woolworths NZ considers the capitalised value of long-term leases is not recognised in the purchase price it paid for Progressive Enterprises, and it should be. The accounting standards at the time did not recognise the value of long-term leases as an asset, which Woolworths NZ considers would have factored into the purchase price. Woolworths NZ also notes that the recent changes to the International Accounting Standard IFRS16 now requires all leases to be accounted for as assets on the balance sheet, which aligns with its view. Woolworths NZ bases its estimation of the value of these leases on Progressive Enterprises' external operating lease expense in 2006 being \$85 million. Capitalising this amount at a multiple of between 6.2x and 8.0x provides a value of between \$530 million and \$680 million.

C156.3 Woolworths NZ expected the acquisition of Progressive Enterprises would generate merger synergies. Woolworths NZ's internal estimates at the time of the acquisition were for increased annual earnings as a result of the acquisition of between \$35 million and \$51 million in year five after the purchase. Capitalising this earnings stream at an Earnings Before Interest, Tax and Amortisation (EBITA) multiple of 13.4x would be worth between \$469 million and \$683 million.

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<sup>987</sup> [ ]  
<sup>988</sup> [ ]

C156.4 Land values were recorded on the balance sheet at a historic cost of \$59 million, which does not reflect the fair market value of this asset. However, accurate records of specific land holdings in 2005 are not available and consequently Woolworths NZ is unable to estimate the market value of the land at the time of acquisition.

C156.5 Woolworths NZ also considers there are other sources of value in the acquisition that are not reflected on the balance sheet and more difficult to objectively quantify. These includes items such as licences, brands, customer contracts, supplier relationships, and transport contracts / networks.

*Our view on Woolworths NZ's arguments for including goodwill*

C157 We recognise that shareholders in Woolworths NZ paid for the goodwill at issue and that this outlay therefore affects the total return on their capital. Our focus is different: we need to test whether the grocery business operated by Woolworths NZ has been earning economic rents. One way that could have happened is if Progressive Enterprises was earning economic rents prior to its acquisition by Woolworths NZ, and effectively sold those rents to Woolworths NZ. If so, the purchase price would have been well above the value of the assets and the difference would be booked as goodwill. This is why we begin by removing the goodwill and then check that the underlying assets are recorded in our model at market value. Against this background we have assessed Woolworths NZ's arguments regarding goodwill and make the following comments:

C157.1 We agree that Progressive Enterprises' assets were heavily depreciated at the time of the acquisition and below their replacement value. However, the approach Woolworths NZ has used to determine their replacement cost is based on these assets being brought brand new. The correct approach should reflect the replacement cost of modern equivalent assets and then depreciate these to the age of the current assets. We have made this adjustment for land and building assets, as discussed earlier.

C157.2 In addition to this, Woolworths NZ's latest consolidated financial statement states that the expected useful life of other fixed assets, such as plant, equipment and fittings is between 2.5 to 10 years.<sup>989</sup> It has been 16 years since the purchase of Progressive Enterprises, so the majority of these assets are likely to have been fully depreciated, scrapped and (where appropriate) replaced with new assets.<sup>990</sup> Given we wish to understand the actual cost of the assets that were employed to generate the earnings, any under-valuation of these shorter-lived assets at the acquisition date will by now have little or no effect on book values.

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<sup>989</sup> Woolworths New Zealand Group Limited "Annual Report" (28 June 2020) at 14, available at: <https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1686297/documents>.

<sup>990</sup> Although some of these assets may have been in the asset base in the early years of the 2010 to 2019 time period. However, this is not expected to be significant.

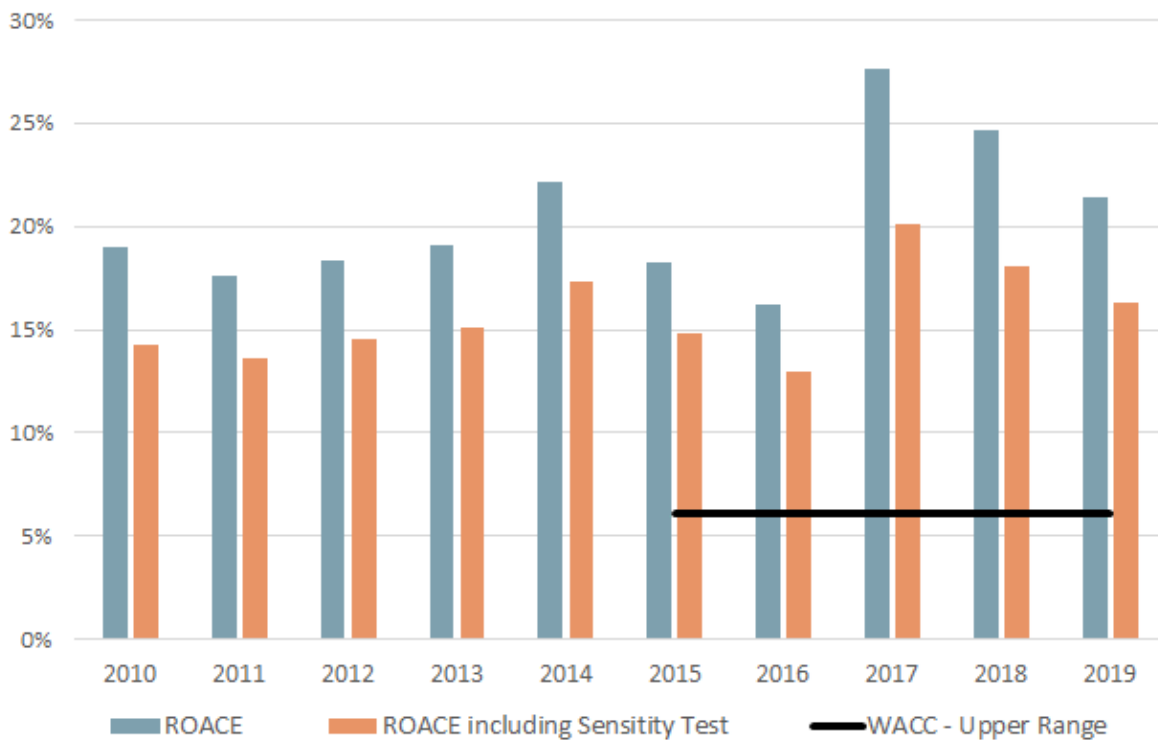


- C157.3 For the reason we discussed earlier, we do not consider including lease in total assets employed is appropriate when assessing economic profit. In addition, the leases that Woolworths NZ obtained through its acquisition of Progressive Enterprises can be viewed similarly to the replacement value of the fixed assets. We assume the majority of these leases would have expired or be largely expired. Once again, we wish to understand the actual cost of the assets that were employed to generate the earnings. Those assets that are no longer part of the asset base should be excluded from the asset base in our profitability assessment.
- C157.4 The synergies that were expected from the acquisition of Progressive Enterprises are relevant for determining what an acquiring firm will pay for a target firm. However, for our purposes we want to understand the market valued cost of the assets that were employed to generate the profits. We do not want to capture any value of future expected profits.
- C157.5 In addition, a competitive market would have seen any merger synergies gradually reduced over time as the forces of competition eroded any competitive advantage a single firm would have. This is the same principle we apply in the regulation of monopoly services providers like electricity transmission and distribution companies.
- C157.6 We agree with Woolworths NZ's argument that land and property values did not reflect the true market value. As discussed earlier, we have adjusted the value of Woolworths NZ's entire land and property assets to reflect the market value of these assets. This has resulted in a \$124 million increase in total assets employed.
- C157.7 We also agree with Woolworths NZ's argument that some elements of goodwill might have reflected items such as set-up costs for customer contracts, supplier relationships, staff contracts, and transport contracts / networks. However, like leases and other shorter-lived assets we consider these to be depreciable assets that (if incurred on Woolworths NZ's entry) would by now have cycled out of the asset register and been replaced by a market-based cost.
- C158 Nevertheless, we are concerned that our conclusions are not compromised by underestimating the value of Woolworths NZ's assets, so as a sensitivity we tested the impact of a material increase in the total value of assets.
- C159 For this, we used the difference between the \$2.3 billion of total value of goodwill and the various amounts of goodwill that Woolworths NZ attributed to various factors, plus our adjustment for land and property. This left a range of unattributed goodwill between \$122 million and \$486 million. We stress that although we have used figures that Woolworths NZ's attributes to goodwill, this sensitivity test relates to the value of real assets, not goodwill. We use the range's mid-point of \$300 million for the sensitivity test, a figure we consider materially exceeds any shortfall that might have occurred in our asset valuation.

C160 By implementing this sensitivity test, we have determined Woolworths NZ’s ROACE to be between 13% and 20% from 2010 to 2019, averaging 15.7%. The following chart shows this result compared to the upper end of our WACC range of 6.1%. Once again, this level of profitability is both consistently and also materially above our estimate of the WACC for the time period assessed.

C161 The WACC in the earlier years of this time series would have been higher given the risk-free rate was higher. However, it was not so high as to increase the overall WACC to levels approaching or greater than the ROACE including the estimated \$300 million of goodwill.

**Figure C6 Woolworths NZ’s ROACE: Post adjustments and including sensitivity test**



Source: Commerce Commission profitability analysis.<sup>991</sup>

**ROACE for Foodstuffs member stores**

C162 As described in our approach section we have focussed on the profitability of Foodstuffs’ member stores – the individual supermarket stores that operate under the Foodstuffs NI and Foodstuffs SI co-operatives. For this we have consolidated as many individual retail stores as were available to derive a ROACE for the North Island and the South Island.

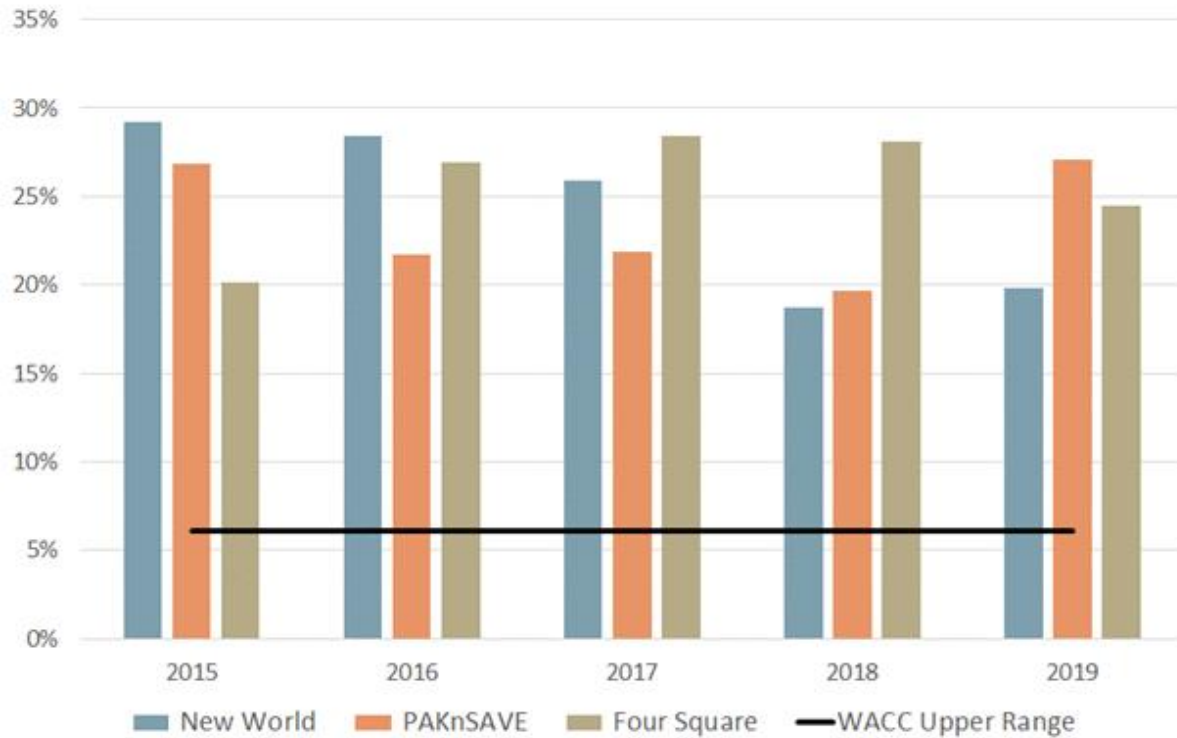
C163 We examine the profitability of the two co-operatives in a separate analysis.

<sup>991</sup> [ ]

### Foodstuffs NI ROACE

C164 Provided below are the ROACE for Foodstuffs NI's retail stores for the five years 2015 to 2019. This is a consolidation of 210 stores under all three of the retail banners: New World, PAK'nSAVE and Four Square.

**Figure C7 Foodstuffs NI retail stores ROACE per retail banner type**



Source: Commerce Commission profitability analysis.<sup>992</sup>

C165 The average ROACE per retail banner is:

C165.1 New World: 24.4%;

C165.2 PAK'nSAVE: 23.4%; and

C165.3 Four Square: 25.6%.

### Foodstuffs SI ROACE

C166 Provided below are the ROACE for Foodstuffs SI's New World, PAK'nSAVE and Four Square retail banners for the five years 2015 to 2019. This is a consolidation of up to 108 stores in any one year under all three of the three retail banners.<sup>993</sup> However, there is limited data available for the Four Square retail banner in the years 2015 and 2016, so these results have been omitted.

<sup>992</sup> [ ].

<sup>993</sup> We have not included the Raeward Fresh retail banner in this analysis because it only has a small number of retail stores.

**Figure C8 Foodstuffs SI retail stores ROACE per retail banner type**

Source: Commerce Commission profitability analysis.<sup>994</sup>

C167 The average ROACE per retail banner is:

C167.1 New World: 22.3%;

C167.2 PAK'nSAVE: 20.1%; and

C167.3 Four Square: 37.3%.

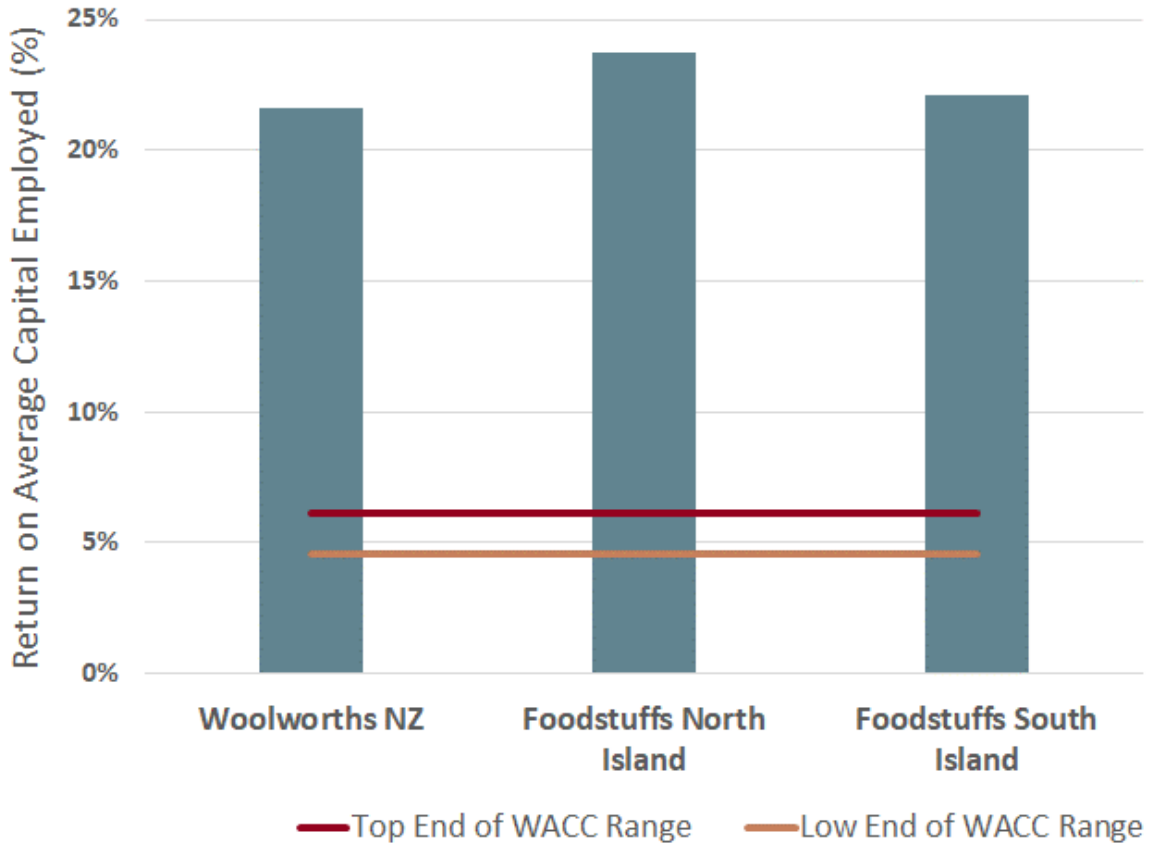
C168 However, we note the ROACE for the Four Square stores is relatively high compared to the other South Island retail banners and to the Four Square North Island ROACE results. Therefore, we place less reliance on this result when drawing any conclusions regarding overall profitability.

*How do the overall ROACE results for the major grocery retailers compare to WACC*

C169 Our analysis indicates that ROACE over the time period between 2015 to 2019 is typically between 16% and 28%. This is materially in excess of our estimate for WACC for these companies of between 4.6% to 6.1%. The following chart shows each major grocery retailer's profitability for 2015 to 2019 compared to the upper end of our WACC range.

<sup>994</sup> [ ]

**Figure C9 Average ROACE for each major grocery retailers in New Zealand compared to WACC (2015-2019)**



Source: Commerce Commission profitability analysis.<sup>995</sup>

*How do these ROACE results compare against international grocery retailers and companies on the NZX50*

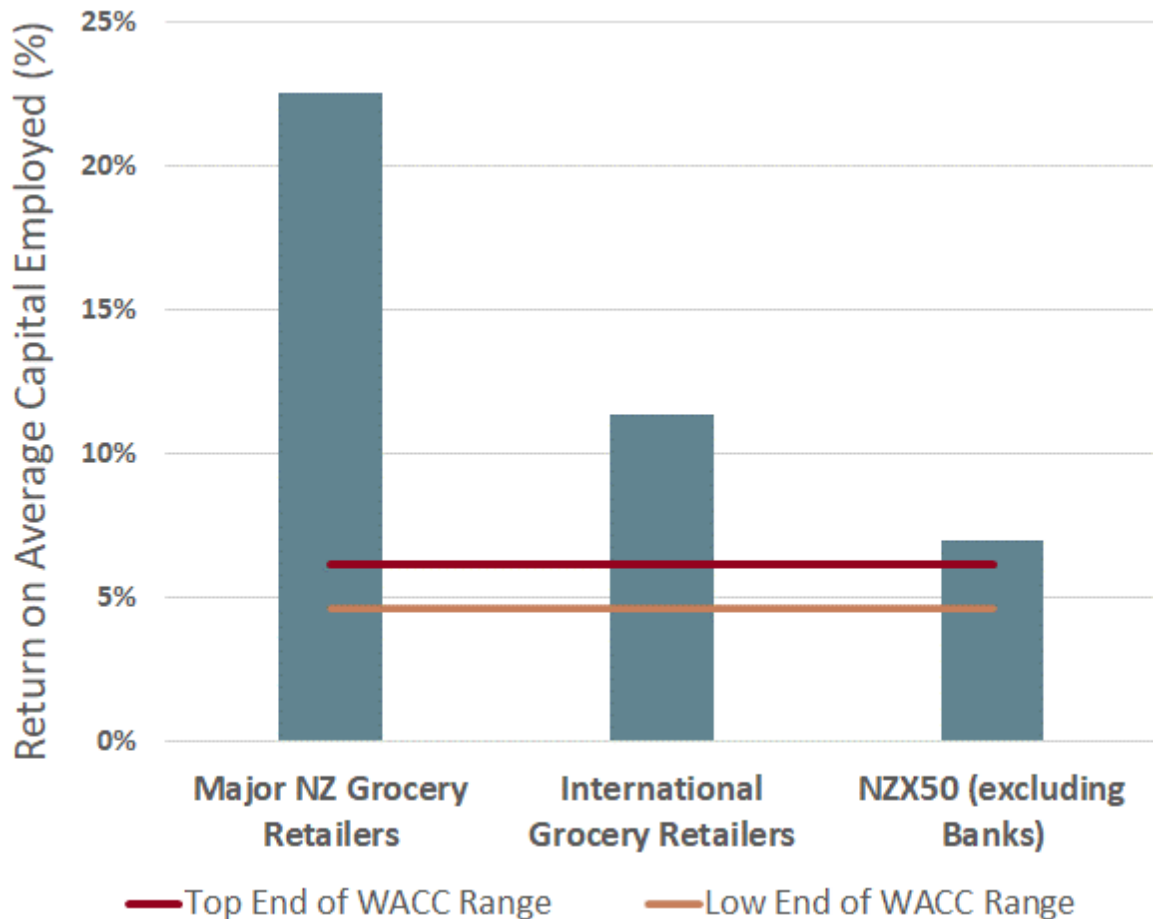
C170 We compared the three grocery retailers’ ROACE to the ROACE of a sample of international grocery retailers between 2015 and 2019. This is the same sample of international retailers that we used for developing the asset beta and leverage figures used in our calculation of the WACC.

C171 We also compared these results to the ROACE for the listed companies in the NZX50 from 2015 to 2019. For this comparison, we removed the ROACE results for the retail trading banks from the sample – including Westpac, ANZ and Heartland bank. This is due to retail banks having a high reliance on debt in the form of borrowing from depositors’ funds, which can distort their ROACE results. Removing these trading banks was also done in our fuel market study for similar reasons.

<sup>995</sup> [ ].

C172 Provided below is the arithmetic average ROACE for the three major grocery retailers compared to the average ROACE for the sample of international grocery retailers and the NZX50 companies between 2015 to 2019. As shown, the profitability for the New Zealand grocery retailers is well in excess of all three comparators.

**Figure C10 Average ROACE for the three major grocery retailers in New Zealand compared with international grocery retailers, NZX returns and WACC (2015-2019)**



Source: Commerce Commission profitability analysis.<sup>996</sup>

C173 The level of profitability for the international grocery retailers is lower than the three New Zealand major grocery retailers. This could be partially explained if the overseas countries have more competitive grocery retailing markets – which the lower ROACE results would suggest. Though their profitability still appears high compared to our estimate of WACC – acknowledging we are comparing a New Zealand based WACC with overseas ROACE.

<sup>996</sup> [ ].

C174 The ROACE returns from the NZX companies are materially lower than the New Zealand and international grocery retailers. They are also only slightly more than our estimate of WACC for New Zealand grocery retailers. This is somewhat surprising given the differences in the relative level of risk associated with grocery retailing and more risky companies on the NZX.

*Testing Foodstuffs member stores' ROACE*

C175 To test the robustness of the Foodstuffs NI and Foodstuffs SI retail store's ROACE, we considered the various cashflows that take place between the retail stores and their respective co-operative in order to assess them on an arm's length basis.

C176 These cashflows include the purchase of groceries, rent for stores, payments for associated administration costs like IT and marketing, and certain financing arrangements.<sup>997</sup> Prima facie, most of these payments appear to be cost reflective and represent what an independent grocery retailer would pay for these services.

C177 However, we consider there are three cashflows between the Foodstuffs co-operatives and their respective retail stores that are not being made at market rates or would not be made by an independent grocery retailer. These are:

C177.1 The Foodstuffs co-operatives charge the retail stores for the property they rent from the co-operatives. We tested the retail stores' rental payments to understand if these payments reflect market-based costs. We confirmed that rent levels for certain store retail banners appear to be below market levels of rent on a percentage of store sales turnover. This suggests that Foodstuffs store rents are below market rates which will artificially increase their NPAT and ROACE measures.<sup>998, 999</sup>

C177.2 We understand the Foodstuffs co-operatives only recover the operational costs associated with wholesaling and distribution, and administration costs like IT and marketing from the retail stores. These charges do not necessarily recover the capital costs associated with the assets that have been employed in this service delivery. This suggests the recovery of these costs is below market rates.

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<sup>997</sup>

[ ].

<sup>998</sup>

An alternative approach to testing the rent payments is to apportion the land and buildings to the retail stores and remove the store rental costs. However, this approach would also require the apportionment of the depreciation expenses of these assets to the stores, and an apportionment of debt and associated interest expenses needed to finance these assets. Overall, we consider this approach would require more adjustments and holds greater risk of getting those adjustments wrong.

<sup>999</sup>

We have been provided further information on store rents that indicates rent being charged to stores is closer to market rents. However, our analysis indicates that co-operative rents may still be below these market rates.

C177.3 The Foodstuffs co-operative business model requires that each retail store provides capital funding to its respective co-operative.<sup>1000</sup> This means permanent capital funding is being provided from the retail store to their respective co-operative. This inflates the total assets employed used in the ROACE, which lowers the ROACE. Outside of a co-operative environment this would not occur.

C178 In order to test the degree to which these transactions between the retail stores and the co-operatives are influencing the ROACE results, we have adjusted these transactions and recalculated ROACE as a sensitivity test. Given there are sufficient similarities between the two Foodstuffs NI and Foodstuffs SI group of companies, we did these changes just for the Foodstuffs NI retail stores.

*Testing Foodstuffs NI retail stores' rental payments to the co-operative*

C179 To account for the store rents being below market rents, we replaced the consolidated rent for all of the 210 Foodstuffs NI stores in our sample with one based on market-based rent as a percent of turnover for each year. The incremental increase in rental costs was then adjusted for tax and used to reduce the NPAT.

C180 This adjustment reduced the average ROACE from 23.8% by around 3.3% to 20.5% for Foodstuffs NI's member stores.<sup>1001</sup>

*Testing Foodstuffs NI retail stores' service payments to the co-operative*

C181 To correct for the under recovery of the capital costs associated with the Foodstuffs co-operatives' servicing the retail stores, we have determined the value of the Foodstuffs NI co-operative's fixed assets associated with these services. This is based on the historic purchase cost (undepreciated book value) of all of the co-operative's fixed assets shown in its financial statements, excluding land and buildings assets. This is a conservative approach, given some of these assets may not be related to servicing the retail stores.

C182 We multiplied these annual values by the upper end of our estimate of WACC to derive a notional annual capital cost that should be recovered by the co-operative from the retail stores. This amount was removed from the post-tax NPAT used in the ROACE for the retail stores. This reduces the average ROACE of 20.5% by around 0.9% to 19.6% for Foodstuffs NI's retail stores.<sup>1002</sup>

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<sup>1000</sup> [ ]  
<sup>1001</sup> Commerce Commission profitability analysis, [ ]  
<sup>1002</sup> Commerce Commission profitability analysis, [ ]



*Testing Foodstuffs NI retail stores' discounted rebate voucher payments*

C183 Foodstuffs NI retail stores are all required to provide capital funding to their co-operative.<sup>1003</sup> To test the effect of this funding, we took a sample of 60 Foodstuffs NI retail stores and made the following adjustments:

C183.1 We tested the sample to account for the rental adjustment and the cost of capital for the co-operative's administration services, as described above.

C183.2 We then removed the funding from the stores' total assets employed and the interest earned on the Deferred Rebate Voucher (DRV) loans for the years 2015 to 2019. The resulting average ROACE for the sample increased by around 8.0%.<sup>1004</sup>

C184 Based on these tests, we conclude that removing it increases the average ROACE by around 8.0%.

*The net effect of these three tests*

C185 Testing for market-based rents and the cost of capital associated with the co-operatives assets that service the retail stores reduces the average ROACE for Foodstuffs NI stores over the five-year period from 2015 to 2019 by around 4.4%. Removing the effects of DRV funding increases the average ROACE for Foodstuffs NI stores by around 8.0%. These three adjustments partially cancel each other out, with the combined adjustments raising the average ROACE by around 3.8%.

C186 Although there are some differences between the Foodstuffs NI and Foodstuffs SI co-operatives, we see no reason why this result would be significantly different to the Foodstuffs SI retail stores given the two co-operative groups have broadly similar arrangements for rent and funding. We therefore conclude that the overall ROACE profitability that we observed for all of the Foodstuffs NI and Foodstuffs SI retail stores is affected by the co-operative arrangements and that their net effect is to reduce store profitability.

**ROACE for the Foodstuffs co-operatives**

C187 As discussed in our conceptual approach, in order to have confidence in our profitability assessment of the Foodstuffs member stores, we have sought to understand the profitability of both of the co-operatives. This was to assess whether they are making economic losses that disguise the true profitability of member stores that own the co-operatives.

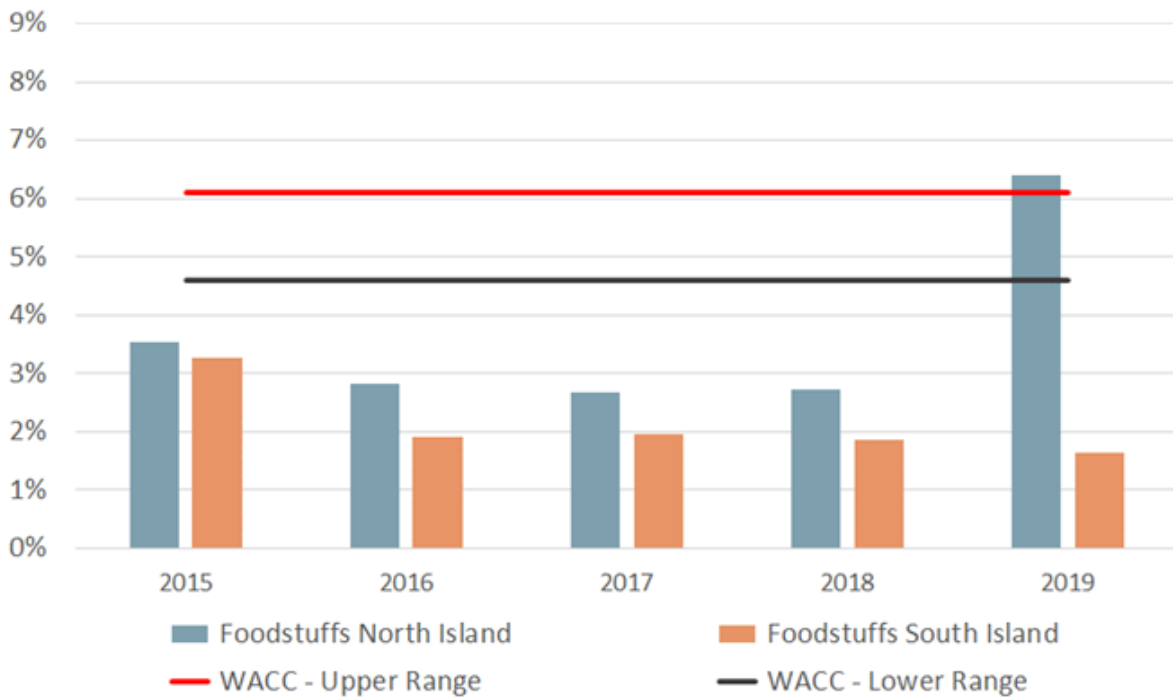
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<sup>1003</sup>

<sup>1004</sup>

[ Commerce Commission profitability analysis, [ ]].

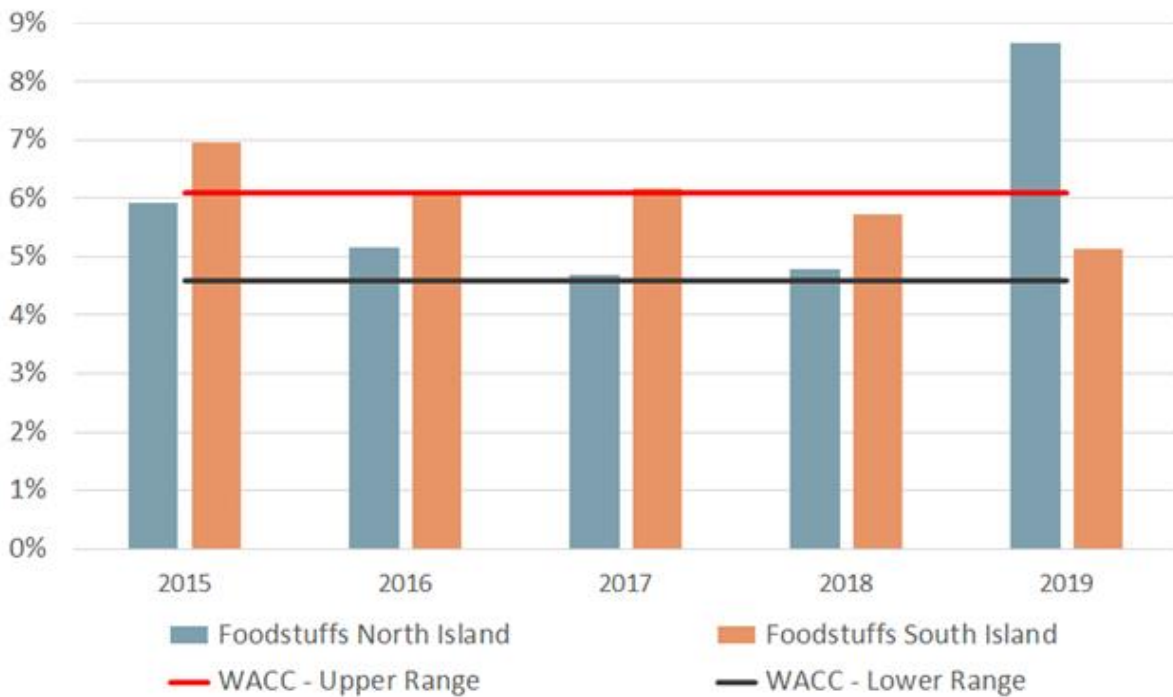
- C188 To test this we determined the ROACE for the two co-operatives. However, determining the economic profitability for the two co-operatives is difficult:
- C188.1 The bulk of each co-operative's assets are land and buildings. These are recorded in their balance sheets at their historical cost less depreciation. (Although in Foodstuffs NI's case, the land and buildings for Foodstuffs Wellington were brought into the Foodstuffs NI financial accounts at Fair Value in 2014.) This makes it difficult to assess profitability in terms of the asset base and the gains they have made from holding these assets.
- C188.2 In addition, because both co-operatives hold considerable portfolios of land and buildings, they can be considered more like a property company than a company involved in grocery retailing. This means the WACC for assessing their profitability is likely to be different to what we estimated for grocery retailing. We have not done this estimation but would suggest it would be broadly equivalent given the property market is also relatively low risk.
- C188.3 Both co-operatives have a number of investments in businesses in non-grocery related activities. In consultation with the two co-operatives, we assessed these businesses for both co-operatives and have concluded these are not materially significant, so no adjustments are required.
- C189 The ROACE for both co-operatives, without making any adjustments to the financial profit or assets employed, is 3.7% for Foodstuffs NI and 1.8% for Foodstuffs SI, as shown in Figure C11 below.<sup>1005</sup> This level of profitability is below our WACC range (acknowledging this WACC range relates to grocery retailing and not property investment) raising a risk that the co-operatives may be making economic losses, and there is a transfer of economic profit between the co-operatives and the stores.

**Figure C11 Foodstuffs NI and Foodstuffs SI co-operatives' ROACE**

Source: Commerce Commission profitability analysis.<sup>1006</sup>

- C190 We tested the retail stores' rental payments for the property they rent from the co-operatives. This was to understand if these rental payments reflect market-based costs. We tested this by increasing the Foodstuffs NI retail stores' rent as per the analysis in the earlier section.
- C191 We also tested the recovery of the capital costs of the fixed assets associated with their wholesaling and distribution, and administration costs like IT and marketing services that they provide the retail stores, but only recover the operational costs of.
- C192 Applying both of these adjustments to Foodstuffs NI and Foodstuffs SI co-operatives increases their overall ROACE to around 5.9%. This level of return is now towards the top end of within our estimated WACC range of 4.6% to 6.1%. Figure C12 provides the annual ROACE per co-operative including these two adjustments.

<sup>1006</sup> [ ].

**Figure C12 Foodstuffs NI and Foodstuffs SI co-operatives' ROACE**

Source: Commerce Commission profitability analysis.<sup>1007</sup>

- C193 As an additional sensitivity, we also tested increasing the asset base of Foodstuffs SI to reflect information we do have on the market value of its land and buildings. This was done in a similar manner to the way we adjusted Woolworths NZ's limited property portfolio. Overall, this reduces its ROACE to just below our estimate of the WACC range. However, this will be offset for both co-operatives by unrealised capital gains associated with the appreciation in value of the property which we have not included.
- C194 We conclude that the co-operatives are earning a level of profitability below their WACC and there may be a certain degree of cross subsidisation taking place between the co-operatives and the stores. However, when we adjust for the apparent rental subsidy, we observe the co-operative's profitability increases to a level akin to its estimate WACC, while the ROACE profitability of the retail stores still remains around 20%, well in excess of its estimated WACC range.
- C195 Therefore, in spite of the relationship between the co-operative and its member stores making it difficult to clearly observe the ROACE profitability, it appears that overall the Foodstuffs NI and Foodstuffs SI co-operatives are making excess profits relative to their WACC.

<sup>1007</sup>

C196 There may be other areas of economic cost under and over-recovery between the co-operatives and the member stores that we are not aware of or fully accounted for. For example:

C196.1 The co-operatives may hold amounts of stock and inventory on their financial accounts on behalf of their member stores that should potentially sit within the grocery retailing business. Although it is difficult to see how this could materially shift profitability between the co-operatives and their retail stores.

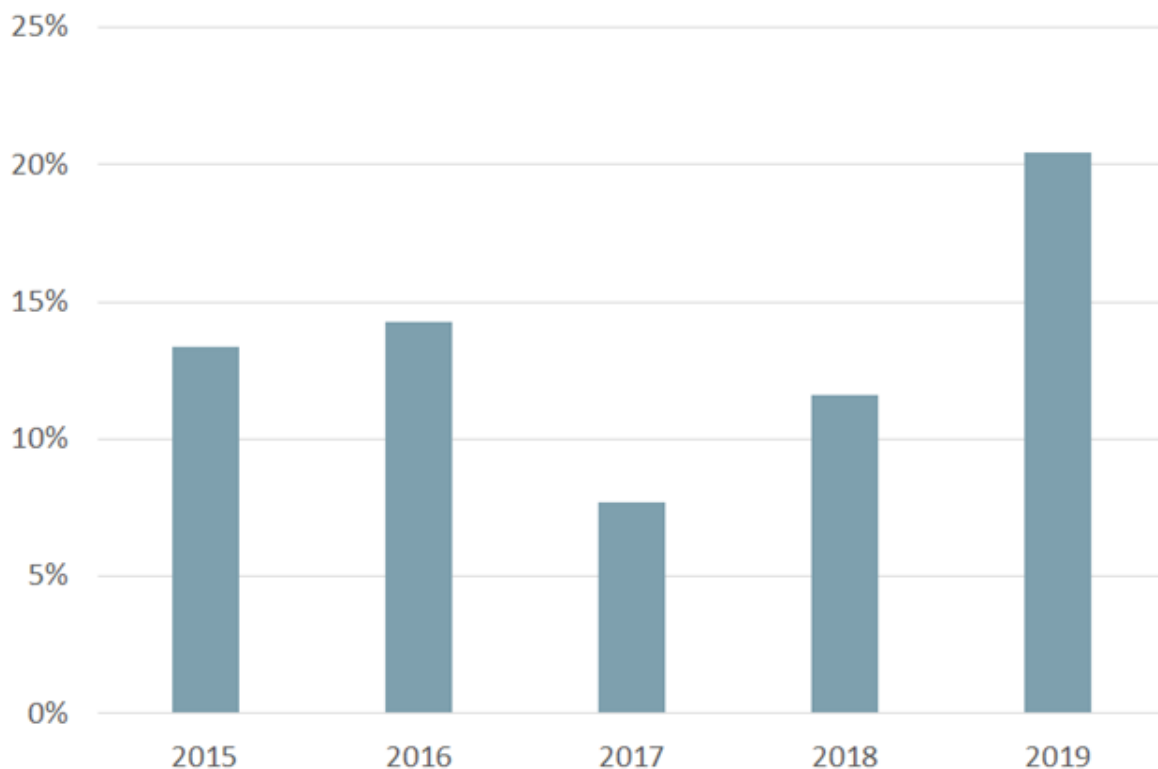
C196.2 In addition, the funding provided by the member stores may be affecting the profitability of the co-operatives. Their next best alternative source of funds is traditional commercial borrowings. If the interest rates paid on their members funds are materially different to commercial borrowing rates this could distort the co-operatives financing costs. There is some indication that this may be happening.<sup>1008</sup>

C197 The other major caveats around this analysis is that land and buildings have not been adjusted to reflect their true economic value. Similarly, none of the capital gains accruing to the co-operatives from their ownership of retail sites has been counted as income, as would normally be done for a ROACE calculation. Although we consider we have at least partially addressed this by testing rents to reflect market rates.

C198 Overall we consider it very unlikely that the co-operatives are systematically losing economic value for the benefit of their member stores. We are therefore comfortable that our estimates of the profitability of Foodstuffs member stores are not subject to a material upward bias from this source.

#### **ROACE for other grocery retailers**

C199 We have assessed the ROACE profitability of three other grocery retailers between 2015 and 2020, namely Moore Wilson's, Farro Fresh and Commonsense Organics.

**Figure C13 ROACE for smaller grocery retailers**

Source: Commerce Commission profitability analysis.<sup>1009</sup>

- C200 The arithmetic average ROACE for the other grocery retailers over this period is 14.8%. This is less than the three major grocery retailers. This may be partially due to their smaller size meaning they lack some economies of scale, but overall they are earning greater than our estimate of WACC.
- C201 However, given these retailers are smaller in scale, our WACC estimates may not necessarily be comparable. Their actual cost of borrowing may be more than we have estimated for the larger major grocery retailers and they may be less diversified making their actual cost of equity higher. We are therefore unable to reach a conclusion about whether they are earning returns above WACC.

#### **The returns firms expect to earn from new investments in the grocery sector**

- C202 A useful indicator of profitability is grocery retailers' own expectations of the profits they expect to earn on new investments. We have examined the returns major grocery retailers expect to earn on new investments in retail grocery sites as forecast in their business cases and how these returns compare to a normal return (WACC).
- C203 We have found that firms expect levels of profitability that are comfortably in excess of a normal level of return. Average IRRs are above our WACC rate for the business cases we have IRR data for.

<sup>1009</sup>

*We looked at the returns firms expect from investing in grocery retailing sites*

- C204 There can be a significant investment required to establish each new supermarket site or the redevelopment of an existing site. Firms only make this investment when they are confident of being able to earn a comfortable margin on their cost of capital.
- C205 Before they invest, firms analyse the costs and returns expected from investment and summarise their analysis in a business case. Typically, these are developed by senior management in the company and are then presented to their board of directors for critical review and approval. Given these corporate governance arrangements, these business cases provide us with a reliable and informed insight into the future profitability expectations of grocery retailers in New Zealand.
- C206 Our approach to considering these business cases was as follows.
- C206.1 We received 116 business cases from the major grocery retailers for a range of new investments. These included new-to-industry sites and “knock-down and rebuilds” of existing sites.<sup>1010</sup>
- C206.2 We reviewed the approach taken by the grocery retailers in assessing profitability in their business cases.
- C206.3 We summarised the returns forecast by the firms in their business cases.
- C206.4 We compared the firms’ expected level of profitability with our estimated normal level of returns (that is, our WACC range).

*The approach taken for assessing profitability*

- C207 The business cases we reviewed covered a range of locations, sizes, types, and retail banners. The majority of the business cases were proposals to develop new retail sites, although there was considerable variety on how these are undertaken. A small number were proposals to invest in wholesale distribution centres. As such, they are broadly reflective of the additional investment taking place in grocery retailing in New Zealand in recent years.
- C208 There are differences in each firm’s approach to making investments and expanding their grocery retailing business. The main differences reflect the underlying business model of Foodstuffs compared to Woolworths NZ:
- C208.1 The two Foodstuffs co-operatives tend to own supermarket land and buildings. The cost of the store fittings is borne by the store retailer.

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<sup>1010</sup> Information provided to Commission by major grocery retailers,  
[ ].

C208.2 Woolworths NZ leases many of the stores it operates out of. As such, most business cases are just from the grocery retailing perspective – there is no landlord perspective. Although in some cases it will propose buying the land, constructing the supermarket premises, but then selling and leasing back the premises to itself. In other cases it will purchase and retain the property.

C209 In keeping with our overall focus of assessing grocery retailing profitability, we have assessed the business cases relating to grocery retailing. We have not considered the profitability from the landlord's perspective, as this is not strictly grocery relating.

C210 The business cases use a variety of metrics to estimate the profitability of new investment. Estimates of NPV, payback periods, returns on net assets, and ROACE are used. The metric which firms most frequently used to assess profitability is the IRR. Given its popularity and its comparability to WACC we focus on this measure.

*Our analysis looked at firms' estimates of IRR*

C211 The IRR is the discount rate that makes the NPV of a set of cash flows equal to zero. There were some differences in firms' approach to estimating IRR – typically around the length of the forecast period, but these differences do not appear significant.

C212 Our analysis includes 36 business cases that contained an IRR from the grocery retailing perspective.<sup>1011</sup> These were between 2015 and 2020, with the bulk being between 2019 and 2020.<sup>1012</sup> We consider this sample of business cases is reflective of a broad cross-section of new investment by New Zealand grocery retailers.

C213 The weighted average IRR for all of these business cases is between 15% and 25%. This is materially above our estimated upper WACC range for 2015 to 2019 of 4.6% to 6.1%. We acknowledge we have included business cases for the 2020 year, which are not necessarily comparable to this WACC range. Nevertheless, it is still informative to include this year's results.

C214 We also note that the average expectation of the profitability of either opening a new site or redeveloping an existing site has not declined materially over the 2015 to 2020 period.

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<sup>1011</sup> A number of business cases did not calculate the IRR from the retail perspective, so we have not included these in our analysis.

<sup>1012</sup> The number of business cases included in each year was as follows: one in 2015, three in 2016, three in 2017, five in 2018, 13 in 2019 and 11 in 2020.



*The IRR forecasts are unlikely to be over-optimistic*

C215 It is possible the high levels of forecast profitability may not eventuate because the expectations in the business cases were overly optimistic due to various biases held by the preparer or the organisation. However, there is no indication from the information available to us that the forecast IRRs in the business cases are based on overly optimistic forecasts. In addition, we note:

C215.1 The continued expansion of new grocery retailing sites suggests that companies are satisfied with the actual performance of their new investments.

C215.2 Most business cases explicitly allowed for possible cannibalisation of sales at the firm's existing nearby sites.

C215.3 Most business cases have extensive understanding of the demographics of the consumer catchment area the proposed new store will be servicing, as well as the local competitors in the vicinity.

C215.4 Post-investment reviews also showed that actual ROACE performance exceeded the business case expectations for the retail business.<sup>1013, 1014</sup>

*The reinvestment rate implicit in the IRR*

C216 As an adjunct to the above analysis, we have also examined the IRR formula that grocery retailers are using to assess proposed investments. The standard IRR calculation implicitly assumes that interim cash flows from an investment can be reinvested at the IRR. If the firm cannot reinvest the cash flows at the same rate as the IRR, then the IRR calculation will overstate the returns of that project. For a single project like a new retail grocery site, an assumption that cash produced by this new site can be reinvested at the same rate as the IRR may not be appropriate. A more appropriate approach is to use a modified IRR (MIRR) instead, whereby the reinvestment rate is specified.

C217 However, most grocery retailers are continuously investing in new sites or redeveloping existing ones, and the nature of each subsequent project is broadly similar. If one views the project for each site as part of a portfolio of projects and programme of investment, then the conventional assumption that cash flows from the first site can be reinvested at the same IRR would appear appropriate.

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<sup>1013</sup> Commerce Commission profitability analysis, [ ].  
<sup>1014</sup> [ ].

*The firms' hurdle rates and how they compare to WACC*

- C218 A hurdle rate is the minimum rate of return that a firm requires to earn from an investment before undertaking it. It is comparable to a project's IRR. It is typically set above a company's WACC in order to ensure that those investments that are selected have sufficient profitability to provide a buffer in case the investment does not perform. The buffer can be considered a risk management tool.
- C219 The business cases for each supermarket retailer have materially different hurdle rates for investment in a grocery retailer. Some of the difference between the hurdle rates of companies will be due to their different WACCs. However, this only accounts for some of the difference in hurdle rates. We suspect the remainder is due to differences in profitability expectations, their approach to risk management and their business composition.

**Profit margin analysis**

- C220 While the ROACE profitability measure is our primary tool for assessing profitability, we have also reviewed the profit margins relative to sales to gain a greater understanding of the sector's profitability. We acknowledge that profit margin analysis does not provide an absolute estimate of whether there is any excess profitability.
- C221 Our analysis includes the three major grocery retailers' GP margin, EBIT margin, and NPAT margin over time. We also compare these profit margins to those seen in a sample of international grocery retailers. This sample is the same group of international retailers that we used for our derivation of the asset beta and leverage figures used in our calculation of the WACC, and also the ROACE that was shown earlier in this section.
- C222 There are some limitations to this analysis. Not least that it relies upon accounting data and there are some difficulties in comparison between international jurisdictions. While companies are required to comply with accounting standards, we still expect there will be some differences in the calculation of certain items. This was a point made in the 2000 UK Competition Commission study.<sup>1015</sup>
- C223 There are also comparability issues associated with the New Zealand grocery retailers. There are also comparability issues associated with the New Zealand grocery retailers. Foodstuffs NI and Foodstuffs SI have different methodologies for charging their respective stores. Foodstuffs NI GP margins are influenced by certain funding being provided from the retail stores to the co-operative, which we understand is included in their cost of goods sold, which reduces their GP margin. Foodstuffs SI states there is no funding recovered or provided by stores in the cost of goods sold.

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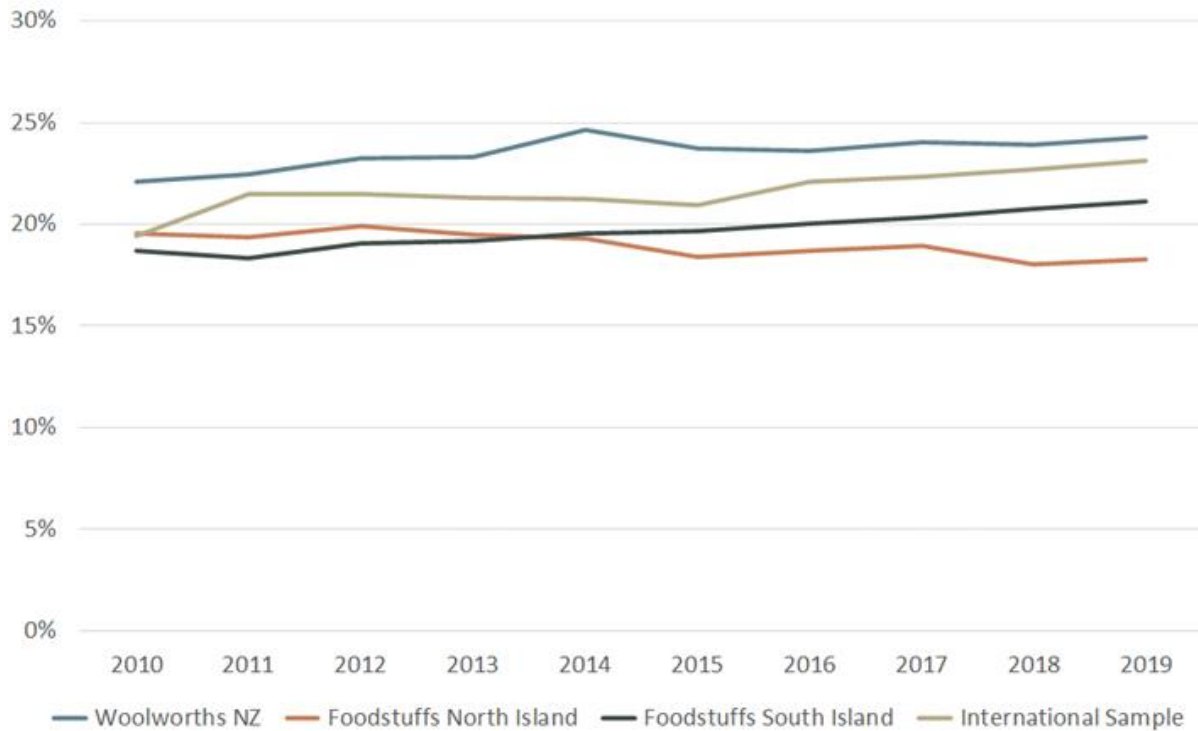
<sup>1015</sup> Competition Commission "Supermarkets – A report on the supply of groceries from multiple stores in the United Kingdom" (October 2000) at Chapter 8, available at: [https://webarchive.nationalarchives.gov.uk/+www.competition-commission.org.uk/rep\\_pub/reports/2000/fulltext/446c8.pdf](https://webarchive.nationalarchives.gov.uk/+www.competition-commission.org.uk/rep_pub/reports/2000/fulltext/446c8.pdf).

C224 We also caution against too much reliance being placed on the earlier years of the Foodstuffs’ data series due to a smaller sample size being available for the years 2010 to 2014. Foodstuffs NI also pointed out that it was formed through the merger of Foodstuffs Auckland and Foodstuffs Wellington in 2013. This merger and the subsequent alignment of their two business models caused considerable changes over the period between then and now, which makes their profit margins less comparable over time.

*Gross profit margin*

C225 The GP margins for the three New Zealand major grocery retailers shows two distinct tiers. The two Foodstuffs co-operatives’ retail stores have GP margins around 20%, whereas Woolworths GP margin is around 24%. This compares to an average GP margin of 22% for our sample of international grocery retailers.

**Figure C14 GP Margin: New Zealand retailers versus international retailers**



Source: Commerce Commission profitability analysis.<sup>1016</sup>

C226 As discussed, the Foodstuffs GP margins are influenced by some funding being provided to the co-operative. This is included in their cost of goods sold, which reduces their GP margin. This makes comparisons between the two Foodstuffs co-operatives and the overseas sample of grocery retailers difficult.

<sup>1016</sup> [ ].

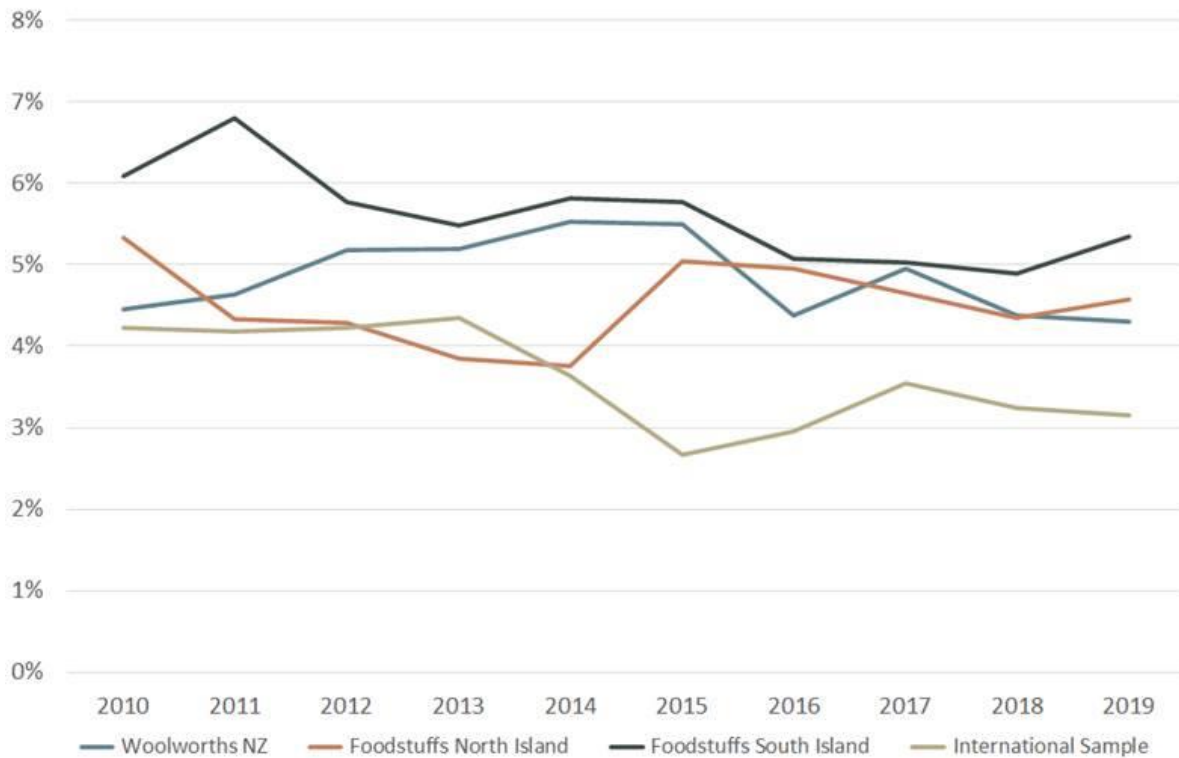
C227 Removing the funding provided to the co-operative will increase the two Foodstuffs co-operatives' GP margins closer to the international average. Woolworths NZ's GP margin has been consistently above the international comparators.

C228 The overall trend of the GP margins suggests that Woolworths NZ's GP margin is relatively stable, after rising gradually between 2010 to 2014. The GP margin for the two Foodstuffs groups is also relatively stable, although we note a recent divergence between the two, which has now become quite material.

*EBIT margin*

C229 The EBIT margin displays a clear divergence between the major grocery retailers and the international sample. The major grocery retailers have EBIT margins of between 4.5% and 5.6% over the time period observed. This is materially greater than the international sample of 3.6%. This difference is material and appears to be persistent.

**Figure C15 EBIT Profit Margin: New Zealand retailers versus international retailers**

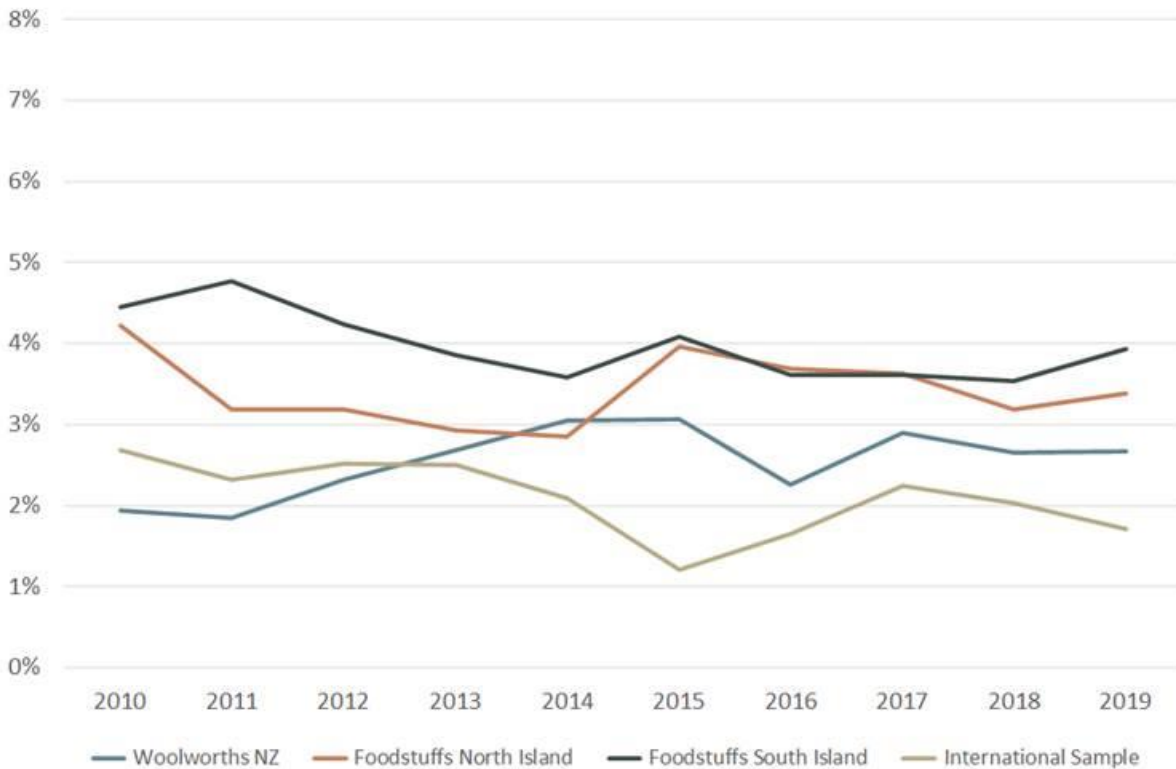


Source: Commerce Commission profitability analysis.<sup>1017</sup>

*NPAT margin*

C230 The NPAT margin shows the Foodstuffs retail member stores and Woolworths NZ have higher NPAT profit margins than the international sample. The Woolworths NZ NPAT profit margin is materially less than that for the retail member stores in the two Foodstuffs groups. This appears to be due to these stores not paying commercial rents and the full cost of wholesale services. Once these are factored into their costs, the Foodstuffs retail member stores' NPAT margin reduces to a level comparable to Woolworths NZ.<sup>1018</sup>

**Figure C16 NPAT Profit Margin: New Zealand retailers versus international retailers**



Source: Commerce Commission profitability analysis.<sup>1019</sup>

C231 The overall conclusion we draw from this analysis is that the major grocery retailers are typically earning greater levels of profit margin than a sample of international grocery retailers. These additional profit margins also appear to be persistent.

C232 Although we acknowledge that these results come with certain caveats, including the results can sometimes be subject to interpretation, comparisons to international stores are not always straightforward, and the unique features of the Foodstuffs co-operatives may distort certain profit margin comparisons.

<sup>1018</sup> Commerce Commission profitability analysis, [ ].  
<sup>1019</sup> [ ].

## Other issues for discussion

### *Accounting for survivor bias*

- C233 An argument could be made that profitability is high because we are only measuring those market participants that have survived and are ignoring the lower profitability of companies that have failed and left the market. Excluding these “marginal” market participants will overstate the level of profitability in the sector and give a false impression that profitability is higher than it really is.
- C234 The most recent significant market exit was The Warehouse Group, which entered the retail grocery market in 2006 under the retail banner Warehouse Extra, but exited that market in 2008. This exit was over 12 years ago and outside our sample time period. However, given there have been so few exits from the market, this does not support survivor bias.
- C235 Another alternative is to examine the number of individual stores that have left the retail grocery sector relative to the size of the sector to gauge the extent of survivor bias. On average, there have only been around five store closures per annum between 2011 to 2020. This compares to an average number of retail grocery stores of around 660 over this period. That is, only 0.8% of stores leave the market every year. This is a relatively small number, which suggests survivor bias is unlikely to be distorting our profitability results. We also note that a number of the store closures coincide with a new store being opened nearby by the same major grocery retailer, indicating the store closure is likely to represent a site move rather than a ‘marginal’ market participant leaving the market.

## Profitability summary – is there persistence of excess levels of profit

### Introduction

- C236 This section addresses whether the levels of excess returns that have been observed are persistent or temporary.

### There are several factors to identify persistence of excess returns

- C237 We see the following factors as relevant to assessing whether excess returns are persistent:
- C237.1 the extent to which returns exceed normal levels of economic profitability;
  - C237.2 the length of time over which these returns have exceeded normal levels;  
and
  - C237.3 anything that would indicate these excess levels of return are likely or unlikely to continue.

### **The extent to which returns exceed a normal competitive level**

- C238 The assessments of profitability discussed in this attachment indicate that returns in the retail grocery sector materially exceed a normal level of return. Our estimate of the average ROACE for the grocery retailers is materially above the upper end of our estimated WACC range.
- C239 The ROACE for the major three grocery retailer is between 16% and 28%, compared to our estimated WACC range of 4.6% to 6.1%.

### **The length of time over which excess returns are being earned**

- C240 The length of time over which excess returns are being earned is a key indicator of their persistence. Through our analysis we have observed:
- C240.1 Excess returns have been observed for ROACE in every year of our assessment from 2015 to 2019 for all three major grocery retailers. There is some volatility between the yearly results, but ROACE profitability has always materially exceeded WACC.
- C240.2 The ROACE for Woolworths NZ was also assessed over an extended period from 2010 to 2019. Its ROACE over this ten-year period averaged 20.4%. When we tested the impact of a material increase in its total value of assets, Woolworths NZ's ROACE still averaged 15.7% over this time period. While our estimated WACC range only applies from 2014 to 2019, we would expect a similarly derived WACC range for the preceding five years (2010 to 2014) would not be at or around such a level.
- C240.3 The overall level of profitability observed in the profit margin analysis for the years 2015 to 2019 was relatively constant; further indicating that the overall levels of excess profitability are persistent.
- C241 The time period we have covered in our assessment has typically been from 2015 to 2019. However in the case of Woolworths NZ, we have assessed ROACE profitability from 2010 to 2019. We consider this ten-year time period is sufficiently representative of a business cycle.
- C242 However, it could be argued that this ten-year period of 2010 to 2019 does not include a material economic slow-down or a recession and is therefore not representative of a business cycle. However, to reduce the average observed ROACE to normal levels of profitability would require a substantially low (if not negative) ROACE. Prima facie, this seems unlikely.

C243 Typically, there will be a lag before new investment occurs in response to the signal from excess returns. This can be because a new market entrant needs time to prepare plans, raise capital, and build assets. As a result, returns to the incumbents may remain above normal levels for a period until sufficient new investment occurs and supply increases. However, this argument does not apply in this instance given we have not seen any major new market entrants into the retail grocery sector. New retail stores have been built, but these have been by the existing incumbents and not by new entrants.

#### **Expectations around future profitability remain high**

C244 Grocery retailers' profitability expectations from their business cases, as measured by their IRR forecasts have not changed materially in the last five to six years – these have consistently averaged between 15% and 20%.

#### **Conclusions on the persistence of excess returns**

C245 Based on our analysis, there is a range of evidence which strongly indicates excess returns are consistently being earned in the retail grocery sector and that this profitability will persist.

C245.1 Excess levels of return have been consistently earned by Woolworths NZ and the retail stores of the two Foodstuffs co-operatives from 2015 to 2019.

C245.2 Woolworths NZ's profitability from 2010 to 2014 was at similar levels to those earned between 2015 to 2019. It is likely this level of profitability also provided excess returns.

C245.3 Various profitability margins have been at consistent levels from 2010 to 2019, and these have also been consistently above our sample of international grocery retailers.

C245.4 Major grocery retailers' profitability expectations from their business cases have been at levels indicating excess returns and have not changed materially in the last five to six years, indicating an expected persistence in profitability.

C246 We conclude that the New Zealand grocery retailing sector has consistently earned significant excess returns over many years, and that excess returns are, absent some unforeseen entry to the market or intervention, expected to continue into at least the near to medium term future. This would suggest that there are impediments to competition for the long-term benefit of consumers.



## Attachment D International price comparison

- D1 This attachment provides further details about the analysis we have conducted to compare the prices of groceries in New Zealand with prices internationally. The findings of this analysis are described in Chapter 3.
- D2 The sections in this attachment are:
- D2.1 datasets used to compare grocery prices;
  - D2.2 methods used in interpreting datasets; and
  - D2.3 further analysis and sensitivity testing.

### Datasets used to compare grocery prices

- D3 In this section, we discuss the datasets we have used and explain how they produce price level and expenditure statistics.

#### Price-level datasets

- D4 We used three datasets of prices for our international comparisons. These are compiled by the ICP, the OECD and Numbeo.<sup>1020, 1021, 1022</sup>
- D5 The ICP and OECD collect “national annual average prices” on a regionally determined product list to produce their price datasets. The prices used are the final prices paid by the consumer and are therefore tax inclusive. They present averaged and normalised (to the World or OECD) prices at the “class” level, which are sets of goods such as bread and cereals. These datasets are produced every three (OECD) and six (ICP) years. The OECD dataset contains data for OECD countries while the latest ICP dataset includes data for 176 economies.<sup>1023</sup>
- D6 Numbeo collects crowd-sourced prices on a product list that it determines. This data is presented as both an average price for each product and an aggregated (average) grocery price index. Prices and indices are available for most countries.

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<sup>1020</sup> Frederic A. Vogel “Executive Summary” in *World Bank Measuring the Real Size of the World Economy: The Framework, Methodology and Results of the International Comparison Program* (World Bank, Washington DC, 2013) at xviii, available at:

<https://openknowledge.worldbank.org/bitstream/handle/10986/13329/9780821397282.pdf?sequence=5>.

<sup>1021</sup> Eurostat, OECD “Eurostat-OECD Methodological Manual on Purchasing Power Parities” (2012) at [5.8.1], available at: <https://www.oecd.org/sdd/prices-ppp/PPP%20manual%20revised%202012.pdf>.

<sup>1022</sup> Numbeo “Methodology and motivation for Numbeo.com”  
[https://www.numbeo.com/common/motivation\\_and\\_methodology.jsp](https://www.numbeo.com/common/motivation_and_methodology.jsp).

<sup>1023</sup> World Bank Group “Purchasing Power Parities and the Size of World Economies: Results from the 2017 International Comparison Program” (2020), available at:  
<https://openknowledge.worldbank.org/bitstream/handle/10986/33623/9781464815300.pdf>.

D7 The EIU also compiles a dataset of prices in selected cities. The EIU collects data twice annually on a product list that is the same for all cities in its survey. We understand that the EIU presents an average of these two prices in its price data. NERA used the EIU in its comparison of international prices. NERA excluded all products that were not priced in every city in its city list as not all cities had prices for every product.

### Expenditure datasets

D8 We also compared New Zealand's expenditure on groceries with a number of different countries using three different expenditure datasets compiled by the OECD, ICP and the USDA.<sup>1024</sup>

D9 The USDA sources its expenditure statistics from a market research firm, Euromonitor. This data is reported annually, broken down for food and non-alcoholic beverages, alcoholic beverages, and tobacco. The most recent data is available for 2018.

D10 The OECD and ICP report expenditure statistics for all "classes" at the same time as prices.

### The OECD and ICP price datasets are likely to be the most suitable for our analysis

D11 Our view is that, for the purposes of our study, the OECD and ICP datasets are likely to be more suitable for analysis of price levels between countries than the Numbeo or EIU datasets. This is because the OECD and ICP:

D11.1 provide extensive documentation detailing their process for collecting prices and averaging them to produce a price level;

D11.2 source prices from national statistical offices, and report these as a national annual average price.<sup>1025, 1026</sup> Therefore, we expect that these prices may be better at smoothing seasonal effects and promotions, which affect price; and

D11.3 average prices using processes that preserve the representativity and comparability of products across countries.

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<sup>1024</sup> USDA "Data on expenditures on food and alcoholic beverages in selected countries: 2013-2018" (2019), available at: [https://www.ers.usda.gov/media/10271/2013-2018-food-spending\\_update-april-2019.xls](https://www.ers.usda.gov/media/10271/2013-2018-food-spending_update-april-2019.xls).

<sup>1025</sup> Prasada Rao "The Framework of the International Comparison Program" in *World Bank Measuring the Real Size of the World Economy: The Framework, Methodology and Results of the International Comparison Program* (World Bank, Washington DC, 2013) at 29, available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/13329/9780821397282.pdf?sequence=5>.

<sup>1026</sup> Eurostat, OECD "Eurostat-OECD Methodological Manual on Purchasing Power Parities" (2012) at [5.8.1], available at: <https://www.oecd.org/sdd/prices-ppp/PPP%20manual%20revised%202012.pdf>.

D12 Due to the nature of user-reported data, we consider the Numbeo and EIU data to be less robust than the OECD and ICP. However, we have used the Numbeo dataset to compare international prices as a cross check to the results of our analysis using the OECD and ICP datasets. We have also conducted some sensitivity testing of the analysis submitted by NERA using the EIU data (more details on this are provided in paragraphs D50 to D53 below).

### Products analysed in datasets

D13 To identify the price level for grocery products, we ensured that datasets of price levels use a product that would be expected to be found at a supermarket.

D14 The OECD and ICP datasets present price levels down to the “class” level. In Table D1 we present the product classes that are included in each category that we used for this analysis.

**Table D1 Product categories included in the OECD and ICP price indices and expenditure statistics**

OECD	ICP
<ul style="list-style-type: none"> <li>• Food and non-alcoholic beverages (category) <ul style="list-style-type: none"> <li>○ Bread and cereals (class)</li> <li>○ Meat (class)</li> <li>○ Fish and seafood (class)</li> <li>○ Milk, cheese and eggs (class)</li> <li>○ Oils and fats (class)</li> <li>○ Fruit, vegetables, potatoes (class)</li> <li>○ Other food (class)</li> <li>○ Non-alcoholic beverages (class)</li> </ul> </li> <li>• Alcoholic beverages (class)</li> <li>• Tobacco (class)</li> </ul>	<ul style="list-style-type: none"> <li>• Food and non-alcoholic beverages (category) <ul style="list-style-type: none"> <li>○ Bread and cereals (class)</li> <li>○ Meat (class)</li> <li>○ Fish (class)</li> <li>○ Milk, cheese and eggs (class)</li> <li>○ Oils and fats (class)</li> <li>○ Fruit (class)</li> <li>○ Vegetables (class)</li> <li>○ Sugar, jam, honey, chocolate and confectionery (class)</li> <li>○ Food products n.e.c. (class)</li> <li>○ Non-alcoholic beverages (class)</li> </ul> </li> <li>• Alcoholic beverages (class)</li> <li>• Tobacco (class)</li> </ul>

Source: OECD and ICP datasets.<sup>1027, 1028</sup>

<sup>1027</sup> Eurostat, OECD “Eurostat-OECD Methodological Manual on Purchasing Power Parities” (2012) at [Box 13.3], available at: <https://www.oecd.org/sdd/prices-ppp/PPP%20manual%20revised%202012.pdf>.

<sup>1028</sup> Paul McCarthy “National Accounts Framework for International Comparisons: GDP Compilation and Breakdown Process” in *World Bank Measuring the Real Size of the World Economy: The Framework, Methodology and Results of the International Comparison Program* (World Bank, Washington DC, 2013) at 82-83, available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/13329/9780821397282.pdf?sequence=5>.

- D15 Numbeo uses a product list with weights to calculate prices.<sup>1029</sup> Given that these prices are crowd sourced, we do not know what type of outlets these prices came from.
- D16 We understand that the OECD, ICP, and USDA datasets only consider products that are purchased for consumption at home. To support this, we obtained the following evidence describing what types of products are included in the lists above.
- D16.1 The OECD specifies that its food, non-alcoholic beverages, and alcoholic beverages categories include those items when purchased for consumption at home. They specifically exclude products:<sup>1030</sup>
- ...sold for immediate consumption away from the home by hotels, restaurants, cafes, bars, kiosks, street vendors, automatic vending machines, etc.
- D16.2 The ICP has a separate category for restaurants and hotels, implying that grocery items consumed at these locations are not included in the calculation of price indices for food and (alcoholic and non-alcoholic) beverages.<sup>1031</sup>
- D16.3 The USDA specifies that they calculate expenditures of products consumed at home.<sup>1032</sup>

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<sup>1029</sup> Numbeo “Methodology and motivation for Numbeo.com” available at: [https://www.numbeo.com/common/motivation\\_and\\_methodology.jsp](https://www.numbeo.com/common/motivation_and_methodology.jsp).

<sup>1030</sup> Eurostat, OECD “Eurostat-OECD Methodological Manual on Purchasing Power Parities” (2012) at [11.01.10.0], [11.01.20.0], [11.02.10.0], available at: <https://www.oecd.org/sdd/prices-ppp/PPP%20manual%20revised%202012.pdf>.

<sup>1031</sup> Paul McCarthy “National Accounts Framework for International Comparisons: GDP Compilation and Breakdown Process” in *World Bank Measuring the Real Size of the World Economy: The Framework, Methodology and Results of the International Comparison Program* (World Bank, Washington DC, 2013) at 87, available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/13329/9780821397282.pdf?sequence=5>.

<sup>1032</sup> USDA “Data on expenditures on food and alcoholic beverages in selected countries: 2013-2018” (2019), available at: [https://www.ers.usda.gov/media/10271/2013-2018-food-spending\\_update-april-2019.xls](https://www.ers.usda.gov/media/10271/2013-2018-food-spending_update-april-2019.xls).

- D17 As noted in Chapter 3, the indices that we have used include food, non-alcoholic beverages, alcoholic beverages and tobacco bought at retail stores. As such, not all products sold by supermarkets are captured in the indices. These are items such as household cleaning supplies, which were included in other indices. These other indices were not included in our analysis, because they also contained items that would not likely be purchased at a supermarket.
- D18 For example, for the ICP dataset, non-durable household goods is included in the “furnishings, household equipment, and routine household maintenance” index which also includes: “household textiles”, and “repair of furniture”. We consider these items unlikely to be purchased at a grocery store, and therefore did not choose to include that index.<sup>1033</sup>

### Methods used in interpreting datasets

- D19 In this report, we used three methods that allowed us to use datasets to attempt to find the price level of groceries in New Zealand’s grocery stores.
- D20 First, we explain how exchange rates were used to convert prices in local currency units to a standardised unit.
- D21 Second, we combined price levels for several product groups to create price indices for grocery products using the OECD and ICP datasets.
- D22 Third, we choose a selection of countries that we will use to compare New Zealand’s price level to which we think have similar determinants of price other than competition to New Zealand.

### Exchange rate methods

- D23 To create price-level indices and compare expenditures, prices must be converted to a common unit.
- D24 In this section, we describe the processes we used to convert prices to a common unit.

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<sup>1033</sup> Paul McCarthy “National Accounts Framework for International Comparisons: GDP Compilation and Breakdown Process” in *World Bank Measuring the Real Size of the World Economy: The Framework, Methodology and Results of the International Comparison Program* (World Bank, Washington DC, 2013) at 84-85, available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/13329/9780821397282.pdf?sequence=5>.

- D25 Price-level indices produced by the OECD and ICP use an annual average exchange rate.<sup>1034</sup> For expenditure statistics produced by the same datasets, we used the annual average exchange rates that the datasets provided to convert expenditure to expenditure in USD.
- D26 Numbeo uses a mid-year exchange rate to convert exchange rates.<sup>1035</sup> We do not consider this to be the most appropriate exchange rate to use, and therefore believe this is an additional reason to place limited weight on analysis on the Numbeo data.
- D27 The USDA converts expenditure data in current US dollars, for the year in question.<sup>1036</sup> The USDA does not provide further detail as to which exchange rate is used beyond this.

### Methods used in combining indices

- D28 To compare prices across a range of products, we had to create a combined index of:
- D28.1 the separate index for food and non-alcoholic beverages;
  - D28.2 the index for alcohol; and
  - D28.3 the index for tobacco.
- D29 To do this, we took an average of the indices for each category, weighted by their share of expenditure, to obtain a combined price level for all products.
- D30 For the expenditure comparisons, we added together the per capita expenditure indices for the food and non-alcoholic beverages, alcohol, and tobacco categories.

### Comparator countries

- D31 As explained in Chapter 3, we identified some countries that appeared to represent price determinants more similar to New Zealand than others.
- D32 These comparisons are for illustrative purposes and we acknowledge that caution must be exercised when comparing prices between any two particular countries. The determinants of price are complex and different factors will determine grocery prices in every country; no country will perfectly mimic New Zealand's determinants of price.

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<sup>1034</sup> Eurostat, OECD "Eurostat-OECD Methodological Manual on Purchasing Power Parities" (2012) at [2.4], available at: <https://www.oecd.org/sdd/prices-ppp/PPP%20manual%20revised%202012.pdf>; World Bank "ICP 2017" (2017) at Market exchange rate (US\$ = 1), Classification <https://databank.worldbank.org/source/icp-2017>.

<sup>1035</sup> Numbeo "Methodology and motivation for Numbeo.com" [https://www.numbeo.com/common/motivation\\_and\\_methodology.jsp](https://www.numbeo.com/common/motivation_and_methodology.jsp).

<sup>1036</sup> USDA "Overview: International consumer and food industry trends" <https://www.ers.usda.gov/topics/international-markets-us-trade/international-consumer-and-food-industry-trends/>.

- D33 Nonetheless, we sought to identify countries that appeared more similar to New Zealand in terms of the factors we considered most likely to affect price:
- D33.1 Supply factors such as the cost of production. For example, access to economies of scale and shipping networks.
  - D33.2 Demand factors such as tastes, preferences and income effects. In addition, countries with similar tastes and preferences are likely to allow for more comparisons between a more similar set of goods.
- D34 To act as a proxy for some of the above factors, we consider the closeness of New Zealand to other countries in terms of output per capita, population, and population density. This was because:
- D34.1 output per capita is likely to capture some of the differences between countries in their demand for grocery products – this is because we would expect income levels to be one determinant of prices;<sup>1037</sup> and
  - D34.2 population and population density were selected as this may affect the economies of scale available for grocery retailers.
- D35 Table D2 summarises these statistics for the countries that we selected as comparators to New Zealand.
- D36 We chose to look at five countries in more detail for illustrative comparisons. These were Australia, Finland, Iceland, Ireland and Israel. We chose to focus on these for our illustrative comparisons for the following reasons:
- D36.1 Australia shares a common market with New Zealand through the Closer Economic Relations regime, which may equalise some commodity prices that are inputs to the grocery market. However, we note that the population of Australia is five times that of New Zealand, the population density is significantly lower overall, that population is more clustered in urban areas, and the climate and landscapes are different. It is unclear how these factors will affect comparisons between New Zealand and Australia.
  - D36.2 Finland has a similar level of output, population, and population density to New Zealand, meaning that input costs for labour and distribution costs may be similar. However, Finland is a member of the European Union (EU) common market, and is geographically close to its neighbours meaning that barriers to trade are likely to be lower.

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<sup>1037</sup> Countries with higher productivity (and therefore higher per capita output) tend to have higher prices, known as the Penn effect (also known as the Balassa-Samuelson effect). Paul A. Samuelson “Facets of Balassa-Samuelson Thirty Years Later” *Review of International Economics*, 1994, Vol.2, No.3, at 205, [            ].

- D36.3 Iceland, being an island in the middle of the Atlantic, may emulate some of the geographic isolation that New Zealand experiences, which act as a barrier to trade. On the other hand, Iceland’s high per capita output, significantly smaller size, and membership to the European Economic Area (EEA) are likely to affect grocery prices in ways that differ from New Zealand.
- D36.4 Ireland has similar output and production size to New Zealand. However, their proximity to the UK, population density and membership in the EU mean they are likely to face a significantly different environment for retail grocery than New Zealand.
- D36.5 Israel has a similar population and output level to New Zealand but is more densely populated. Israel also faces a number of unique geopolitical circumstances but it is unclear whether these make it more or less comparable to New Zealand in terms of distance from trading partners and costs for grocery retailers.

**Table D2 Comparator summary statistics**

Country	GNI/capita (2017) PPP constant international dollars <sup>1038</sup>	Population (2017) <sup>1039</sup>	Population density (2017) <sup>1040</sup>
New Zealand	40,700.5	4,813,600	18.281
Australia	47,163.2	24,601,860	3.198
Iceland	53,923.2	343,400	3.425
Ireland	41,407.4 <sup>1041, 1042</sup>	4,807,388	69.784
Israel	38,637.0	8,713,300	402.648
Finland	47,593.9	5,508,214	18.124

Source: Commission analysis of World Bank dataset.<sup>1043</sup>

<sup>1038</sup> World Bank “Gross National Income (GNI) per capita PPP (constant 2017 international dollars)” [https://data.worldbank.org/indicator/NY.GNP.PCAP.PP.KD?locations=AU-NZ-IL-IE-FI-IS&year\\_high\\_desc=true](https://data.worldbank.org/indicator/NY.GNP.PCAP.PP.KD?locations=AU-NZ-IL-IE-FI-IS&year_high_desc=true). Gross National Incomes are converted to a single unit, called the international dollar. One international dollar has the same purchasing power as one US Dollar in 2017.

<sup>1039</sup> World Bank “Population, total” [https://data.worldbank.org/indicator/SP.POP.TOTL?end=2017&locations=AU-NZ-IL-IE-FI-IS&start=2017&year\\_high\\_desc=true](https://data.worldbank.org/indicator/SP.POP.TOTL?end=2017&locations=AU-NZ-IL-IE-FI-IS&start=2017&year_high_desc=true).

<sup>1040</sup> World Bank “Population density (people per sq. km of land area)” [https://data.worldbank.org/indicator/EN.POP.DNST?end=2017&locations=AU-NZ-IL-IE-FI-IS&start=2017&year\\_high\\_desc=true](https://data.worldbank.org/indicator/EN.POP.DNST?end=2017&locations=AU-NZ-IL-IE-FI-IS&start=2017&year_high_desc=true).

<sup>1041</sup> Ireland uses modified Gross National Income to discount for the effect of tax havens. This data is available from the Central Statistics Office. A PPP of 0.913 was used to convert to int’l \$, which comes from the ICP dataset.

<sup>1042</sup> Central Statistics Office “Measuring Ireland’s Progress 2017” <https://www.cso.ie/en/releasesandpublications/ep/p-mip/measuringirelandsprogress2017/ef/>.

<sup>1043</sup> [ ].



## Further analysis and sensitivity testing

D37 In order to better understand New Zealand's relative grocery prices, we sought to:

D37.1 compare our analysis for 2017 to more recent years;

D37.2 present price index data from the OECD, split by alcohol and tobacco; and

D37.3 conduct sensitivity analysis of data submitted by NERA.

### Analysis using more recent datasets

D38 The analysis that we presented in Chapter 3 used data from 2017 as this was the year with data available from a number of countries. To understand how findings from 2017 are likely to be helpful in understanding prices today, we considered results from datasets that had more recently available data available.

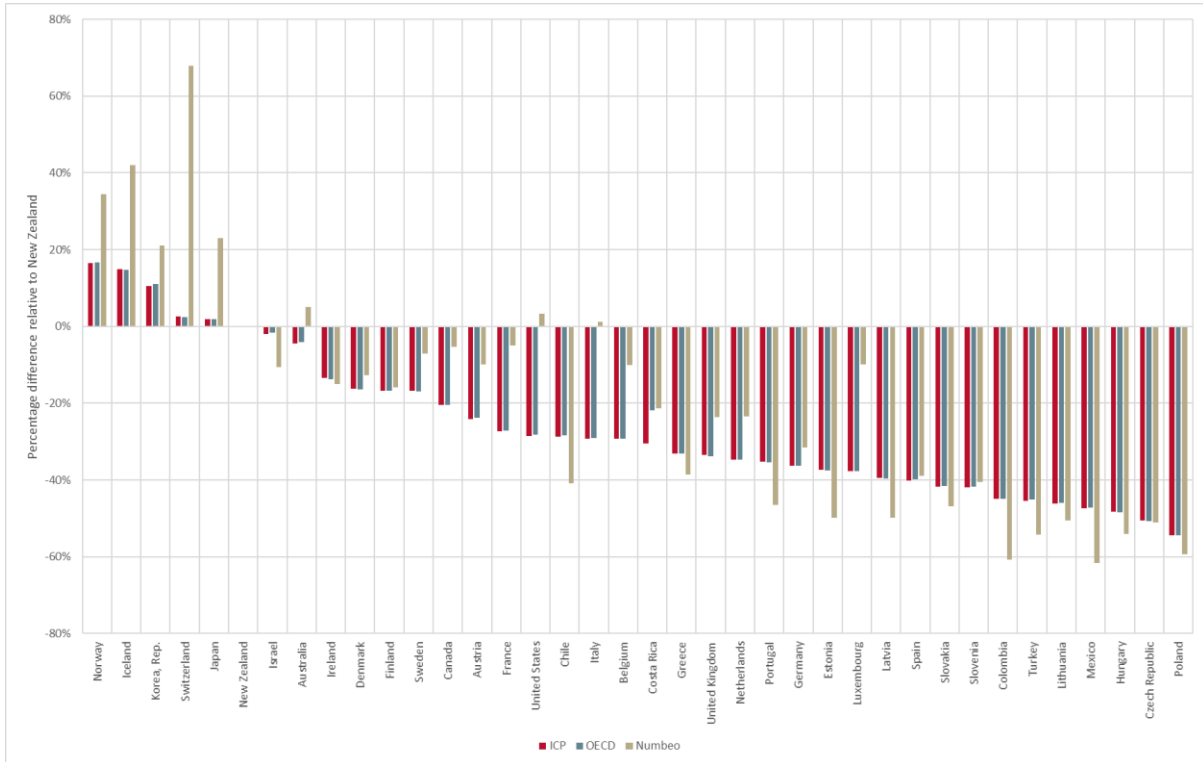
D39 This sensitivity analysis suggests that there is unlikely to have been a material change in New Zealand's relative ranking regarding grocery prices in recent years.

D40 Data from Numbeo is available as recently as 2021, produced on a half-yearly basis. Although we consider limited weight can be placed on the Numbeo data, we still consider there to be some value in looking at more recent data from this source.

D41 Figure D1 below shows the price levels for OECD countries using the Numbeo, ICP and OECD datasets for 2017 as a percentage difference relative to New Zealand's price level. This graph supports our preliminary finding in Chapter 3 that datasets are consistent in their relative ranking of prices.

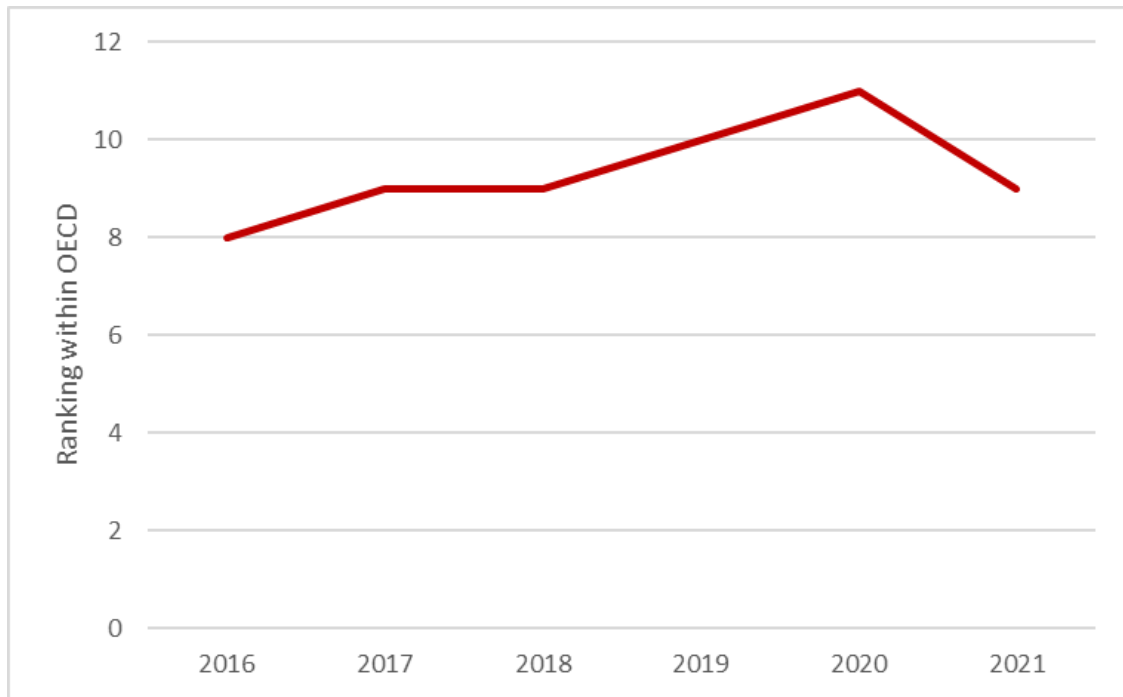
D42 Figure D2 below shows New Zealand's ranking for grocery prices out of countries in the OECD, calculated by Numbeo, between 2016 and 2021. It shows that New Zealand's relative ranking does not vary substantially from year to year. From this, we consider that it is unlikely that New Zealand's relative grocery price ranking has changed significantly since 2017.

**Figure D1 Percentage difference in food, beverages (alcoholic and non-alcoholic) and tobacco prices compared to New Zealand (NZ = 0, market exchange rate, 2017)**



Source: Commission analysis of ICP, OECD and Numbeo datasets.<sup>1044</sup>

**Figure D2 Ranking of New Zealand grocery prices within OECD countries (Numbeo, 2016-2021)**



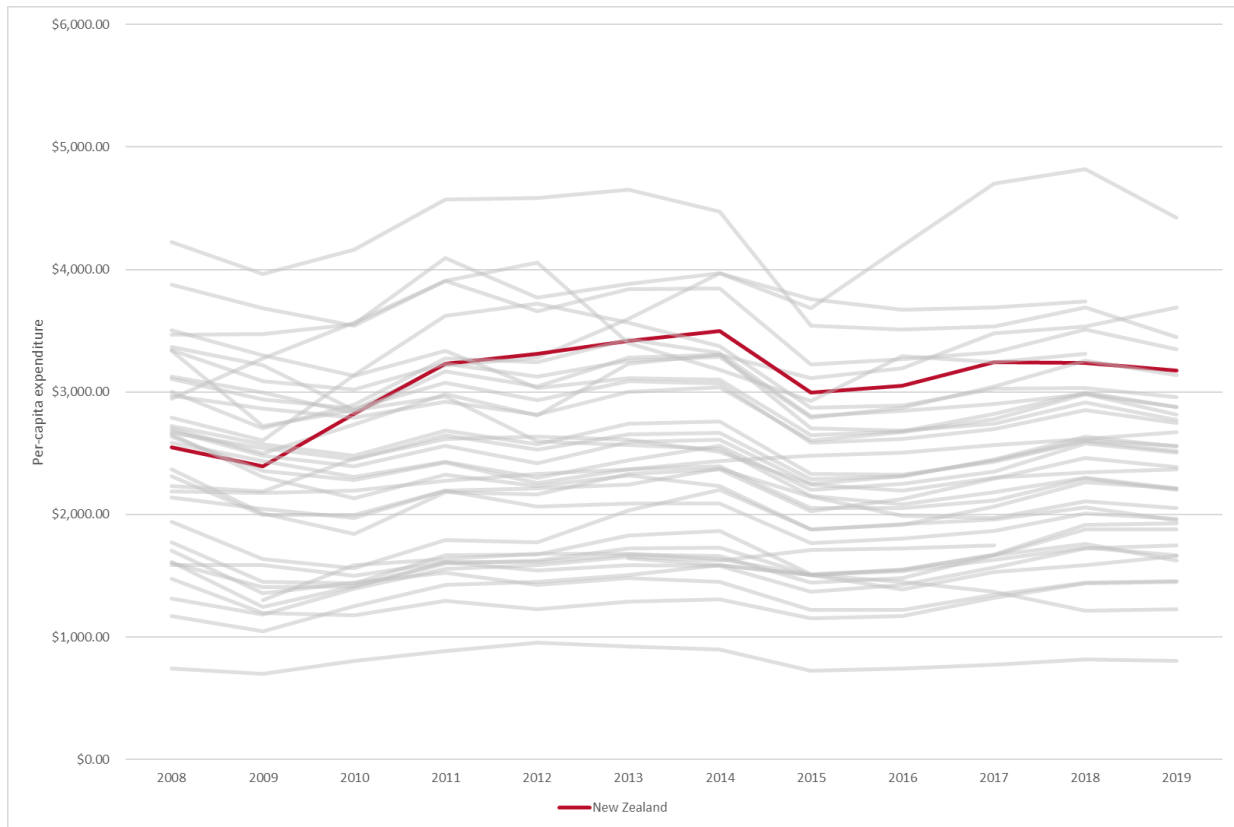
Source: Commission analysis of Numbeo dataset.<sup>1045</sup>

- D43 In addition, we considered expenditure data from the OECD. The OECD compiles expenditure statistics for food and non-alcoholic beverages annually, which is available as recently as 2019 for many OECD countries.
- D44 Figure D3 below shows expenditure per capita on grocery items (alcohol and tobacco exclusive) for OECD countries between 2008 and 2019. New Zealand is shown as the red line, while other countries are in grey. We note that 2017 is the most recent year where all countries in the OECD had submitted an expenditure statistic for food and non-alcoholic beverages.
- D45 Out of 35 OECD countries that submitted expenditure statistics for 2019, Figure D3 shows New Zealand ranks as fifth in terms of grocery item expenditure.<sup>1046</sup>

<sup>1045</sup> [ ].

<sup>1046</sup> Switzerland, Japan, and Costa Rica have not submitted food and non-alcoholic beverage expenditure statistics for 2019.

**Figure D3 Per capita expenditures on food and non-alcoholic beverages for OECD countries (USD, 2008-2019)**

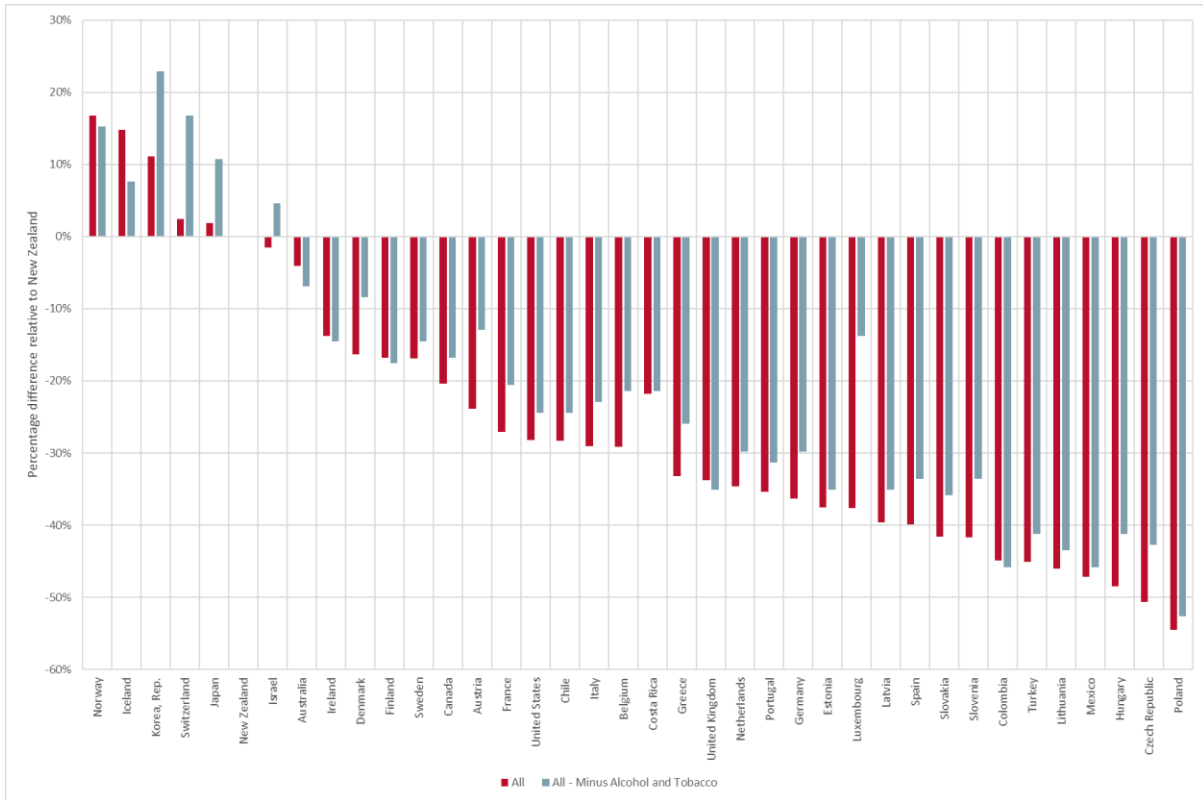


Source: Commission analysis of OECD dataset.<sup>1047</sup>

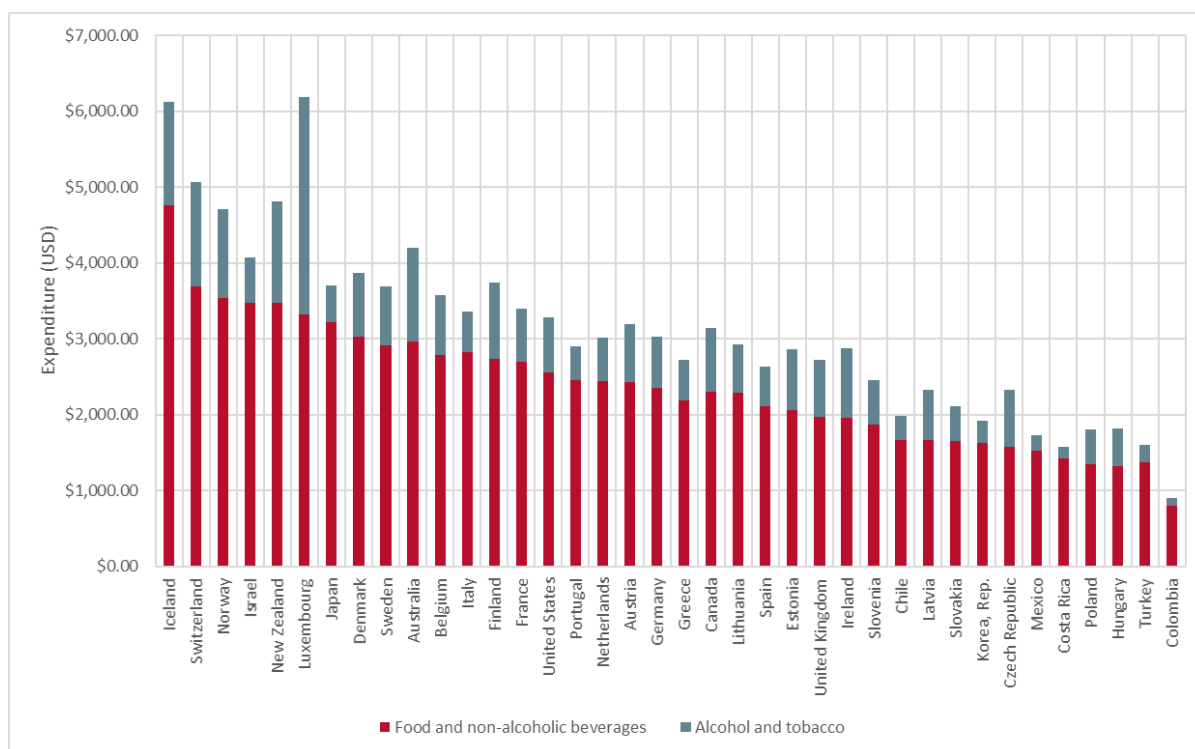
### Grocery prices inclusive and exclusive of alcohol

- D46 In Chapter 3, we used data from the ICP dataset to show that grocery prices in New Zealand are unlikely to be primarily driven by higher alcohol and tobacco prices. Below, we show that the OECD dataset shows the same results as the ICP dataset.
- D47 Figure D4 below shows a price level for groceries calculated with and without alcohol and tobacco using the OECD dataset.
- D48 Figure D5 below shows per capita grocery expenditures, calculated with and without alcohol and tobacco using the OECD dataset.
- D49 Both Figure D4 and Figure D5 are the same as the graphs produced in Chapter 3 for the ICP datasets. Analysis using data from the OECD shown below supports our finding that grocery prices remain high when alcohol and tobacco are removed.

**Figure D4 Percentage difference in grocery prices, inclusive and exclusive of alcohol (NZ = 0, market exchange rate, 2017)**



Source: Commission analysis of OECD dataset.<sup>1048</sup>

**Figure D5 Per capita grocery expenditure, inclusive and exclusive of alcohol (USD, 2017)**

Source: Commission analysis of OECD dataset.<sup>1049</sup>

### Sensitivity testing of analysis submitted by NERA

- D50 To understand how the use of a ranking mechanism could affect the results obtained by NERA, we took the mean of prices for each city, and compared those results to NERA's analysis.
- D51 We observed that when prices were averaged by taking a mean of prices, we see an increase in the ranking of Auckland and Wellington.
- D52 In Table D3 below, we demonstrate with an example how using a median ranking system and mean can result in different price levels being measured. We calculate the mean and median for three products in three cities using the prices given below.

**Table D3 Example calculation of a mean and median price with for three products**

	Product X	Product Y	Product Z	Mean	Median
City A	\$4	\$4	\$1	\$3	\$4
City B	\$3	\$3	\$6	\$4	\$3
City C	\$12	\$2	\$1	\$5	\$2

Source: Commission analysis of EIU dataset.<sup>1050</sup>

<sup>1049</sup> [ ].

<sup>1050</sup> [ ].

D53 In the example given, we see that using a mean to calculate an average, City C is the most expensive city, while City A is the least expensive. On the other hand, when a median is used to calculate the average, City A ranks the highest, while City C ranks the lowest. This demonstrates that using different methods to calculate the mean and median can affect the relative rankings of these three cities.

## Attachment E Promotions and pricing data analysis

### Introduction

- E1 This attachment provides details of our analysis of pricing and promotion data that has been provided by the major grocery retailers.
- E2 The sections in this attachment are:
- E2.1 description of data provided;
  - E2.2 initial data cleaning;
  - E2.3 data limitations;
  - E2.4 analysis of promotions; and
  - E2.5 analysis of pricing behaviour.
- E3 The results of our analysis are also described in the main body of our report, in particular, in Chapter 5, Chapter 7, and Chapter 8.

### Description of data provided

- E4 The analysis was based on detailed sales data provided by the three major grocery retailers, Foodstuffs NI, Foodstuffs SI and Woolworths NZ, for their four main retail banners: Four Square, New World, PAK'nSAVE, and Countdown.<sup>1051</sup> Sales data for calendar year 2019 was provided for all individual products sold in any store of each of these retail banners. Foodstuffs NI and Woolworths NZ provided weekly data and Foodstuffs SI provided daily data.<sup>1052</sup> After converting the Foodstuffs SI data to weekly (see below), the combined dataset consisted of approximately 430 million records.

### Variables

- E5 For every combination of store, product, and week (for Foodstuffs NI and Woolworths NZ) or day (for Foodstuffs SI), the following key variables were provided by all three major retail chains:<sup>1053</sup>
- E5.1 Product identifiers: SKU (article) number and description, and barcode (if applicable).

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<sup>1051</sup> We were also provided with data on other retail banners but chose to focus this analysis on these four retail banners. Foodstuffs NI also provided data for one Fresh Collective store. This was grouped with Foodstuffs NI New World stores in the analysis.

<sup>1052</sup> The data provided spans 53 calendar weeks and includes the last few days of 2018 and the first few days of 2020. All weeks were retained in the analysis, including those that partially fell outside calendar 2019.

<sup>1053</sup> Various additional variables were provided by some of the three major grocery retailers and some of these were used to augment the analysis in ways that are described below, however most of the analysis is based on the variables above that are common to the data provided by all of the major grocery retailers.



- E5.2 Product characteristics: Descriptors of the product (eg, sales department or category) and sales units (see below).
- E5.3 Promotion label: The type(s) of promotion(s) that applied to the product in the given store and week, if any.
- E5.4 Total revenue: The revenue from sales of the product (including GST).
- E5.5 Total quantity: The amount of the product sold, in appropriate units (see below).
- E5.6 Total cost of goods sold (COGS): The total cost of the product sold (excluding GST).
- E6 The variables above were used to calculate the quantity-weighted weekly average price (total revenue/total quantity) and average COGS (total COGS/total quantity) for each combination of store, product, promotion label, and week.

### Sales quantities and units

- E7 Quantities of products sold were provided separately for in-store and online sales. Online sales were associated with a store in the dataset, so in-store and online sales were added together to calculate the total weekly sales of each product in each store.
- E8 Some products are sold in different units. For example, an item of wine may be sold as individual bottles or as cases of multiple bottles, with sales units of bottles (denoted 'each') and cases of multiple bottles as a single unit. Our analysis was based on the sales units provided since prices and revenues correspond to sales units.<sup>1054</sup>
- E9 When a product was signalled as on promotion for a given week there may be both promotional and non-promotional sales of the product in a store that a week. This can occur for promotions that last for less than a week, or for multi-buy or loyalty card promotions that may not apply to all sales. The data provided by Foodstuffs NI and Foodstuffs SI separated quantities of products sold on promotion and not on promotion in a store in the same week, where this occurred.
- E10 The data provided by Woolworths NZ did not separate weekly quantities into promotional and non-promotional sales, but promotional and non-promotional unit prices provided by Woolworths NZ were used to calculate the implied promotional and non-promotional quantities where necessary.<sup>1055</sup>

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<sup>1054</sup> Foodstuffs NI and Woolworths NZ provided quantities in sales units while Foodstuffs SI provided quantities in 'base' units ('kg' or 'each').

<sup>1055</sup> If  $p_p$  and  $p_{NP}$  are the promotional and non-promotional prices of a product in a store in a week,  $q_p$  and  $q_{NP}$  are the corresponding (unknown) quantities,  $R = p_p q_p + p_{NP} q_{NP}$  is the total revenue, and  $Q = q_p + q_{NP}$  is the total quantity, then  $q_p = (Q p_{NP} - R) / (p_{NP} - p_p)$  and  $q_{NP} = Q - q_p$ .

## Additional datasets

- E11 Separate datasets were also provided by each major grocery retailer that were linked to the sales data using product identifiers:
- E11.1 Key value items: lists of products that the major grocery retailers use to monitor their competitors' pricing.
  - E11.2 Basket penetration: For each product sold in 2019, the proportion of total shopping baskets in which that product appeared, across all stores of each retail banner.

## Initial data cleaning

### Conversion of Foodstuffs SI daily data to weekly

- E12 The daily data provided by Foodstuffs SI was aggregated to weekly summaries to be consistent with the weekly data provided by Foodstuffs NI and Woolworths NZ. This was done by summing revenues, COGS, and quantities for each combination of store, product, promotion label, and calendar week in the Foodstuffs SI daily data.
- E13 The minimum, mean, and maximum of the daily unit prices were also calculated for each combination, to capture any variation of prices within a week.

### Removing stores without a full year of data

- E14 The data provided included 630 stores in total and the analysis was based on data from 594 stores where data was provided for all of calendar 2019. Data was not used from 36 stores that opened or closed during calendar 2019, or which otherwise had missing sales data for any weeks in 2019.

### Validating barcodes

- E15 Some data provided in the 'barcode' field for products were not valid barcodes, such as four-digit codes for fresh produce or products sold in bulk. An algorithm was used to identify the valid barcodes for products.<sup>1056</sup>

### Identifying individual products

- E16 Individual products were identified in the data using the combination of SKU number and sales units (as described above) where sales units were provided. This enabled products that have the same SKU number but different sales units to be distinguished as separate products (eg, bottles and cases of wine). The combination of SKU number and sales unit for a product is referred to as 'product identifier' below.

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<sup>1056</sup> Barcode entries were assumed to be invalid if they included any non-numeric characters or were shorter than eight digits or longer than 14 digits. For numeric entries between eight and 14 digits, a checksum was computed to test if these were valid. See: [https://en.wikipedia.org/wiki/Check\\_digit](https://en.wikipedia.org/wiki/Check_digit).

### Identifying common products sold by different major retail grocery chains

- E17 Some of the analysis focussed on a set of common products that are sold in at least some stores of all major grocery retailers. These common products were identified using product barcodes and product identifiers. To accommodate the possibility of a product being sold under multiple barcodes, common products were identified by grouping any products that had either the same barcode or the same product identifier. This enabled some identical products that were sold using different barcodes and/or different product identifiers to be grouped for analysis.<sup>1057</sup>

### Data limitations

- E18 The data has some limitations that affect the analysis and interpretation of results:
- E18.1 The data provided by all three major grocery retailers does not contain records for products that were not sold in a store in a week. This could occur if the product was introduced or deleted at some point in 2019, was temporarily out of stock (or out of season) in some weeks, or if it was in stock but was not bought by any customers. This missing data has the following implications.
- E18.1.1 It is not possible to know why no sales were recorded for a product in a store in a week. For a product without sales recorded in every week, an assumption must be made about whether it was available for sale or not.
- E18.1.2 In any cases where products were in stock but were not bought by any customers in a store in a week, the price at which these products were offered for sale is not known.
- E18.1.3 If all sales of a product are recorded as promotional sales, this does not necessarily mean it was always on promotion, as it may have been available for sale but was unsold whenever it was not on promotion.
- E19 The data provided by Foodstuffs NI and Foodstuffs SI does not include information about non-promotional prices for products in weeks where the only sales were at promotional prices. This affects promotions that apply to all sales of a product in a store in a week (eg, New World's 'Saver' and PAK'nSAVE's 'Extra Low' promotions, if these lasted for a full week), and may also affect loyalty card and multi-buy promotions if all sales in a store in a week were at the promotional price. This affects the comparison of promotional and non-promotional pricing for Foodstuffs NI and Foodstuffs SI.

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<sup>1057</sup>

For example, suppose that a product is sold by retail chain A under SKU numbers A1 and A2 using barcode 1234 and is sold by retail chain B using SKU number B1 using barcodes 1234 and 4567. These four different cases can all be linked to a single product group as they have either the same SKU number or the same barcode as another product in the group.

- E20 Analysis of pricing behaviour that involves looking at changes in prices over time is limited by the weekly frequency of the data. In practice, retailers may change their prices more quickly in response to changes in external factors such as costs, demand, and competitors' pricing.

### Analysis of promotions

- E21 The main types of promotions used by the major grocery retailers in 2019 were examined in the following ways:
- E21.1 *Proportion of revenue from products on promotion:* Analysis of the proportion of total revenues in 2019 which came from sales of products on promotion.
  - E21.2 *Prevalence of each type of promotion:* Analysis of the overall extent to which each promotion was used by each major grocery retailer in its stores. This reflects the number of products that are on promotion as well as how often during the year products were on promotion in each store.
  - E21.3 *Prevalence of multiple promotions:* How common it was for products to be sold under more than one type of promotion in a store in a week.
  - E21.4 *Frequency of promotions:* For products that were sold on promotion at some time during 2019, how often this occurred, ie, for how many weeks of the year the product was on promotion in a retailer's stores.
  - E21.5 *Pricing:* Comparisons of promotional versus non-promotional prices for products that were sold on promotion in at least some stores and weeks.

### Revenue from promotions

- E22 Across all major grocery retailers in 2019, around half of revenues came from sales of products on promotion. The largest category of promotional sales was all other promotions, with multi-buy and loyalty card promotions each accounting for less than 8% of revenues (Table E1).<sup>1058</sup>

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<sup>1058</sup> The vast majority of all other promotions are fixed discount promotions and very small proportion are in-store specials.

**Table E1 Proportion of total revenues from products on promotion by type of promotion**

Promotion type	Proportion of total revenues
Multi-buy	1-7%
Loyalty card	3-8%
All other promotions	35-40%
Not on promotion	50-55 %

Source: Commission analysis of pricing and promotional data.<sup>1059</sup>

E23 The overall proportion of revenues from sales of products on promotion varies across retail banners, from around a quarter to around two thirds of revenues (Table E2).

**Table E2 Proportion of total revenues in 2019 from sales of products on promotion**

Retail banner	Proportion of total revenues
FSNI: PAK'nSAVE	65 – 75%
FSSI: PAK'nSAVE	50 – 60%
FSNI: New World	45 - 55%
FSSI: New World	40 – 50%
Woolworths: Countdown	35 – 45%
FSSI: Four Square	30 – 40%
FSNI: Four Square	25 – 35%

Source: Commission analysis of pricing and promotional data.<sup>1060</sup>

### Prevalence of promotions

E24 For each major grocery retailer, the total set of 'sales opportunities' in 2019 is all feasible combinations of products, stores, and weeks (PSW). Prevalence of promotions seeks to measure the proportion of PSW that are accounted for by promotions, which reflects how many products were available for sale on promotion, and in which stores and weeks these products were available for sale.

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<sup>1059</sup> [ ].

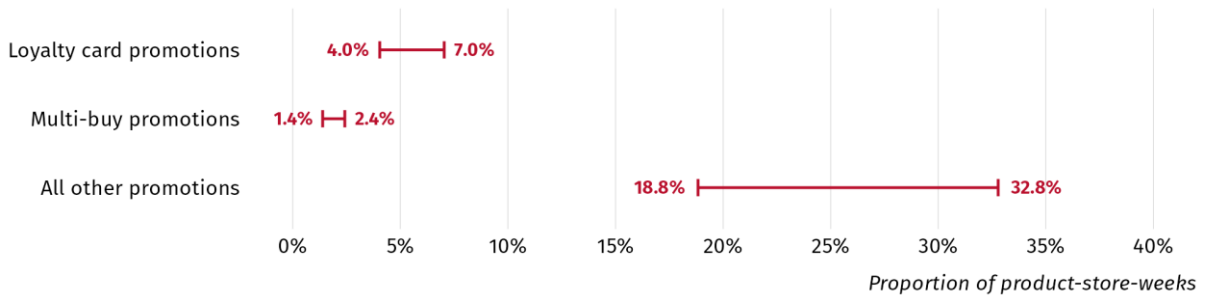
<sup>1060</sup> [ ].

- E25 For each store, the total number of product-weeks (PW) was calculated in two different ways that reflect the limitations of the data discussed above and help to assess the potential impact of missing information about availability of products in weeks when they were not sold:
- E25.1 *Weeks sold method*: PW for a store reflects the number of weeks in which sales of the product were actually recorded in the store.
- E25.2 *Full year method*: PW for a store assumes that every product sold in the store at some point during the year was available for sale in all weeks of the year.
- E26 These two methods can be thought of as upper and lower limits respectively for estimating the true PSW for each retailer. For each major grocery retailer, total PSW was calculated as the sum of PW across all its stores. Thus, the PSW for a retailer reflects the combinations of products and stores that were observed in the sales data for 2019 and incorporates the fact that not all products are sold by all stores.
- E27 The prevalence of each type of promotion used by each major grocery retailer was calculated as the ratio of PSW for which sales were recorded under that promotion to the total PSW for the retailer (using the two alternative definitions of total PSW above).<sup>1061</sup> This reflects the proportion of total ‘sales opportunities’ of that retailer for which sales were recorded under each type of promotion. The prevalence of multiple weekly promotions was also examined by looking at the proportion of total PSW for which products were on more than one different type of promotion in a store in a single week.
- E28 Across all retail banners, the most prevalent type of promotion was fixed discount promotions that apply to all sales of a product in a store for a given period (Figure E1). Loyalty card and multi-buy promotions were less common overall, but the prevalence of these types of promotions does vary somewhat by retail banner.

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<sup>1061</sup> For example, if a retailer recorded sales of 50 products on ‘special’ promotion in 10 stores for 20 weeks and the retailer sells a total of 100 products in 25 stores for 52 weeks then the overall prevalence of the ‘special’ promotion is  $50 \times 10 \times 20 / (100 \times 25 \times 52) = 8\%$  of total product-store-weeks.

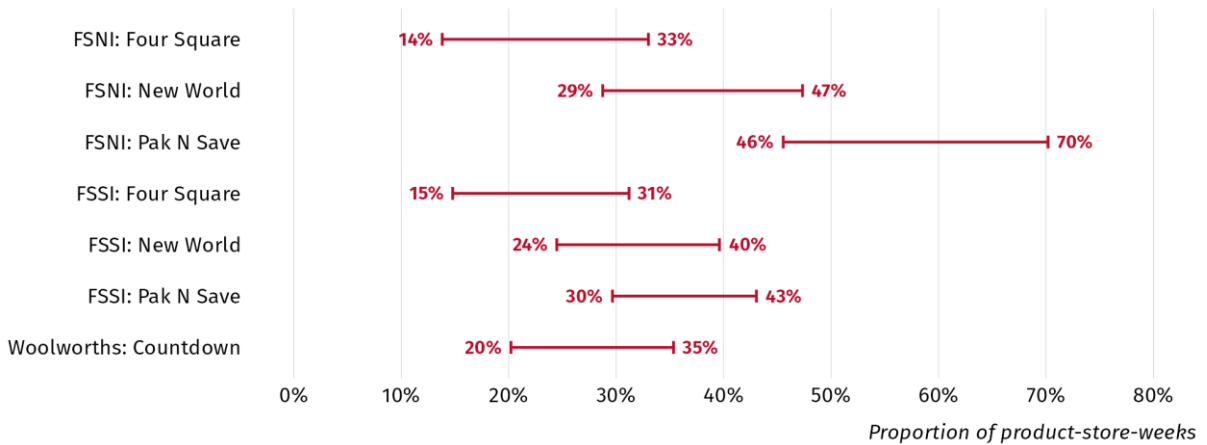
**Figure E1 Overall prevalence of promotions by type of promotion across all retail banners combined – the lower and upper limits respectively reflect the ‘full year’ and ‘weeks sold’ methods described above**



Source: Commission analysis of pricing and promotional data.<sup>1062</sup>

E29 This analysis indicated that the overall prevalence of promotions in 2019 varied across retail banners from around 14% to 46% of PSW using the ‘full year’ method or from 31% to 70% of PSW using the ‘weeks sold’ method (Figure E2). Prevalence of promotions also varies across stores within each retail banner, with more variation across stores observed for retail banners where individual stores have more ability to price independently.

**Figure E2 Overall prevalence of all promotions by retail banner – the lower and upper limits respectively reflect the ‘full year’ and ‘weeks sold’ methods described above**



Source: Commission analysis of pricing and promotional data.<sup>1063</sup>

1062 [ ].  
 1063 [ ].

E30 Figure E3 breaks down prevalence of individual promotion types used by each retail banner. Loyalty card promotions were more common in Foodstuffs SI New World stores (Club Deals) compared to Foodstuffs NI New World (also Club Deals) and Countdown stores (Onecard). Multi-buy promotions were relatively uncommon across all retail banners. Fixed discount promotions are most common across all retail banners, and are particularly prevalent in Foodstuffs NI PAK’nSAVE stores.

**Figure E3 Prevalence of promotions by retail banner and promotion type – the lower and upper limits respectively reflect the ‘full year’ and ‘weeks sold’ methods described above**



Source: Commission analysis of pricing and promotional data.<sup>1064</sup>



E31 Promotions (of any kind) were found to be relatively common for products in alcohol, dairy, meat, frozen products, and general grocery categories. Promotions were relatively uncommon for speciality categories such as fresh flowers, tobacco, pharmaceuticals, café, and other services. It was also relatively uncommon for products to be on more than one type of promotion in a store in a single week. The prevalence of multiple promotions was estimated to be rare for each of the retail banners.

### Frequency of promotions

E32 Frequency of promotions was analysed by looking at products that were sold on promotion at some time during 2019. For these products, the proportion of total store-weeks for which the product was sold on promotion was calculated (across all stores of the retailer where that product was sold).<sup>1065</sup> Again, total store-weeks for each product were calculated using the weeks sold and full year methods described above.

E33 Findings from this analysis include the following (Figure E4):

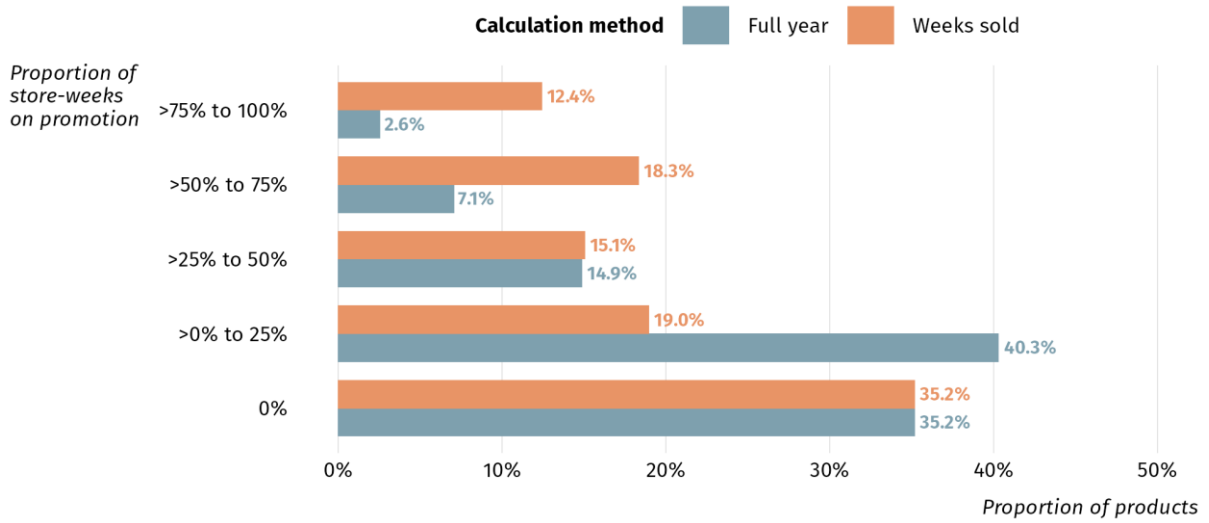
E33.1 Overall, around 35% of products were never on promotion in any of the stores in which they were sold during 2019. Across retail banners, this proportion varied from 19% to 59% of products.

E33.2 Between 2.6% and 12.4% of products (depending on calculation method) were on promotion in more than three quarters of the combinations of stores and weeks in which they were sold. Across retail banners, this proportion varied from between 0.1% and 3.5% to between 13% and 43%. This indicates that, for some retail banners, a significant proportion of products were on promotion in almost all combinations of stores and weeks in which they were sold.

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<sup>1065</sup> For example, if a product was sold on promotion in 10 stores for five weeks and in total it was sold in 20 stores for 52 weeks, it was on promotion for  $10 \times 5 / (20 \times 52) = 5\%$  of store-weeks.

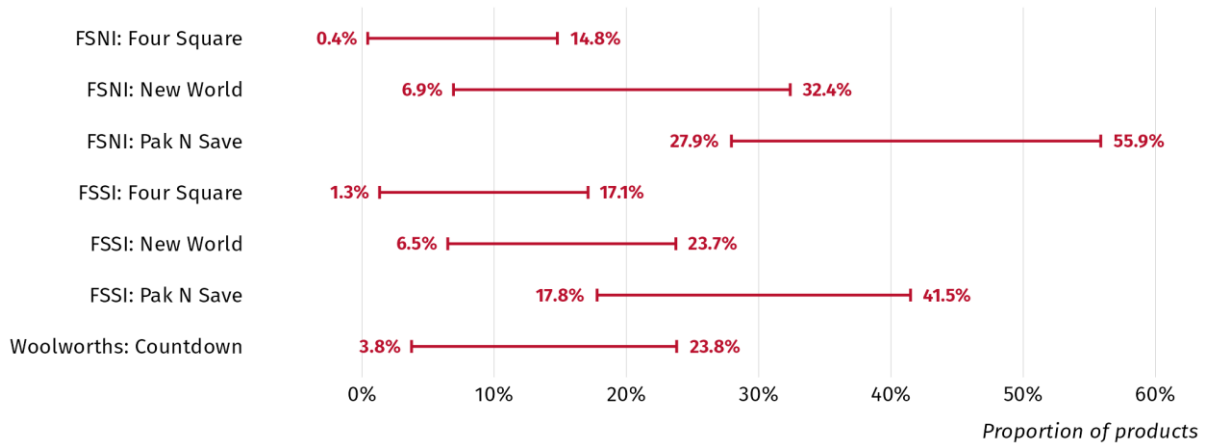
**Figure E4 Frequency of all types of promotions across all retail banners**



Source: Commission analysis of pricing and promotional data.<sup>1066</sup>

E34 Figure E5 shows the proportion of products that were on promotion in more than half of store-weeks in which they were sold, by retail banner. This proportion is relatively high for PAK’nSAVE stores compared to other retail banners.

**Figure E5 Proportion of products that were on promotion in more than 50% of store-weeks – the lower and upper limits respectively reflect the ‘full year’ and ‘weeks sold’ methods described above**



Source: Commission analysis of pricing and promotional data.<sup>1067</sup>

1066 [ ].  
 1067 [ ].

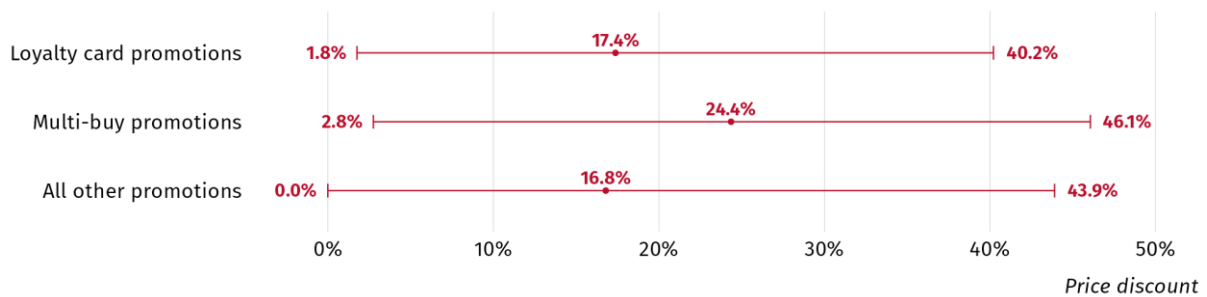
### Promotional vs non-promotional pricing

- E35 For each product sold in each store of each major grocery retailer that was sold on promotion at some point in 2019, the overall quantity-weighted average non-promotional and promotional prices were calculated by dividing total revenues by total quantity sold, for each type of promotion and for all non-promotional sales.<sup>1068</sup> For some products in some stores, the average non-promotional price could not be calculated as no non-promotional sales were recorded during the year. For those product-store combinations where average non-promotional prices could be calculated, the average discount offered by each applicable type of promotion was calculated by comparing the weighted average promotional and non-promotional prices across the year.
- E36 Weighted average promotional prices were also compared to some other pricing metrics:
- E36.1 The overall unweighted average of all selling prices observed for each product in each store over the year (both promotional and non-promotional prices). The difference between this average and the weighted average promotional price gives an indication of the volume of promotional versus non-promotional sales.
- E36.2 The maximum and minimum weekly weighted average price (ie, weekly total revenue/total quantity) observed for each product in each store over the whole year. This gives an indication of how the average promotional price compares to the highest and lowest prices seen for a product in a store over the year.
- E37 Across all combinations of products and stores for which weighted average promotional and non-promotional prices could be calculated, Figure E6 shows the median and 2.5<sup>th</sup> / 97.5<sup>th</sup> percentiles of the promotional price discount, by type of promotion. Multi-buy promotions tend to offer slightly greater discounts than loyalty card or other promotions (ie, fixed price discounts). Across retail banners, the median discount ranges from around 10% to 30% depending on the retail banner and type of promotion.

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<sup>1068</sup> This was done for each product in each store separately to allow for differences in pricing of a product across stores.

**Figure E6 Median and 2.5<sup>th</sup> / 97.5<sup>th</sup> percentiles of weighted average promotional prices vs non-promotional prices across all retail banners, by type of promotion**



Source: Commission analysis of pricing and promotional data.<sup>1069</sup>

E38 This analysis also found that:

- E38.1 Discounts calculated by comparing promotional prices versus unweighted average prices are substantially smaller than discounts versus weighted average non-promotional prices, indicating that promotions do have a noticeable impact on customers' purchasing patterns.
- E38.2 In most cases, average promotional prices are greater than the lowest price that a product sold for in a store during the year.
- E38.3 Depending on retail banner and promotion type, between 0.5% and 24% of combinations of products and stores had no sales recorded at non-promotional prices in 2019. This is due to the combined impact of some products being on promotion very often (see Figure E4 above), and the effect of promotions on customer purchasing behaviour such that some products are less likely to be bought when they are not on promotion.
- E38.4 Small discounts were relatively common. Depending on retail banner and promotion type, the average promotional price was less than a 10% discount off the average non-promotional price for between 5% and 44% of combinations of products and stores for which average promotional and non-promotional prices could be calculated.

### Analysis of pricing behaviour

E39 The data was used to examine some aspects of pricing behaviour by individual stores and by retail banners. This was done by looking at changes in prices over time during 2019 across stores and analysing relationships between prices and COGS.

### Analysis of pricing correlations

E40 The data provided was used to calculate the weighted average weekly retail price for each product in each store by dividing weekly total revenue by quantity sold. These averages reflect both promotional and non-promotional pricing, where these occurred. Correlations of week-to-week changes in these average prices were calculated for the set of common products across stores of different retail banners in five selected geographically defined clusters (Table E3). The clusters were selected for this analysis based on having two or more stores from different retail banners in relatively close proximity to each other.

**Table E3 Geographic clusters used for analysis of price correlations across stores**

Cluster	Stores	No. of common products
Milford (Auckland)	Milford Countdown New World Milford PAK'nSAVE Wairau Road	500 – 1,000
Hamilton Central	Hamilton Countdown PAK'nSAVE Clarence Street PAK'nSAVE Mill Street	500 – 1,000
Newtown (Wellington)	Newtown Countdown New World Newtown	1,000 – 1,500
Oamaru	Oamaru Countdown New World Oamaru	1,000 – 1,500
Fendalton (Christchurch)	Church Corner Countdown New World Ilam Riccarton PAK'nSAVE	1,500 – 2,000

Source: Commission analysis of pricing and promotional data.<sup>1070</sup>

E41 Contemporaneous correlations (ie, pricing in the same week), as well as correlations with lags of one and two weeks were calculated, to analyse whether stores in these clusters appear to change their pricing at around the same time, or whether some stores tend to follow the price changes of other stores. Across all five clusters, this analysis found no clear pattern of high correlations of price changes with a one- or two- week delay across stores, for products that are sold by all stores in the cluster. Thus, there is no obvious evidence of leader-follower type pricing across the stores in the clusters used in this analysis.

- E42 However, this analysis did reveal some products where pricing is very highly correlated across stores in a cluster, either in the same week or with a one- or two-week delay. In some cases, this appears to be due to pricing promotions that alternate across stores of different retail banners within a cluster on a regular schedule. Several examples of products were found with pricing promotions that alternate between stores on a weekly basis for all or almost all weeks of the year.
- E43 More detailed analysis of characteristics of products that were found to have high pricing correlations within these clusters showed that:
- E43.1 Between eight and 29 of the top 1,000 products (by annual revenue) have high pricing correlations across stores in the clusters. These products account for between 0.4% and 2.1% of total annual store revenue.
  - E43.2 Across stores, between 0.1% to 2.1% of 'key value items' have high pricing correlations.
  - E43.3 Some products with high pricing correlations also have high basket penetration. The median basket penetration ranking for high pricing correlation products for each store in the clusters was between 420 and 3,359, with some high correlation products having basket penetration ranking below 100 (ie, are within the top 100 products by basket penetration).
  - E43.4 These proportions appear to vary by retail banner and by geographic cluster within retail banners.

#### **Analysis of price-cost relationships**

- E44 Relationships between weighted average weekly prices and weighted average weekly COGS were analysed for individual products. As these relationships may differ across stores within a retail banner, each product sold in each store was treated as a separate item in this analysis. Several different methods were used to examine the extent to which changes in average COGS were reflected in changes in average prices, and the extent to which changes in prices can be explained by changes in COGS.<sup>1071</sup>

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<sup>1071</sup> As COGS excludes GST, the analysis in this section was based on revenues and prices also excluding GST.

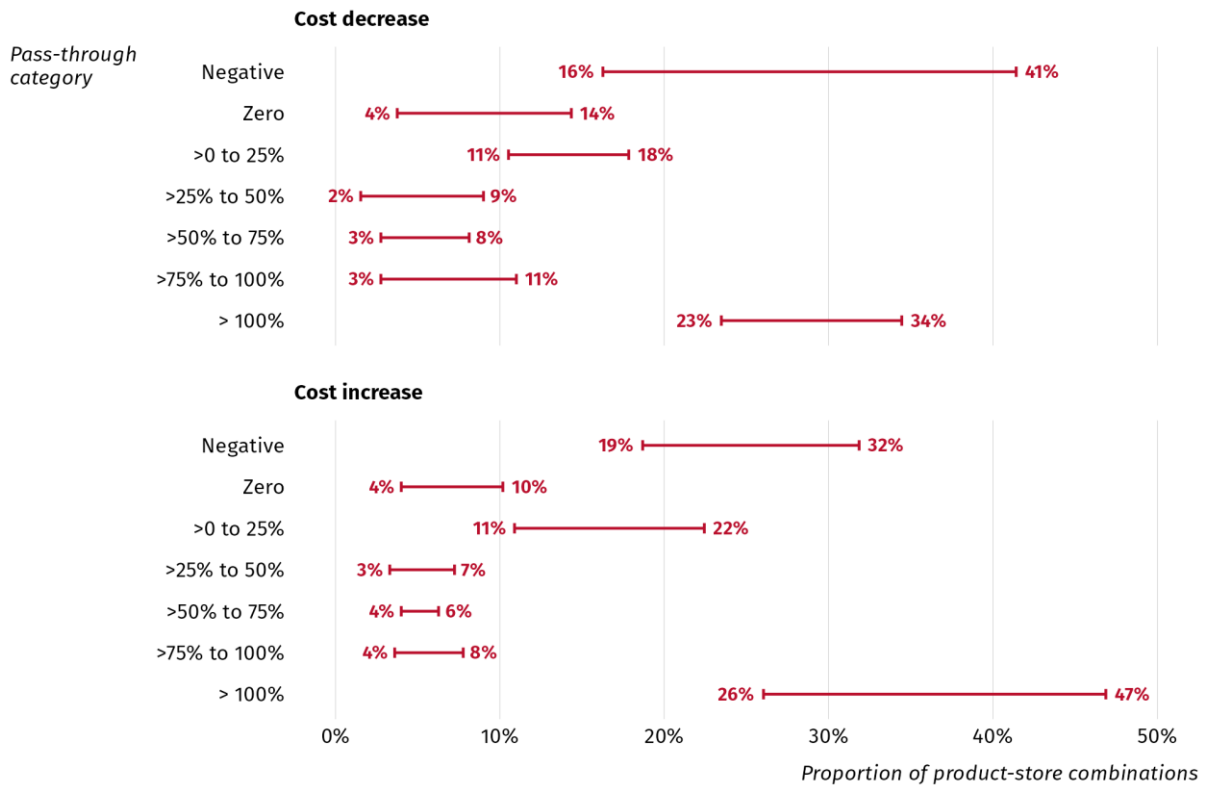
### *Analysis of one-off cost changes*

- E45 Products that experienced one-off increases or decreases in average COGS of at least 5% during 2019 were identified and weighted average prices in the periods before and after these changes were compared. Pass-through of the cost change for an individual product was calculated as the ratio of the difference in its average price after versus before the cost change to the difference in its average COGS after versus before the change. Across all stores, 2,413 examples of one-off cost decreases and 3,327 examples of one-off cost increases were identified for analysis.<sup>1072</sup>
- E46 This analysis found median pass-through across all combinations of products and stores for each retail banner of between 0% and 65% for cost decreases and between 8% and 75% for cost increases, suggesting a slightly stronger tendency for cost increases to be passed through compared to cost decreases. However, a very wide range of pass-through rates for individual combinations of products and stores within each retail banner was also found. Figure E7 shows the range (across retail banners) of the proportion of combinations of products and stores that fell into seven different categories of pass-through for cost decreases and cost increases. This shows:
- E46.1 Negative pass-through (ie, average prices changing in the opposite direction to average COGS) occurred for between 16% and 41% of product-store combinations that experienced cost decreases, and for between 19% and 32% of product-store combinations that experienced cost increases.
  - E46.2 Zero pass-through (ie, average price remaining unchanged before and after the cost change) occurred for between 4% and 14% of product-store combinations that experienced cost decreases, and for between 4% and 10% of product-store combinations that experienced cost increases.
  - E46.3 Greater than 100% pass-through (ie, the change in average price exceeded the change in average COGS) occurred for between 23% and 34% of product-store combinations that experienced cost decreases, and for between 26% and 47% of product-store combinations that experienced cost increases.
  - E46.4 The remainder of products experienced rates of pass-through that were greater than zero but less than 100%, ie, not all of the cost change was reflected in prices.

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<sup>1072</sup> As each product in each store was treated separately, some of these are cases where the same product sold in multiple stores experienced a one-off cost increase or decrease. The analysis was also restricted to combinations of products and stores where at least 20 weeks of sales were recorded during 2019.

**Figure E7 Ranges of rates of pass-through of one-off cost changes to prices, across retail banners**



Source: Commission analysis of pricing and promotional data.<sup>1073</sup>

*Case studies of pack size changes*

E47 Changes in pack sizes may have a similar effect as cost changes, even if unit costs remain unchanged. Three case studies of products that had pack size changes during 2019 were identified and the trends in weekly average prices for these products were examined for each retail banner. These examples illustrated a range of pricing responses to pack size changes, including maintaining similar pricing, and changing either or both of standard and promotional pricing.

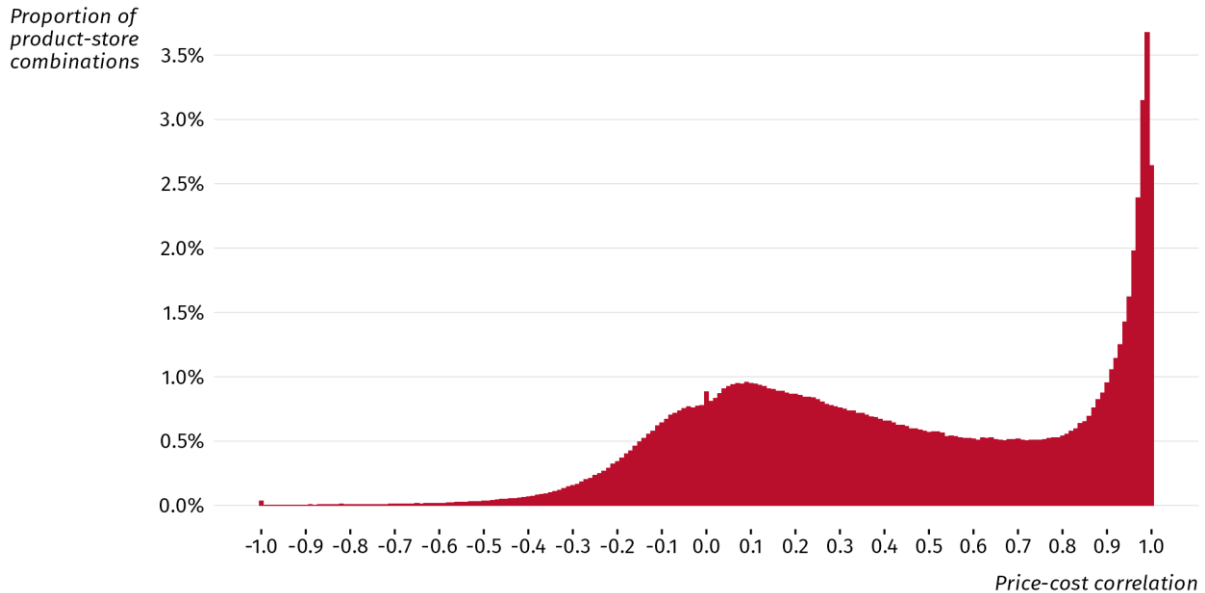
<sup>1073</sup>



*Price-cost correlation analysis*

E48 For each combination of product and store, the correlation between its weekly average price (excluding GST) and average COGS was calculated and the distribution of these correlations was analysed across retail banners and across products within individual stores. Across retail banners, the median price-cost correlation for all combinations of products and stores for each retail banner ranged from 0.25 to 0.69, with substantial differences in the distribution of these correlations for each retail banner. Figure E8 shows the distribution of price-cost correlations for all combinations of products and stores for all retail banners combined. About 83% of product-store combinations have positive correlations between prices and costs and almost all the remainder have negative correlations (0.1% were zero). Weak correlations between prices and costs (between -0.1 and 0.1) were found for 16.5% of product-store combinations. Correlations greater than 0.5 were found for 43.5% of product-store combinations, and greater than 0.9 for 20.8% of product-store combinations.

**Figure E8** Distribution of price-cost correlations for all retail banners combined

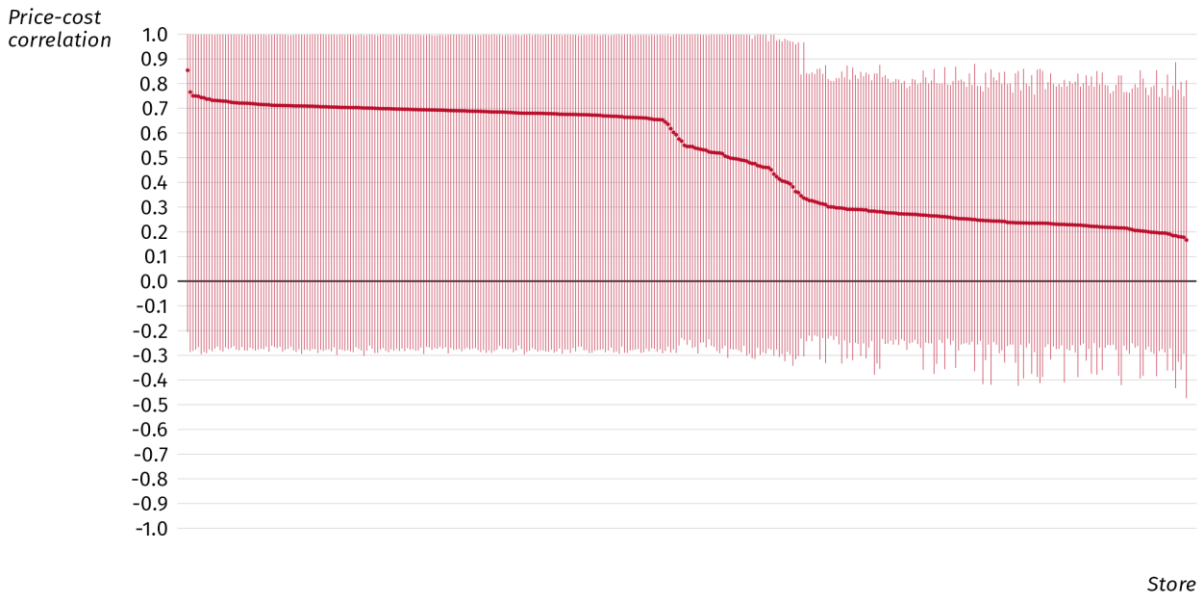


Source: Commission analysis of pricing and promotional data.<sup>1074</sup>

E49 Figure E9 shows the distribution of median price-cost correlations for individual products across all stores of all retail banners. This suggests that the relationship between prices and costs varies across stores, with median correlations for stores ranging from 0.17 to 0.85. Within stores, a wide range of correlations for individual products was also found, as shown by the range between the 2.5<sup>th</sup> and 97.5<sup>th</sup> percentiles of correlations in Figure E9.

<sup>1074</sup>

**Figure E9 Median and 2.5<sup>th</sup>/97.5<sup>th</sup> percentiles of price-cost correlations of products in each store**

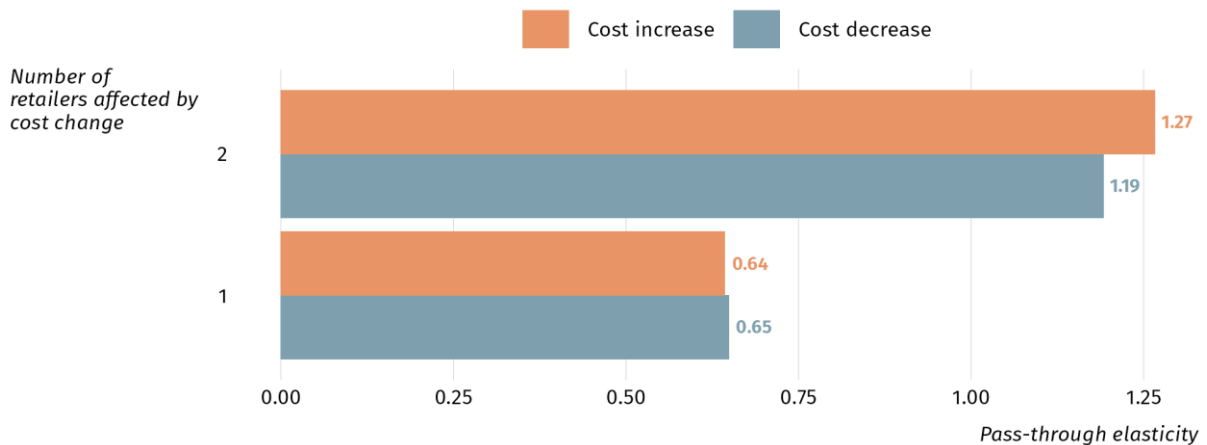


Source: Commission analysis of pricing and promotional data.<sup>1075</sup>

#### *Analysis of asymmetric cost changes*

E50 For the subset of products that were in the top 1,000 products by revenue for each retail banner and were sold by all five retail banners, impacts on prices of cost changes that did not affect all retailers were examined relative to those that did affect all retailers. Figure E10 shows the estimated median rates of pass-through for cost changes that affected both Foodstuffs and Woolworths compared to cost changes that affected only one retailer. This shows substantially higher pass-through of cost changes that affected both retailers compared to changes that affected only one retailer. Slightly higher pass-through for cost increases compared to cost decreases is also observed when both retailers are affected.

<sup>1075</sup>

**Figure E10 Median pass-through elasticities for symmetric and asymmetric cost changes**

Source: Commission analysis of pricing and promotional data.<sup>1076</sup>

### Price-cost regression modelling

E51 Simple regression models of the relationship between changes in weekly average costs and prices for individual products in stores were estimated, of the form:

$$\Delta p_t = \alpha + \beta_1 \Delta c_t + \beta_2 \Delta p_{t-1} + \beta_3 d_t + e_t$$

where  $\Delta p_t$  is the weekly change of the average price of a product in a store,  $\Delta c_t$  is the weekly change in the product's average COGS in the store,  $d_t$  is a dummy variable indicating whether the product was on any kind of promotion in week  $t$  in the store, and  $e_t$  is a random error. In this model, the long-run impact of changes in costs on changes in prices is valid if  $-1 < \beta_2 < 1$  and is estimated as  $\beta^* = \beta_1 / (1 - \beta_2)$ .

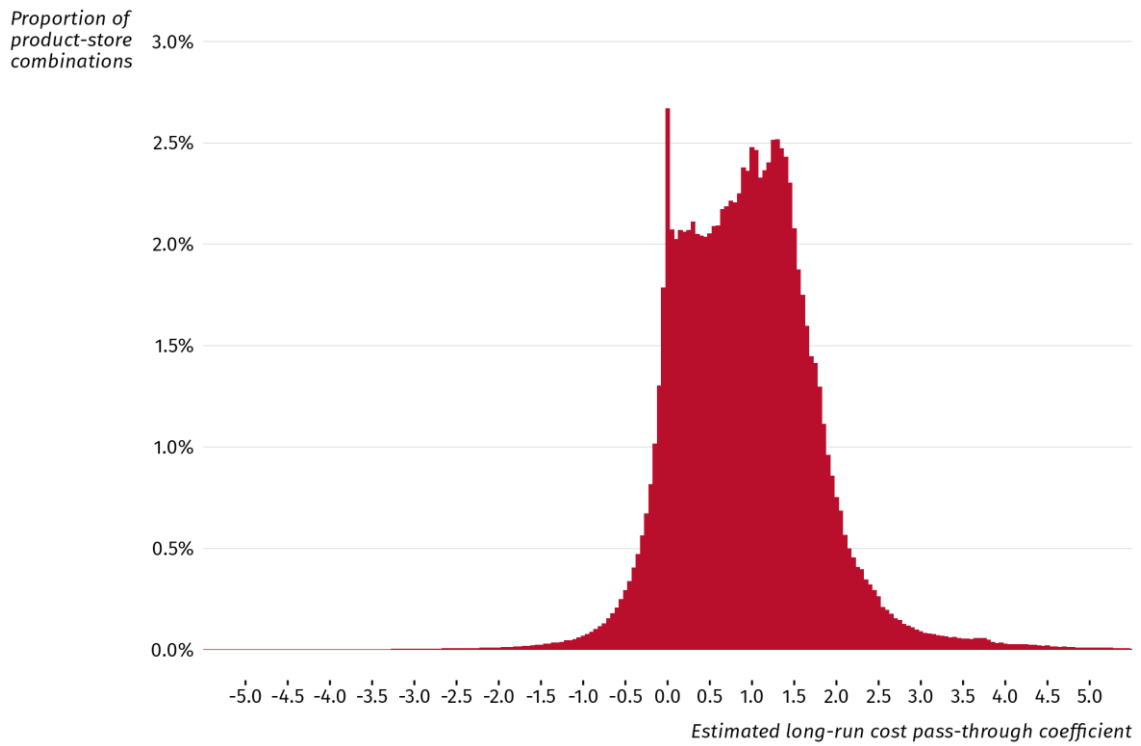
E52 Estimates of  $\beta^*$  were calculated for individual products in individual stores separately and compared across products within stores and retail banners to understand the variation in the overall relationship between costs and prices for different products. Across retail banners, these models explain an average of between 29% and 85% of the variation in weekly price changes.

E53 Figure E11 shows the distribution of these estimated long-run pass-through coefficients for all combinations of products and stores, across all retail banners combined. Estimated pass-through coefficients were positive for 89% of combinations of products and stores. Around 8.2% were between -0.1 and 0.1 indicating a weak relationship between price and cost. Around 68% were greater than 0.5 and 46% were greater than 1.0.

<sup>1076</sup>

[ ].

**Figure E11** Distribution of estimated long-run pass-through coefficients for all product-store combinations across all retail banners



Source: Commission analysis of pricing and promotional data.<sup>1077</sup>

<sup>1077</sup>

[ ].

## **Attachment F                      Consumer survey**

- F1      This attachment provides further information about our consumer survey.
- F2      The sections in this attachment are:
- F2.1    about our consumer survey;
  - F2.2    how we designed and conducted this survey;
  - F2.3    how we have used the results of this survey;
  - F2.4    some limitations to our consumer survey;
  - F2.5    comparison of survey results with other datasets;
  - F2.6    how we conducted the quantitative analysis of this survey;
  - F2.7    summary of our analysis of shopping behaviour;
  - F2.8    how respondents told us they get to their main store;
  - F2.9    why respondents choose to shop at their main store;
  - F2.10   how respondents compare and choose grocery products;
  - F2.11   what respondents told us about how they use grocery loyalty programmes;
  - F2.12   what respondents told us about their experiences shopping for groceries;  
and
  - F2.13   question script for our consumer survey.

### **About our consumer survey**

- F3      In March 2021 we conducted an online consumer survey hosted on our website. The aim of the survey was to help identify themes relevant to our study and better understand consumer behaviour, including how consumers decide where to shop and what to buy. Our consumer survey was available to the public from 4 March to 25 March 2021. During this time, we received 12,269 responses. Just over half of the respondents also provided a free-text comment.
- F4      The findings of this survey helped us to test information gathered from other sources and identify further areas for analysis. In particular, we used these findings to gain further understanding where, how and why people shop where they do for groceries, and whether this varied by location. This analysis also informed our understanding of how consumers decide what groceries to purchase, and why consumers join grocery loyalty programmes.

- F5 Analysing the responses to our consumer survey highlights that there are range of different shopping behaviours from consumers in New Zealand, driven by a diverse range of preferences. However, we also found that most respondents:
- F5.1 do at least one grocery shop a week;
  - F5.2 consider convenience or price as their main drivers for their choice of main store;
  - F5.3 drive and travel less than 10 minutes to their main store;<sup>1078</sup>
  - F5.4 shop at one of New World, Countdown or PAK'nSAVE in a typical week; and
  - F5.5 consider one of New World, Countdown or PAK'nSAVE to be their main store and would shop at these stores if their main store closed.
- F6 Although we did not design this survey to be statistically representative, we received a broad range of representation from a large number of New Zealand grocery shoppers. This gives us confidence the results of this survey provide valuable insights into consumers' behaviours and perceptions in the retail grocery sector. We discuss the demographics of who responded to our consumer survey at paragraphs F50 to F53.
- F7 For more explanation on how we have used the results of this survey to inform our findings, see paragraphs F26 to F31 below.

## How we designed and conducted this survey

### Design and development

- F8 This survey script contained 30 unique multiple-choice questions and an optional free-text field. Some of these multiple-choice questions were repeated for respondents who visited multiple stores. For example, if respondents said they visited three different stores in a typical week, they would have been asked how many times they visited, what they bought and how much they spent at each store.
- F9 However, no respondent was asked all 30 questions, as many questions were dependent on previous responses. For example, respondents who stated they were members of a loyalty programme were asked about their experiences, those that did not were asked why they were not a member. Additionally, as noted below, respondents had the ability to skip some questions.
- F10 This means the total number of questions asked of each respondent was dependent on their shopping experiences. For example, a respondent who shopped at many stores and was a member of a loyalty programme could be asked more than 35 questions, whereas a respondent not usually involved in the grocery shopping would be asked only seven questions.

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<sup>1078</sup>

'Main store' was defined as "the store you spend most at or do most of your grocery shopping with".

*We sought to minimise framing effects*

- F11 Respondents' answers to survey questions can vary systematically depending on how the survey is designed. That is, how respondents interpret questions can affect the response they provide. For example, research has observed respondents can answer differently depending on the order in which the possible answers are listed, or how the questions or responses are worded.<sup>1079</sup>
- F12 Given the potential for these effects to impact the reliability of any results of the survey, we sought to minimise the risk of these occurring. We did this by varying the order in which answers were presented to respondents and seeking to word questions using plain language which did not prompt specific types of responses.<sup>1080</sup> For example, we attempted to frame the free-text question to allow consumers to freely provide their views on any areas of the sector they deemed relevant. Figure F1 below shows how respondents provided free-text response.

**Figure F1 The free-text question as it was displayed to respondents**

**Your experience shopping for groceries**

**Is there anything else you would like to tell us about your experiences shopping for groceries?**

*This could include your views on the grocery options available to you or anything else you think we should be aware of.*

Previous Next

- F13 To help with this, we were assisted by Professor Philip Gendall, an experienced survey designer, during the development of this survey. Professor Gendall reviewed a draft of the survey script and provided advice and recommendations to improve this script to minimise the risk of framing bias and to gather the data we required. However, we were responsible for the design and implementation of the survey.

<sup>1079</sup> Regarding how responses can differ depending on the order in which answers are presented, see: Holbrook, et al. "Response Order Effects in Dichotomous Categorical Questions Presented Orally." *Public Opinion Quarterly*, Vol 71 (2007) at 325-348. Regarding how responses can vary due to wording, see: Chong et al. "Framing Theory". *Annual Review of Political Science* 10 (2007) at 103–106.

<sup>1080</sup> For the general principles we referred to when attempting to minimise these effects, see: CMA "Good practice in the design and presentation of customer survey evidence in merger cases (Revised)" (May 2018) at [3.7]-[3.31] and [3.20a].

*We adjusted the design in an attempt to capture ‘typical’ behaviour*

F14 During the latter stages of the design process, we adjusted our design to account for lockdown periods in Auckland, notably changing from asking about the previous week’s shopping to a “typical” week. We made this change as we expected shopping behaviour during these lockdowns was likely to differ from typical shopping behaviour. We do not think this change materially changes the quality of responses, as it still aids respondents to recall their typical shopping behaviour.

*We framed questions to aid recall and reduce cognitive load*

F15 When asking respondents to recall some aspect of their behaviour, we framed questions in a general sense as illustrated in Figure F2 below (eg, how long does it usually take you to get to this store?). This was done to help respondents recall how they do most of their shopping, accepting these behaviours may sometime differ which could make it most challenging to respond accurately.

**Figure F2 Example of question-answer format presented to respondents**

**How long does it usually take you to get there?**

0-5 mins  
 5-10 mins  
 10-15 mins  
 15-20 mins  
 20-25 mins  
 25+ mins

F16 Additionally, some questions we asked were restricted to respondents’ “main stores” (eg, how do you usually travel to your main store?). This was done to reduce the complexity of the survey design, and to minimise the time taken by respondents to complete the survey.

**Conducting the survey**

F17 The survey was conducted online and hosted on our website. Respondents did not have to provide any personal information to participate. We estimate it took about five to 10 minutes to complete. However, as noted at paragraph F10, this would vary depending on the number of questions each respondent was asked. Figure F3 shows the information provided to respondents at the start of the survey.



**Figure F3 Landing page of our consumer survey**

The screenshot shows the landing page for the 'Consumer groceries survey' on the Commerce Commission New Zealand website. The page includes a header with the logo and navigation links, a breadcrumb trail, a main title, a 'Begin' button, and several paragraphs of introductory text.

COMMERCE COMMISSION NEW ZEALAND  
Te Kaitiaki Take Kōwhiri

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Home > About us > Our role > Market studies > Market study into the grocery sector > Consumer groceries survey > Consumer groceries survey

## Consumer groceries survey

This page was updated 2 months ago Share [Twitter](#) [LinkedIn](#) [Facebook](#) [Email](#)

### Kia Ora and Welcome

Thank you for clicking through to our survey, it should take you around five to 10 minutes to complete.

This survey will help us understand how New Zealanders typically shop for groceries. When completing the survey, please think about how you typically shop for groceries (ie, at Alert Level 1), rather than how you might shop due to any COVID-19 restrictions.

Your response will be used by the Commission as part of our study into New Zealand's grocery sector. We will not share your response with third parties unless required to do so by law.

Your response will be grouped with others and we may publish a summary of these grouped results on our website.

If you need to provide us with confidential, commercially sensitive or personal information, please email us at [marketstudies@comcom.govt.nz](mailto:marketstudies@comcom.govt.nz) to discuss the best way to do this.

The Commission has also published a [factsheet](#) which outlines the purpose of the study and what we are looking at, the process we are following, what the potential outcomes can be, and how and when you can take part.

Click the 'Begin' button below to start the survey.

[Begin](#)

- F18 To encourage consumers to complete the survey, we engaged Tilt Digital, a digital marketing agency, to run a social media advertising campaign across Facebook and Instagram. As nearly all New Zealanders buy groceries, the campaign aimed to get engagement and responses from across the population, and particularly from communities we expected to be hard to reach based on prior experience. The campaign ran with an accompanying short video fronted by Associate Commissioner Joseph Liava'a explaining why we wanted consumers to take part.
- F19 We conducted regular audience assessments of the three-week campaign, with targeting changes made to reach communities who appeared underrepresented, based on Statistics NZ demographic data, in the survey responses being collected.
- F20 In conjunction with this advertising campaign, we engaged with a wide range of consumer organisations to help also promote the survey through their own individual consumer channels. These groups included FinCap, Consumer New Zealand, Consumer Protection (Ministry of Business Innovation and Employment), Super Seniors (Ministry of Social Development), Federated Farmers, Office of Ethnic Affairs, Ministry for Pacific Peoples and Age Concern.

## The questions we asked

F21 Our survey asked a range of questions about where, why and how respondents shop for groceries. The survey presented written questions to respondents, and respondents selected the most appropriate answers from a list. Respondents could skip most questions by selecting 'Next'. For example, see Figure F2 above. We asked questions about:

- F21.1 shopping behaviour during a typical week (eg, how often they shop, how much they spend and what they buy);
- F21.2 which store(s) they usually do most of their shopping at, and why this is;
- F21.3 how they select products, including whether they have brand preferences or check unit price; and
- F21.4 whether they were members of loyalty programmes and, if so, why they joined and their awareness of the attributes of these programmes.

### *We asked a range of demographic questions*

F22 We also asked respondents a range of demographic questions, such as ethnicity, age, and income. Respondents had the ability to skip demographic questions or select "Prefer not to say".

F23 We also asked questions about where respondents lived, as we wanted to compare responses to some questions by location. We asked respondents about which region, district, city, and, in some cases, suburb they lived in. The options provided were based on the Statistics NZ Geographic Areas Table 2021 dataset (Geographic Areas Table), except for the following cities: <sup>1081</sup>

- F23.1 Auckland;
- F23.2 Lower Hutt;
- F23.3 Tauranga;
- F23.4 Christchurch;
- F23.5 Dunedin;
- F23.6 Hamilton; and
- F23.7 Wellington.

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<sup>1081</sup>

See: <https://datafinder.stats.govt.nz/table/105172-geographic-areas-table-2021>.

- F24 The suburb-level options provided to for these cities were instead created based on lists of suburbs available online. This is because we considered the options provided for these cities in the Geographic Areas Table would not be easily recognised by respondents.
- F25 An illustrative copy of the survey script, including a full list of the questions asked, is provided at the end of this attachment at page 490.

### **How we have used the results of this survey**

- F26 We have used the findings from this survey to identify areas of interest, and to support information we have collected from other sources. These findings are not intended to draw specific conclusions on the behaviour and perceptions of all grocery consumers in New Zealand. Rather, it is one piece in the puzzle to building a detailed picture of consumer behaviour and perceptions in New Zealand's retail grocery sector.
- F27 The results of the survey are unlikely to be truly representative of the underlying population of interest (ie, grocery shoppers in New Zealand). This means we have not sought to draw specific statistical inferences from the analysis conducted with this data regarding to the behaviour of all New Zealand grocery shoppers.

### **We are confident this survey provides good insights into consumer behaviour and perceptions**

- F28 Despite the limitations discussed below, we consider our consumer survey provides valuable insight into consumer behaviour and perceptions in the retail grocery sector. This is because:
- F28.1 our sample size is very large;
  - F28.2 we had a broad range representation across many demographic variables; and
  - F28.3 estimates of other variables are consistent with other datasets.

#### *Our sample size is large*

- F29 A large number of consumers told us about their grocery shopping behaviour, and it is important we reflect this. As noted, 12,269 New Zealand grocery shoppers responded to our consumer survey. This provides a large sample of respondents to draw on when conducting our analysis.

#### *We had a broad range of representation across many demographic variables*

- F30 As discussed from paragraph F45 below, we received a broad range of representation across geography and ethnicity. This gives us confidence the responses to this survey represent a diverse range of grocery shoppers with different experiences and perceptions in the sector.

*Estimates of other variables are consistent with other datasets*

F31 As noted below, our estimates of respondents' spending behaviour are consistent with our findings in Chapter 5. This gives us confidence our underlying data, and ensuing analysis, is broadly consistent with other, statistically robust, datasets.

**Some limitations to our consumer survey**

*Certain groups of consumers are likely to be underrepresented*

F32 Due to the design of our consumer survey, it is possible some groups of consumers with particular attributes are systematically underrepresented. For example, grocery shoppers who do not have internet access, and therefore were unlikely to have completed our consumer survey, may have different experiences with the retail grocery sector than those who do.

F33 If this is the case, our results may be biased, and this should be considered when interpreting this analysis.

F34 However, as explained below, we have conducted analysis and comparisons to identify any areas where responses appear biased. While we cannot fully verify the extent of this potential bias, these results provide reassurance that our consumer survey results are unlikely to be misleading regarding the general behaviour and perceptions of grocery shoppers in New Zealand.

*Our survey focuses on grocery shopping*

F35 The questions in our consumer survey intended to capture how New Zealanders shop for groceries. Our survey is unlikely to capture respondents' shopping and spending on all food consumed in a typical week as our consumer survey did not provide specific options for some sources of food like take-away foods, restaurants, or markets.

F36 However, some respondents may have included these sources of food under the option 'other.' Therefore, it is important to note that our analysis relates to how respondents' source groceries rather than all types of food in a typical week.

*The survey required respondents to recall past behaviour which may inhibit accuracy*

F37 Respondents may struggle to accurately recall some aspects of their past behaviour, such as how much they typically spend at a given store. As discussed at paragraph F15 above, we attempted to mitigate this by framing questions in ways that would aid recall. However, it is important to note this risk of reduced accuracy is an inherent limitation in this type of survey design, as it relies on respondents recalling past actions.

F38 Although this design may result in imperfect recall, we do not consider this is likely to cause a systematic over or under-reporting of certain behaviour (generally referred to as a response bias). Response bias is a systematic, rather than random, error caused by differences in the accuracy of respondents' recollections of past behaviour.<sup>1082</sup>

*Respondents may have over-reported their in-store behaviour*

F39 However, there may have been systematic over-reporting of some questions. That is, respondents may have reported engaging in certain behaviour (such as comparing prices between products) more often than they actually do.

F40 This is referred to as a social desirability bias, which is the tendency of some respondents to report an answer in a way they deem more socially desirable than their "true" answer.<sup>1083</sup> For example, some respondents may have considered the act of comparing prices or referring to unit pricing as being socially desirable, leading to an over-reporting of this behaviour.

F41 However, this analysis still provides useful insight, for example, when comparing variance in reported behaviour between different groups of respondents.

*Our analysis of where respondents would shop if their main store(s) closed may overestimate spending diverted to retailers other than major grocery retailers*

F42 We asked consumers where they would shop if their main store closed, and they could choose multiple stores. We did not ask respondents to estimate how they would split their spend between different options. For example, a respondent could report that they would switch their shopping from New World to another New World and a Four Square. We assumed that the spend would be split evenly. This approach may overestimate the proportion of spend that would be diverted to retailers other than the major grocery retailers as, based on the other responses, we expect that consumers are likely to spend more at the major grocery retailers than other retailers.

F43 We recognise that this limitation is likely to apply to all respondents. However, most respondents (71%) said they would switch their shopping to one store.<sup>1084</sup> This means any impact of this limitation would be limited to less than one third of respondents, give two thirds would not split their shopping spend.

F44 We set out these findings at paragraphs F107 to F125 below.

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<sup>1082</sup> Paul Lavrakas "Encyclopedia of Survey Research Methods" (2008) at 486, available at <https://methods.sagepub.com/reference/encyclopedia-of-survey-research-methods/n486.xml>.

<sup>1083</sup> Paul Lavrakas "Encyclopedia of Survey Research Methods" (2008) at 537, available at <https://methods.sagepub.com/reference/encyclopedia-of-survey-research-methods/n537.xml>.

<sup>1084</sup> Source: Commission analysis based on data from our survey (n=11,585) [ ].

*We have not reweighted this survey*

- F45 We chose not to reweight the results of this survey using the demographic data we collected. Given we did not design this survey to collect a statistically representative sample, reweighting the results would give a misleading impression about the statistical representativeness of any findings.
- F46 However, we did conduct some sensitivity testing on some pieces of analysis using reweighted samples to check whether this materially changed the outcomes of the analysis. This did not appear to change the analysis in any material way. We conducted this testing by re-running some pieces analysis using four datasets, each reweighted by a separate demographic variable: ethnicity, age, region, and urban-rural location.

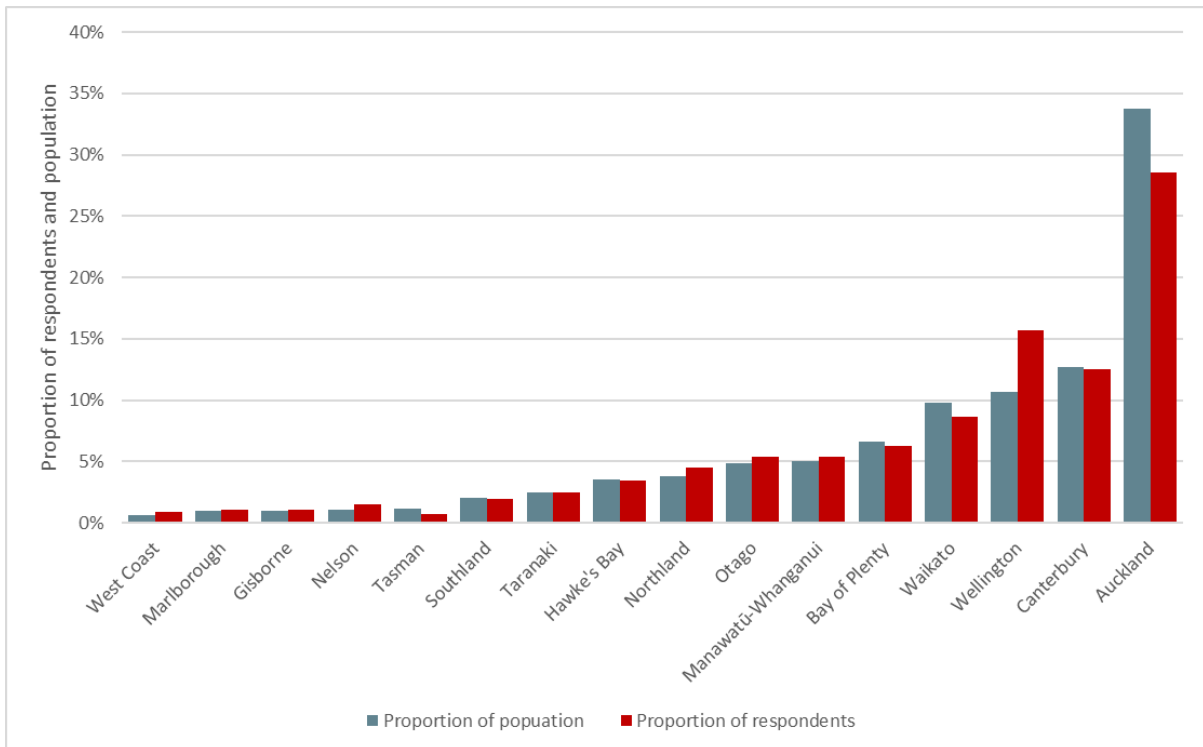
**Comparison of survey results with other datasets**

- F47 We received responses from 12,269 New Zealanders. More than 99% of these were the main grocery shopper in their household. We cleaned our data and removed unreliable data from the raw dataset before conducting analysis on the results of our consumer survey. This resulted in removing 172 responses across the whole dataset, and turning less than 20 responses across responses to questions around store behaviour and loyalty programmes. This explains why the sample size is less than 12,269 in the figures below. We discuss our cleaning process in paragraph F57 to F68 below.
- F48 As shown in the analysis below, our sample is broadly consistent with key population demographics collated by Statistics NZ, such ethnicity and region. This gives us confidence that our consumer survey respondents reflect a broad range of New Zealand grocery shoppers.
- F49 We also compared spending estimates from responses with other datasets, such as Statistics NZ household expenditure statistics. Our estimates appear to be broadly consistent with these external datasets.

**Demographics of respondents in comparison to Statistics NZ data**

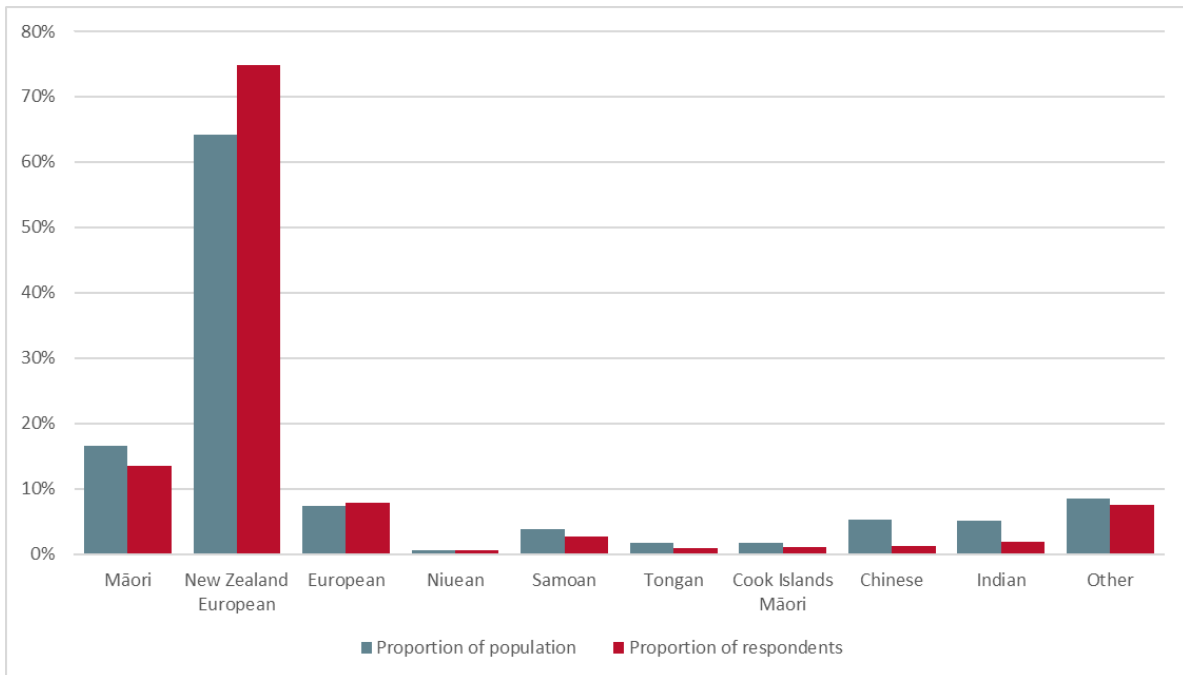
- F50 The regional representation of respondents appears to be broadly consistent with Statistics NZ population estimates, as illustrated in Figure F4 below. However, Wellington was somewhat overrepresented in the sample and Auckland was underrepresented in the sample.

**Figure F4 Region of respondents in comparison to Statistics NZ 2020 estimates**



Source: Commission analysis based on data from our consumer survey (n=12,003) and from Statistics NZ.<sup>1085</sup>

<sup>1085</sup> Statistics NZ “Subnational population estimates: At 30 June 2020”  
<https://www.stats.govt.nz/information-releases/subnational-population-estimates-at-30-june-2020>;  
 [ ].

**Figure F5 Ethnicity of respondents in comparison to Statistics NZ 2018 estimates**

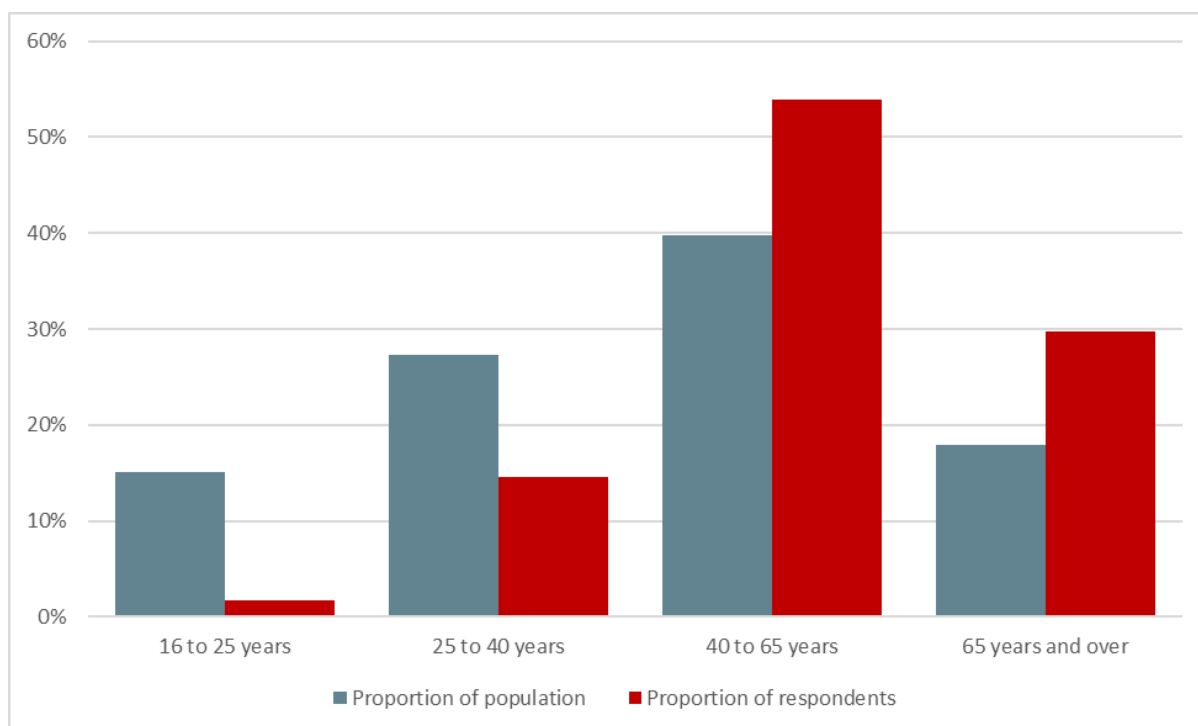
Source: Commission analysis based on data from our consumer survey (n=12,097) and from Statistics NZ.<sup>1086</sup>

- F51 Respondents to our consumer survey identified with a range of ethnicities, as illustrated in Figure F5 above.<sup>1087</sup> The distribution of ethnicities identified is largely consistent with Statistics NZ Census 2018 data. However, Chinese and Indian respondents were relatively underrepresented in our sample.
- F52 As discussed at paragraph F19, we re-targeted our communications to try and mitigate this underrepresentation. This re-targeting had some effect on engagement; however, these groups remained underrepresented in the final sample.

<sup>1086</sup> Statistics NZ “Estimated resident population (2018-base): At 30 June 2018” <https://www.stats.govt.nz/information-releases/estimated-resident-population-2018-base-at-30-june-2018/>; [ ].

<sup>1087</sup> As with the Statistics NZ 2018 census, our consumer survey enabled respondents to select as many ethnicities as they identified with, explaining why each dataset sums to >100%.



**Figure F6 Age of respondents compared to Census 2018 data**

Source: Commission analysis based on data from our consumer survey (n=11,927) and Census 2018 data based on usually resident population counts for individuals aged 16 or over.<sup>1088</sup>

F53 Representation of older age groups was higher in our consumer survey, compared to populations estimates. Although it is likely that main household shoppers may be older than the population average, this is unlikely to completely explain the overweighting towards older respondents in our sample as illustrated Figure F6 above.

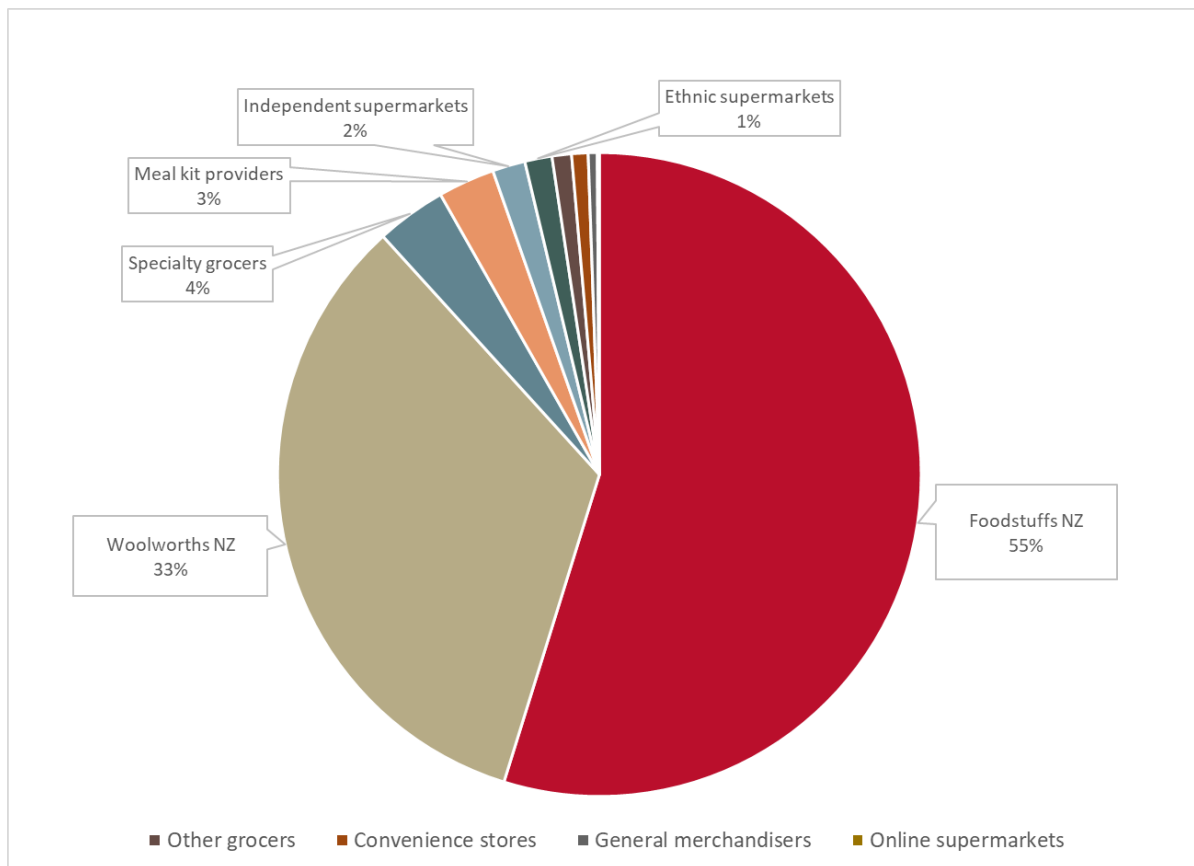
#### Estimated shares of supply in comparison to other estimates

F54 We also used responses on weekly spend to estimate shares of supply for the grocery sector. This estimate is shown in Figure F7.

F55 We do not necessarily consider our estimate to be a representative view of shares of supply in the retail grocery sector. However, we consider its consistency with more robust estimates, conducted by other parties, supports the strength of this spending data.

F56 In Chapter 5, we reviewed a range of estimates from the major grocery retailers, and we calculated our own estimates. We found that most estimates of the combined shares of supply for the major grocery retailers were between 80% to 90%. Our estimate based on respondents reported spending is consistent with this, finding that the major grocery retailers had a market share of 88%.

<sup>1088</sup> See: <https://www.stats.govt.nz/information-releases/2018-census-totals-by-topic-national-highlights-updated>; [ ].

**Figure F7 Estimated national market share of grocery sector from our survey**

Source: Commission analysis based on data from our consumer survey.<sup>1089</sup>

## How we conducted the quantitative analysis of this survey

### We cleaned the raw dataset

- F57 Given that our consumer survey was publicly available, there is a risk that we received responses to the survey that may not be genuine or which lack accuracy due to haste in completion. However, the fact half of the respondents took the time to submit free-text responses indicates most were prepared to spend time to accurately provide the information requested.
- F58 Nonetheless, we sought to identify responses that we considered were unlikely to accurately reflect the grocery shopping experiences of New Zealanders. We did this by removing data which may be unreliable and removing responses to certain questions.
- F59 We removed 172 responses across the whole dataset. We also removed some responses and additional variables created related to store behaviour or loyalty programmes. Our cleaning resulted in less than 20 observations being turned to missing for most responses and variables.

F60 The rest of this section discusses how we identified and removed potentially unreliable data, and the impact of this process.

*How we identified unreliable data*

F61 We identified potentially unreliable data by identifying respondents who were unlikely to be representative of grocery shoppers in New Zealand. This could include respondents who told us they do not usually do grocery shopping and respondents with potentially unrealistic shopping habits.

F62 For example, some respondents who did not report visiting the stores they selected as their main store(s). Respondents' "main store" was defined as the grocery store or service they spend most at or do most of their shopping with.

F63 Given the purpose of our consumer survey was to understand consumer behaviour and perceptions of New Zealand grocery shopper, these types of respondents are unlikely to be the type of consumers we are aiming to seek views from.

*We removed some unreliable data from the whole dataset*

F64 We removed responses by respondents who we did not consider to be representative of typical grocery consumers in New Zealand. This resulted in us removing:

F64.1 85 responses from respondents who said they are not usually involved in the grocery shopping;

F64.2 17 responses with the Commerce Commission's IP address, as these responses may have been influenced by information about our study;

F64.3 11 responses made before 4 March 2021 as our consumer survey was not publicly available until this date, these are likely to be test responses;

F64.4 31 responses made after the survey closed on 25 March 2021. This occurred because the webpage was still live until 29 March 2021 when the webservice provider closed the survey; and

F64.5 28 duplicate responses which were submitted from the same IP address, on the same day, gave the same responses to questions around how they shopped and identical free-text responses.<sup>1090</sup>

F65 We also checked whether any respondents selected the first answer to each question, as this may have indicated that their responses were rushed or unconsidered. We did not find any respondents who did this.

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<sup>1090</sup> The questions around shopping behaviour related to shopping involvement (main shopper, not involved, shared with others), number of people shopped for, shopping channel (in store, online and delivered, ordered online and collected at store) and frequency of shops in a typical week.

*We removed some unreliable data from questions related to shopping behaviour and loyalty programmes*

- F66 We removed some responses to questions related to shopping behaviour in a typical week, choice of main store and the stores respondents would shop at if their main store closed, and loyalty programmes. We did this by transforming responses into missing observations, meaning these responses were not included in our analysis.
- F66.1 We generated dummy variables (explained at F74 below) to identify whether a respondent visited a store in a typical week. Dummy variables are variables that take the value of 0 or 1 to indicate whether a condition is true or not, and they are useful for grouping responses into categories.<sup>1091</sup>
- F66.2 We removed some observations within some dummy variables about shopping behaviour. We did this if a respondent reported visiting a store but did not report spending anything at the store as we would expect a consumer to spend money at a store. We removed between 0 and 20 observations depending on the dummy variable.
- F66.3 We also asked respondents what their main stores were (respondents could select up to two) and we created dummy variables to identify if a respondent reported a store as their main store or not. We transformed observations in the dummy variables to missing if respondents did not report having a main store in the first place or did not report visiting their main store(s) in a typical week.
- F66.4 We would expect a respondent to visit their main store in a typical week as main store was defined as the store a respondent spends most at or does most of their grocery shopping with.
- F66.5 We also generated dummy variables to indicate which stores respondents told us they would shop at if their main store(s) closed for the foreseeable future. We removed observations from these dummy variables if a respondent did not report having a main store or did not report shopping at any stores in a typical week. This resulted in up to 345 observations being removed, depending on the variable. These observations were removed as respondents told us they do less than one shop a week and therefore were not asked questions about their shopping in a typical week.
- F67 We turned five observations into missing for dummy variables related to loyalty programmes. These dummy variables indicated which type of loyalty programme membership respondents had. We also created dummy variables indicating the reasons for having a loyalty card if respondents did not report being a member of a loyalty programme in the first place.

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<sup>1091</sup> For example, a dummy variable may be created to take the value of 1 if a respondent lives in Napier, and 0 if they do not.

F68 We also adjusted responses to questions around shopping behaviour which we considered were outliers and potentially unrealistic. This included transforming responses to store behaviour questions to missing if:

F68.1 respondents bought more than 20 product categories per person in a household in a typical week. This resulted in up to 59 observations being transformed to missing,<sup>1092</sup> and

F68.2 respondents spent less than \$10 or more than \$400 per person in a household in a typical week. This resulted in up to 16 observations being transformed to missing.

### **We created additional variables to conduct our analysis**

F69 We also derived variables from our raw dataset for our analysis.

#### *We derived estimates from some variables*

F70 We created estimates of some variables by taking the mid-point of responses to multi-choice questions. For example, when asking respondents how long it takes them to travel to their main store, we provided options such as “0-5 minutes”, “5-10 minutes” and so on. These responses were then converted to numeric values such as 2.5 and 7.5.

F71 We presented these questions as multi-choice options, rather than an asking respondent to construct their own estimate, as we considered it would significantly ease the cognitive load on respondents. Further, we considered asking for an exact estimate may give an impression of false accuracy in the responses.

F72 Following this process enabled us to calculate estimates such as total travel time to main stores (see Figure F18) and total spending across stores (see Figure F12).

F73 Using mid-point estimates requires assuming responses are distributed around the mid-point of each option (ie, the mean spending of respondents who selected “\$100-\$150” is \$125). We recognise we are unable to test this in practice. However, this assumption is unlikely to materially bias our analysis, given the large sample size, and our spending estimates appear broadly consistent with Statistics NZ estimate.

#### *We created dummy variables*

F74 We created dummy variables from the raw dataset which we used to create many of the figures in our analysis of respondents’ shopping behaviour and why respondents choose to shop at their main store. For example, we created the following dummy variables to indicate:

F74.1 whether respondents visited a store in a typical week;

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<sup>1092</sup> Respondents could choose up to 15 groups of product categories per store. Examples of product categories include fresh fruit or vegetables or meat, poultry, or seafood.

- F74.2 whether respondents selected a store as one of their main store(s); and
- F74.3 whether respondents selected a store as one of the store(s) they would shop at if their main store closed for the foreseeable future.
- F75 We also created a dummy variable to categorise types of stores visited in a typical week, main stores and substitute stores. These dummy variables indicate:
- F75.1 if respondents only visited major grocery retailers, only other stores, or visited a mix of major grocery retailers and other stores in a typical week;
- F75.2 if respondents' main stores were only major grocery retailers, only other stores or a mix of major grocery retailers and other stores in a typical week; and
- F75.3 if respondents selected stores they would shop at if their main store closed which were only major grocery retailers, only other stores or a mix of major grocery retailers and other stores.
- F76 Survey respondents were able to select from retail banners owned by Foodstuffs and Woolworths NZ, or categories of other grocery retailers as shown in Table F1 below. A mix of stores refers to a mixture of major grocery retailers and other grocery retailers. These dummy variables are used in Figure F11, Figure F13, Figure F15 and Figure F22.

**Table F1 Grocery retailers survey respondents could select from**

Major grocery retailers	Other grocery retailers
New World	Ethnic supermarket (eg, Tai Ping, Japan Mart, Yogijis Food Mart)
Countdown	Another supermarket (eg, Farro Fresh, Moore Wilson's, Bin Inn)
PAK'nSAVE	A single-category or specialist grocery store (eg, greengrocers, butchers, bakeries)
Four Square	A general merchandiser (eg, The Warehouse)
FreshChoice	A convenience store (eg, dairies, petrol stations, Night 'n Day)
SuperValue	A meal kit provider (eg, Hello Fresh, My Food Bag)
	An online-only supermarket (eg, The Honest Grocer)
	Other (please state)

### Urban-Rural Indicator

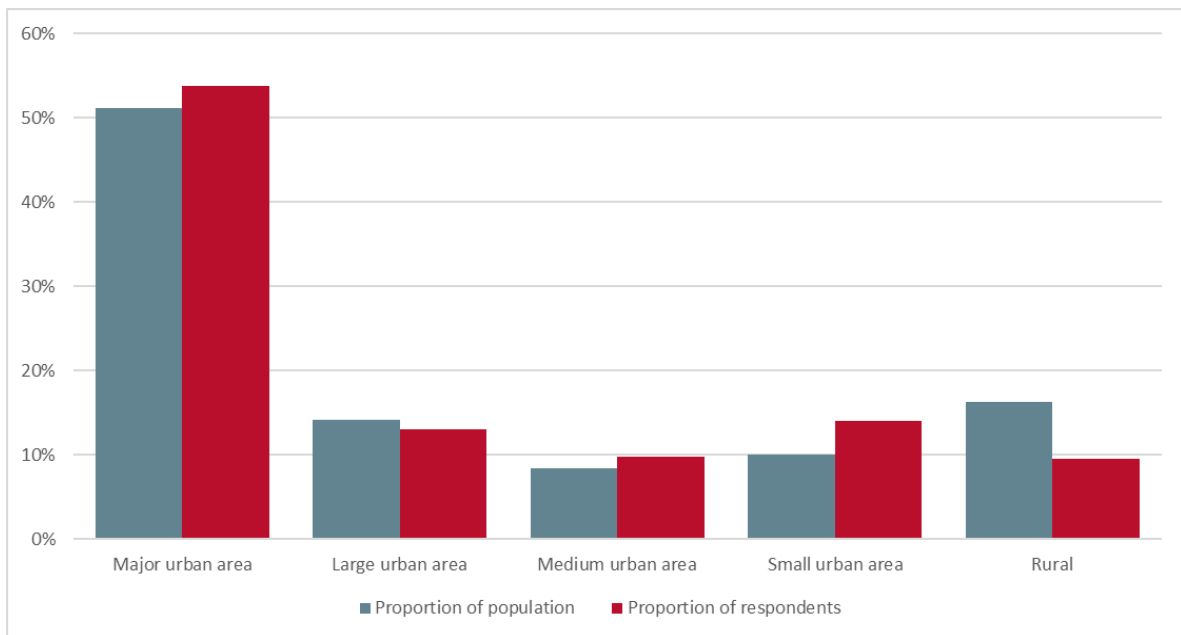
- F77 As shown in a number of graphs below, we conducted some analysis by looking at where respondents lived. To achieve this, we constructed a variable which matched respondents against the “Urban-Rural Indicator 2018” variable from the Statistics NZ Geographic Areas Table using the location respondents provided.
- F78 However, as noted at paragraph F23 above, the suburb options for some cities differed from those contained in the Geographic Areas Table. These cities were instead marked with the Urban-Rural Indicator corresponding to their population size, as defined by Statistics NZ (see Table F2 below). For example, all observations with Area=Auckland were set to “Major urban area”.
- F79 The parameters of these Urban-Rural Indicators, as defined by Statistics NZ, are set out in Table F2 below.<sup>1093</sup>

**Table F2 Respondents’ urban-rural location**

Urban-Rural Indicator	Population	Examples
Major urban area	100,00 or more residents	Auckland, Christchurch, Wellington, Hamilton, Tauranga, Dunedin and Lower Hutt
Large urban area	30,000-99,999 residents	Rotorua, Whanganui and Invercargill
Medium urban area	10,000-29,999 residents	Cambridge, Te Awamutu and Rolleston
Small urban area	1,000-9,999 residents	Thames, Stratford and Gore
Rural settlements	200-1,000 residents, or at least 40 residential dwellings	
Rural other	Other mainland areas located outside urban areas or rural settlements	

- F80 The “rural settlement” and “rural other” categories were consolidated at the analysis stage. We did this as the geographic data provided by respondents made it challenging to easily distinguish which category of the two categories was most appropriate based on the Geographic Areas Table.
- F81 Summary statistics of this variable, in comparison to Statistics NZ’s 2018 population estimate, is at Figure F8 below.

<sup>1093</sup> Statistics NZ “Urban accessibility – methodology and classification” (2020) at 25, available at: <https://www.stats.govt.nz/assets/Uploads/Methods/Urban-accessibility-methodology-and-classification/Download-document/Urban-accessibility-methodology-and-classification.pdf>.

**Figure F8 Area of respondents compared to Census 2018 data**

Source: Commission analysis based on data from our consumer survey (n=11,205) and Census 2018 data.<sup>1094</sup>

F82 7.3% of respondents did not provide enough geographic data to generate an Urban-Rural Indicator (eg, they provided no response, or only region).

### Summary of our analysis of shopping behaviour

F83 This section summarises some of the analysis we conducted to understand how respondents told us they shop for groceries. We asked respondents a range of questions about how often they shop, where they shop, how much they spend and what their main store is.

#### Main findings on shopping behaviour

F84 Based on this analysis, it appears that:

F84.1 most respondents visit between one and three different grocery stores in a typical week;

F84.2 most visits are to Countdown, New World and PAK'nSAVE;

F84.3 around 60% of respondents shop only at stores owned by Foodstuffs and Woolworths in a typical week;

F84.4 respondents who visit Countdown, New World or PAK'nSAVE or use meal kit services spend more on average in a typical week compared to respondents' spending at other stores or services in our consumer survey; and

<sup>1094</sup>

See: <https://www.ehinz.ac.nz/indicators/population-vulnerability/urbanrural-profile/>; [ ].



F84.5 most respondents report Countdown, New World and PAK’nSAVE as their main stores across the whole of New Zealand and across different regions.

F85 These findings indicate that most respondents shop at Countdown, New World and PAK’nSAVE and spend the most money there. This results in Foodstuffs and Woolworths NZ having a larger estimated market share, compared to other retailers, as shown in Figure F7 above.

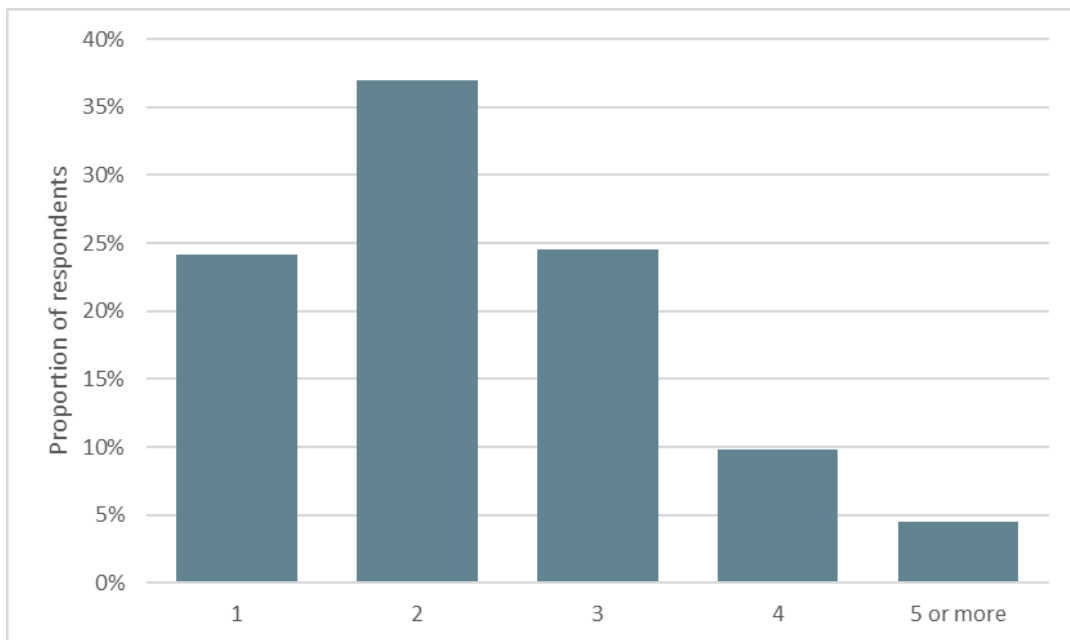
F86 We discuss the following findings on shopping behaviour which shows how respondents reported the shopped below:

- F86.1 how often respondents told us they shop;
- F86.2 where respondents told us they shop;
- F86.3 how much respondents told us they spend; and
- F86.4 respondents’ choice of main store(s).

**How often respondents told us they shop**

F87 Figure F9 shows that 86% of respondents make between one and three visits to different grocery stores in a typical week.

**Figure F9 Number of different grocery stores respondents said they visit in a typical week**



Source: Commission analysis based on data from our consumer survey, n=10,619.<sup>1095</sup>

<sup>1095</sup> [ ].

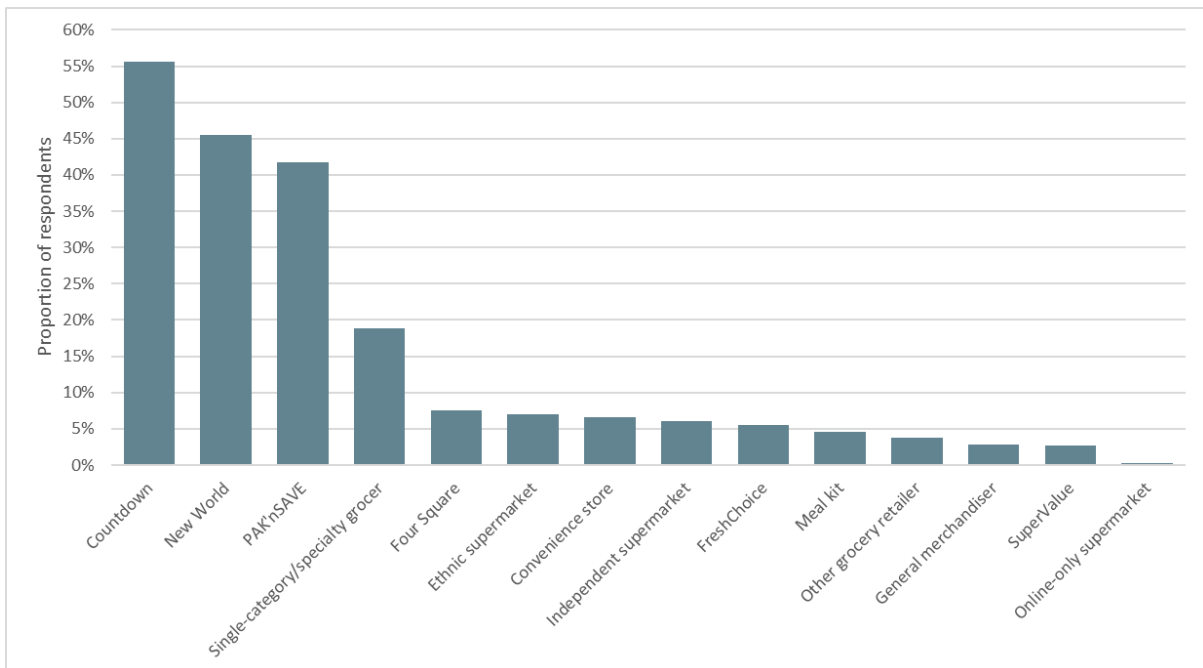
**Where respondents told us they shop in a typical week**

F88 Figure F10 below shows the following:

- F88.1 A large proportion of respondents reported visiting one or more of Countdown, New World and PAK'nSAVE in a typical week. For example, more than half of respondents reported visiting Countdown in a typical week.
- F88.2 Nearly one in five respondents reported visiting a single-category or speciality grocery store (eg, greengrocers, butchers and bakers) in a typical week.
- F88.3 It was uncommon for respondents to report visiting other types of grocery store in a typical week. For example, less than one in 10 respondents reported visiting an ethnic supermarket in a typical week and less than one in 20 reported shopping with a meal kit in a typical week.

F89 However, we did not ask how many times respondents visit each store in typical week. Therefore, we are unable to draw any inference on how frequently respondents visit a store in a typical week, only whether they typically do or not. However, spending estimates shown in Figure F12 provides some insight regarding respondents' expenditure at each of these stores in a typical week.

**Figure F10 Proportion of respondents who reported visiting a given store in a typical week**



Source: Commission analysis based on data from our consumer survey, n=12,097.<sup>1096</sup>

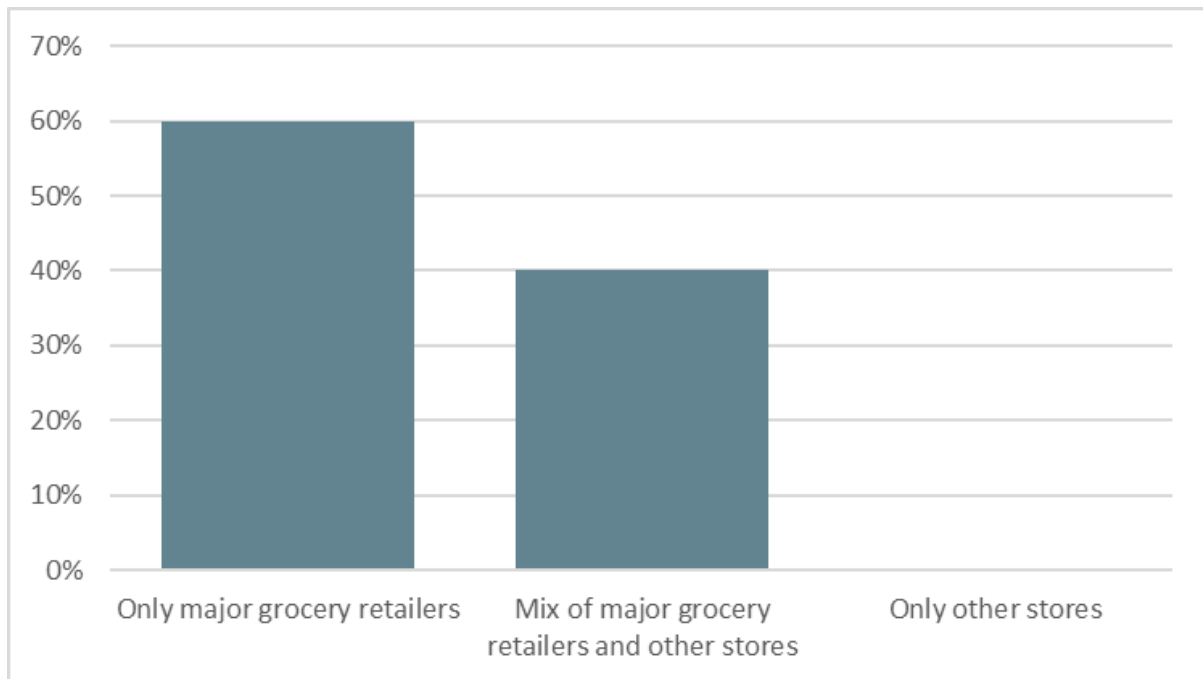
F90 Figure F11 shows that, in a typical week:

F90.1 60% of respondents visit only major grocery retailers;

F90.2 less than 0.5% visit only other stores; and

F90.3 40% visit a mix of major grocery retailers and other stores.

**Figure F11 Proportion of respondents who visit only major grocery retailers, only other stores, or a mix of both types of stores in a typical week**



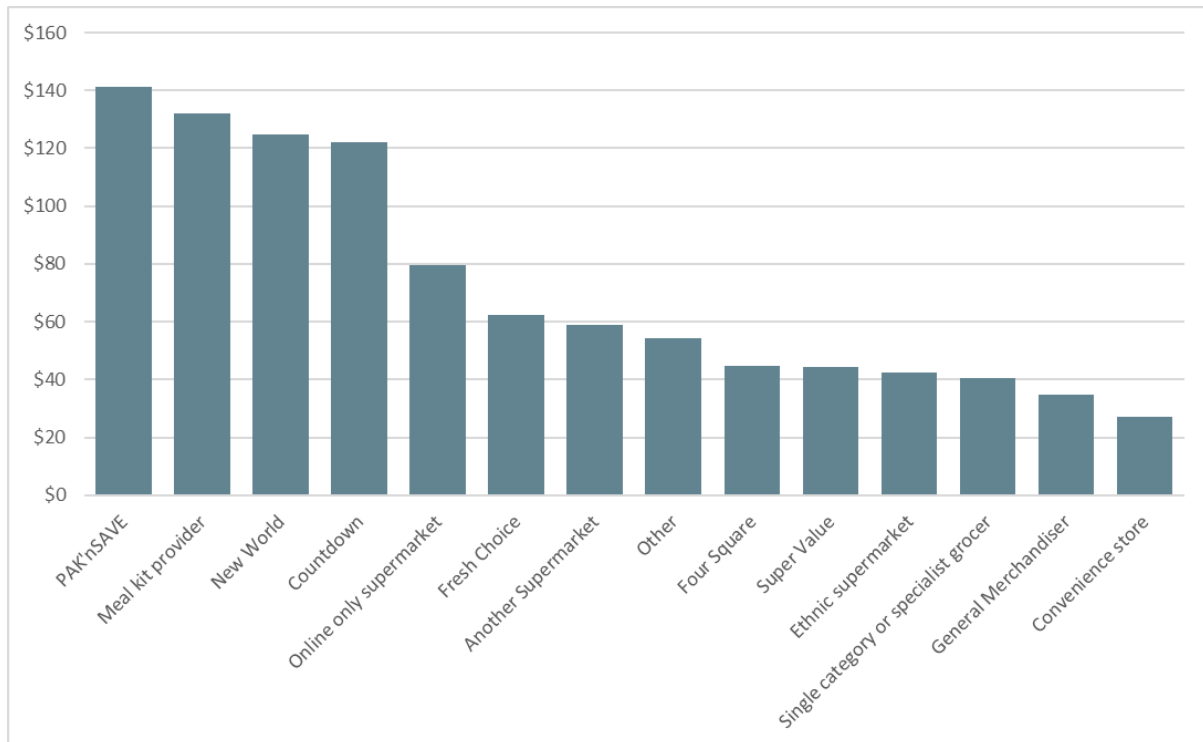
Source: Commission analysis based on data from our consumer survey, n=10,523.<sup>1097</sup>

### How much respondents told us they spend

F91 Figure F12 below shows that respondents who visit Countdown, New World, PAK'nSAVE or use meal kits in a typical week spend nearly twice as much on average as respondents who reported their spending at other stores.

F92 As discussed earlier, we estimated average spending by using the mid-point of spending categories selected by respondents. For example, if respondents stated they spent \$0-\$10 a week at a store, this would be treated as \$5 for the purposes of the estimate. Therefore, it is important to interpret our spending estimates as an indication of how much respondents' may spend in a typical week.

**Figure F12 Average spend at each store in a typical week for respondents who said they visited the given store**



Source: Commission analysis based on data from our consumer survey, n=12,097.<sup>1098</sup>

- F93 Figure F13 shows average spending by respondents who only visit major grocery retailers, only visit other stores or a mix of both.
- F94 Figure F13 shows that the level of average spending by respondents varies across all stores. Only Countdown, New World and PAK'nSAVE have similar and high levels of spending. This high level of spending is regardless of whether a respondent only shops at only that store, or at a mix of both major grocery retailers and other stores.
- F95 Average spending in a typical week also appears to vary depending on whether respondents shop only at major grocery retailers, only at other retailers, or a mix of stores. Figure F13 shows:
- F95.1 average spending at other stores is generally higher if respondents only shop at other stores compared to respondents who shop at a mix of stores. However, we recognise the sample of respondents who shop at other retailers is very small and so this finding may not be representative of consumers in New Zealand,<sup>1099</sup> and

<sup>1098</sup>

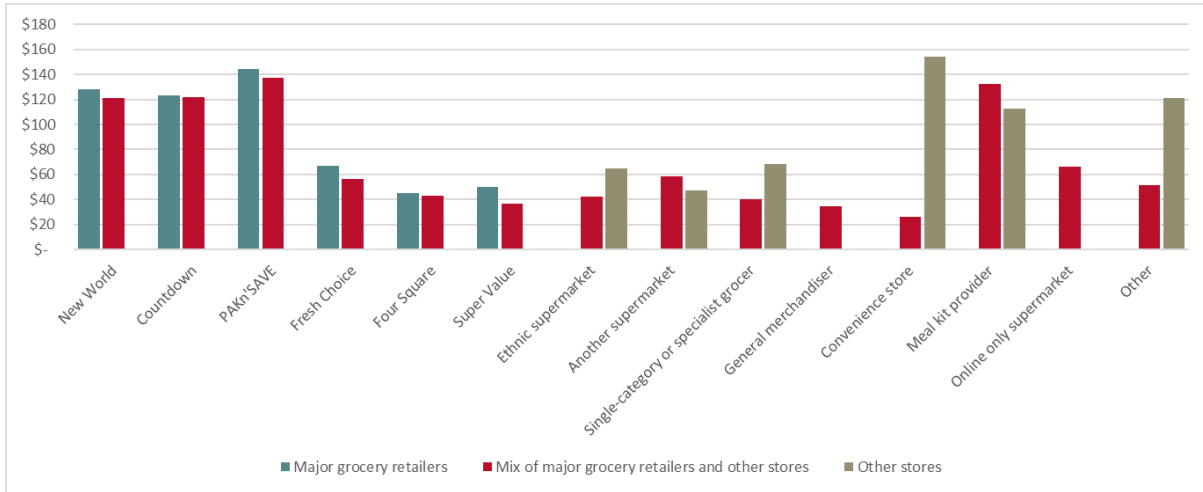
[ ].

<sup>1099</sup>

From the sample of respondents used to estimate Figure F13, a total of 36 respondents shop at other retailers and the sample of respondents shopping at individual other retailers ranges from two to 12 respondents. For example, two respondents used meal kit providers and 12 respondents bought groceries from other stores.

F95.2 there is little difference in average spending at major grocery retailers by respondents who shop only at major grocery retailers or a mix of stores.

**Figure F13 Average spending by respondents who only visit only major grocery retailers, only other stores or a mix of both types of store in a typical week<sup>1100</sup>**



Source: Commission analysis based on data from our consumer survey, n=2 to n=3,919.<sup>1101</sup>

**Respondents' choice of main store(s)**

F96 We asked respondents what their main grocery store was. Respondents could choose up to two stores. We explained to respondents that their “main store” was defined as “the store you spend most at or do most of your grocery shopping with”.

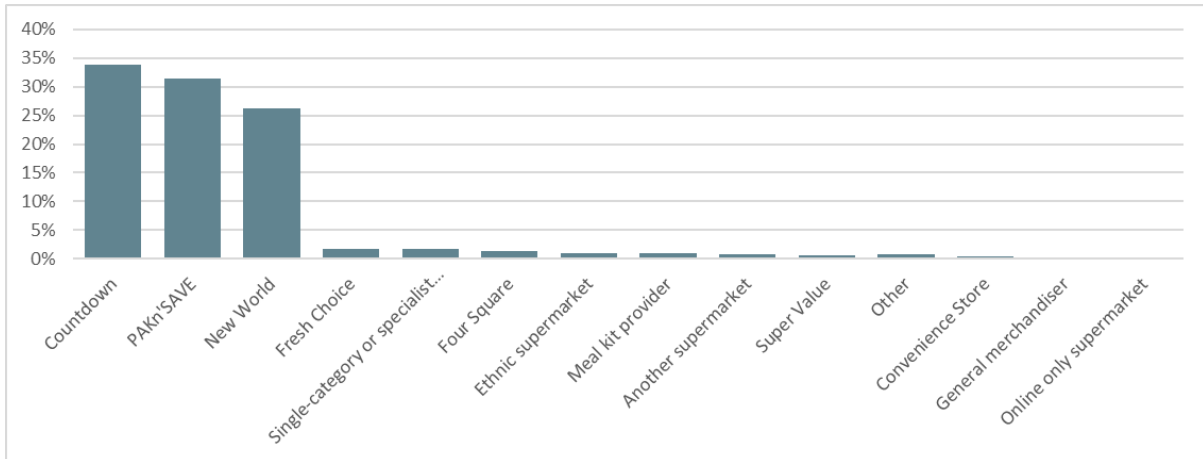
F97 Figure F14 below shows that most respondents (91%) reported Countdown, New World and PAK’nSAVE as one of their main store(s).<sup>1102</sup>

<sup>1100</sup> The sample size ranges from two for respondents who only visit other stores/services and one of those other services is meal kits up to 3,919 for respondents who only visit major grocery retailers and one of those major grocery retailers is Countdown.

<sup>1101</sup> [ ].

<sup>1102</sup> The totals of these proportions may sum to >100% due to respondents being able to select two options. We chose not to reweight respondents who provided two options, as we considered this would cause proportions for some stores to be misreported. Sensitivity testing indicates this reweighting would increase the relative proportion of respondents who reported a major grocery retailer as their main store, and decrease the relative proportion of respondents who selected another type of retailer as their main store.

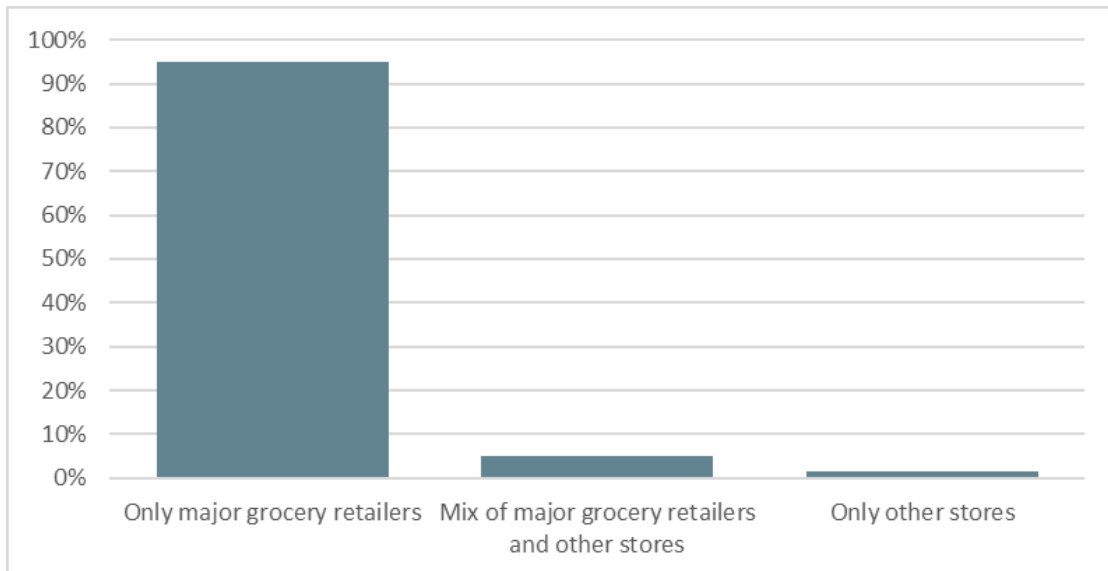
**Figure F14 Proportion of respondents who report a store as their main store, or one of their main stores**



Source: Commission analysis based on data from our consumer survey, n=12,097.<sup>1103</sup>

F98 Figure F15 shows that most respondents (95%) reported only major grocery retailers as their main store(s). This means that out of the respondents who reported one main store, most told us their main store was a major grocery retailer; and out of the respondents who reported two main stores, most told us their two main stores were major grocery retailers.

**Figure F15 Proportion of respondents who report main store(s) which were only major grocery retailers, only other stores, or a mix of both types of stores**



Source: Commission analysis based on data from our consumer survey, n= 11,730.<sup>1104</sup>

1103 [ ].  
 1104 [ ].

F99 We also see that there is the same overall trend in respondents' choice of main stores across New Zealand as shown in Figure F14, as respondents' choice of main stores across different regions in Figure F16.

F100 However, there are some slight differences in respondents' main stores across different regions. We find the following:

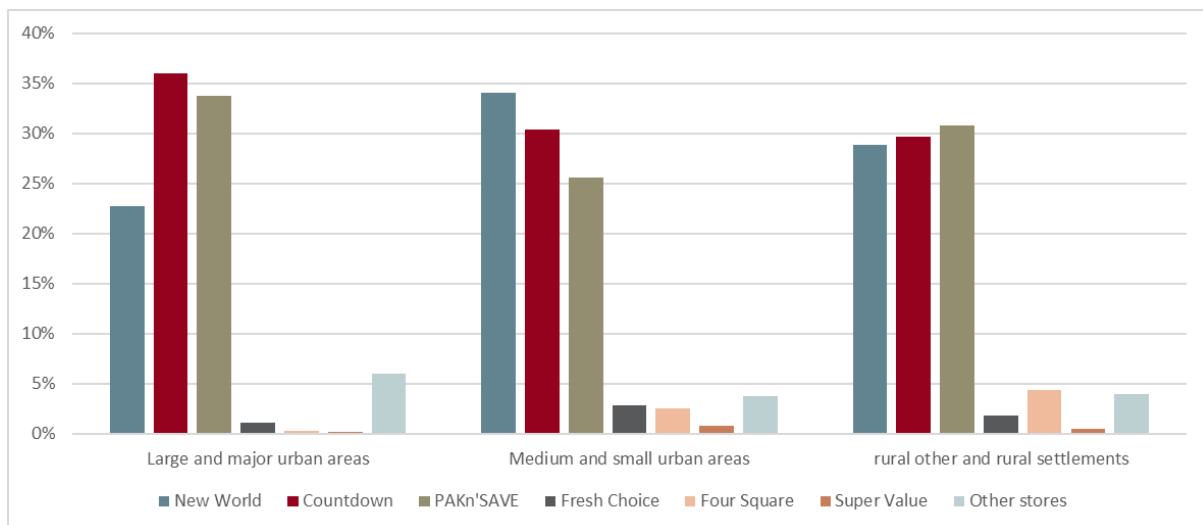
F100.1 more respondents told us Four Square and Fresh Choice are one of their main stores in rural areas and medium and small urban areas compared to large and major urban areas;

F100.2 fewer respondents told us New World is their main store in large and major urban areas compared to other areas;

F100.3 more respondents told us Countdown is their main store in large and major urban areas compared to other areas; and

F100.4 fewer respondents told us PAK'nSAVE is their main store in small and medium urban areas compared to other areas.

**Figure F16 Proportion of respondents who report each store as one of their main store(s) by region**



Source: Commission analysis based on data from our consumer survey, n=1253 to n=8379. The sample size ranges from 1253 in rural other and rural settlements to 8379 in large and major urban areas.<sup>1105</sup>

## How respondents told us they get to their main store

F101 We asked respondents how they usually travel to their main store, and how long it usually takes them to get there. We found:

F101.1 most respondents said they usually drive to their main store;

F101.2 most respondents said they usually travel less than 10 minutes to their main store; and

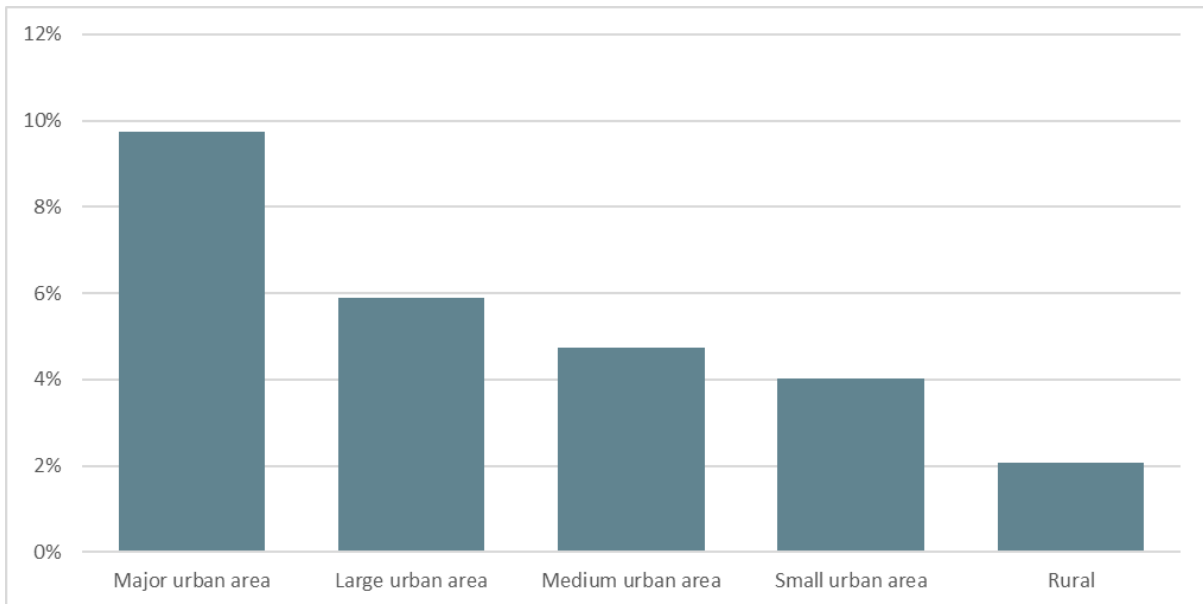
F101.3 respondents in more rural areas were more likely to drive and tended to take longer to get to their main store.

F102 The responses only covered how respondents travel to their main store. Consumers' mode of travel, and travel times, may differ for other types of shopping trips (such as top us shops).

**Most respondents said they drive to their main store**

F103 More than nine in 10 respondents said they usually drive to their main store. As shown in Figure F17 below, this tended to be higher in smaller urban and rural areas (eg, 98% of rural respondents drive to their main store).

**Figure F17 Proportion of respondents who do not usually drive to their main store**



Source: Commission analysis based on data from our consumer survey, n=11,328.<sup>1106</sup>

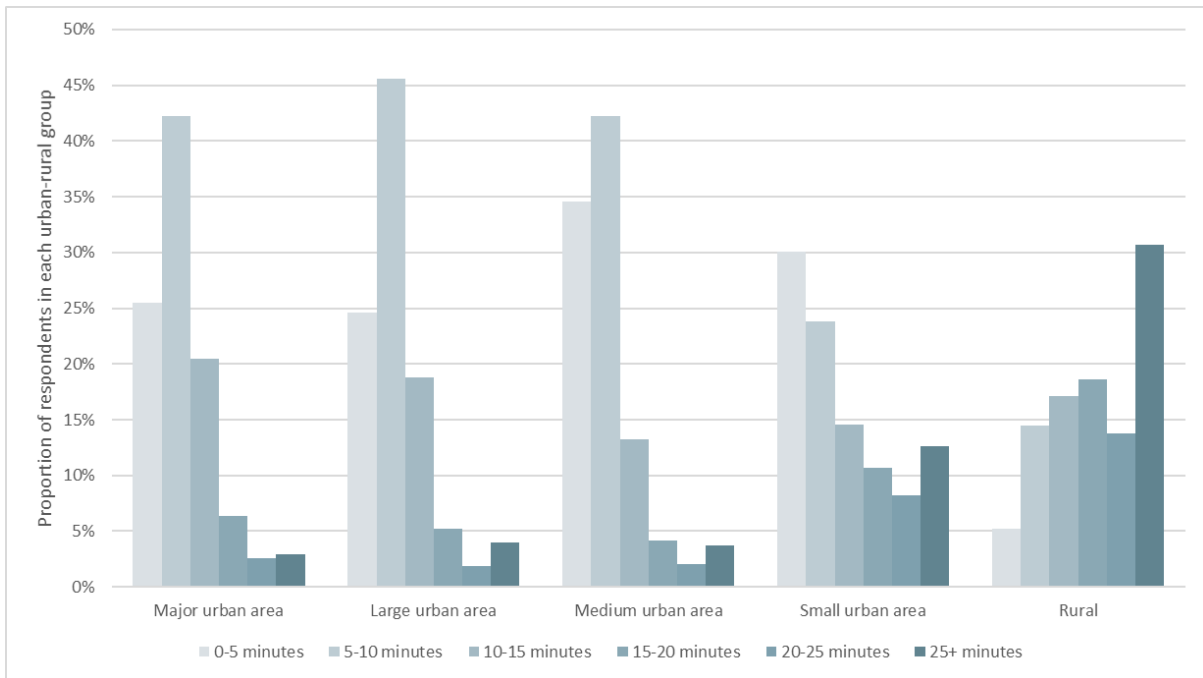
**Most respondents do not usually drive more than five to 10 minutes to their main store**

F104 On average, respondents in medium, large and major urban areas said they usually travel less than 10 minutes to their main store. Respondents in rural areas, on average, said they travel almost 20 minutes to their main store. Approximately a quarter of urban respondents said they travel less than five minutes to their main store. A summary of this analysis is shown in Figure F18 below.

<sup>1106</sup> [ ].

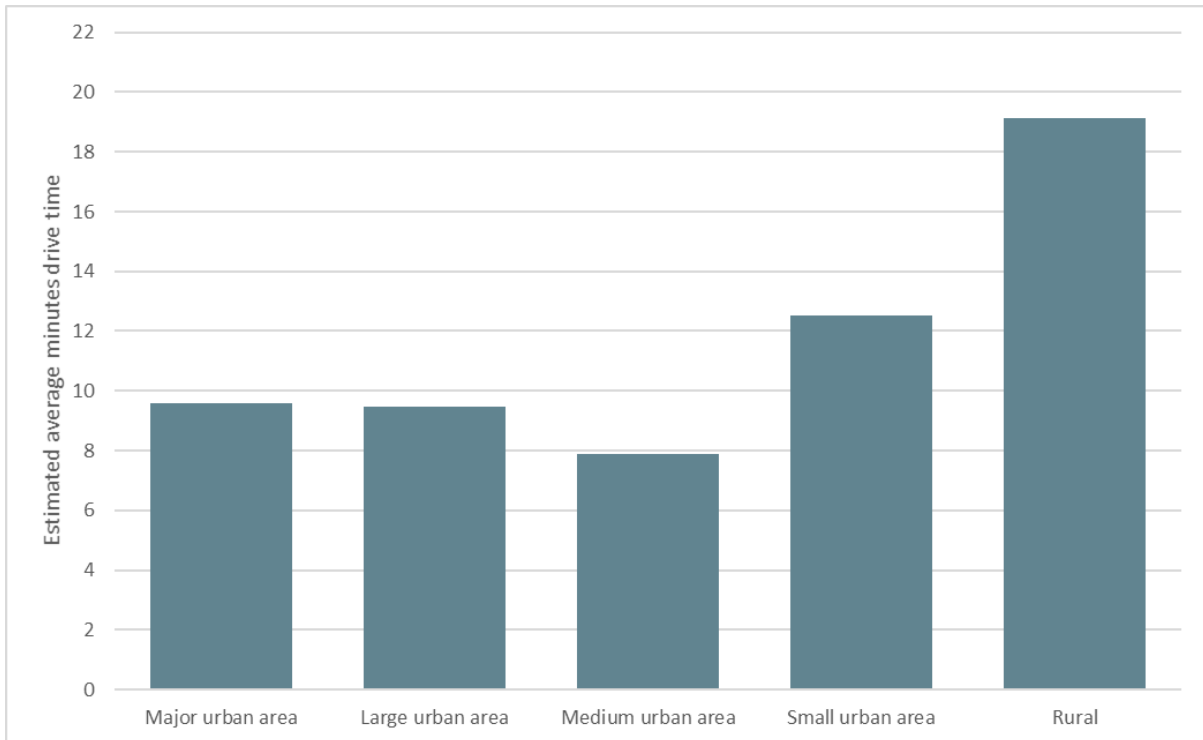


**Figure F18 How long it usually takes respondents to get to their main store**



Source: Commission analysis based on data from our consumer survey, n=10,363.<sup>1107</sup>

**Figure F19 Average time it takes respondents to drive to their main store**



Source: Commission analysis based on data from our consumer survey, n=6,534.<sup>1108</sup>

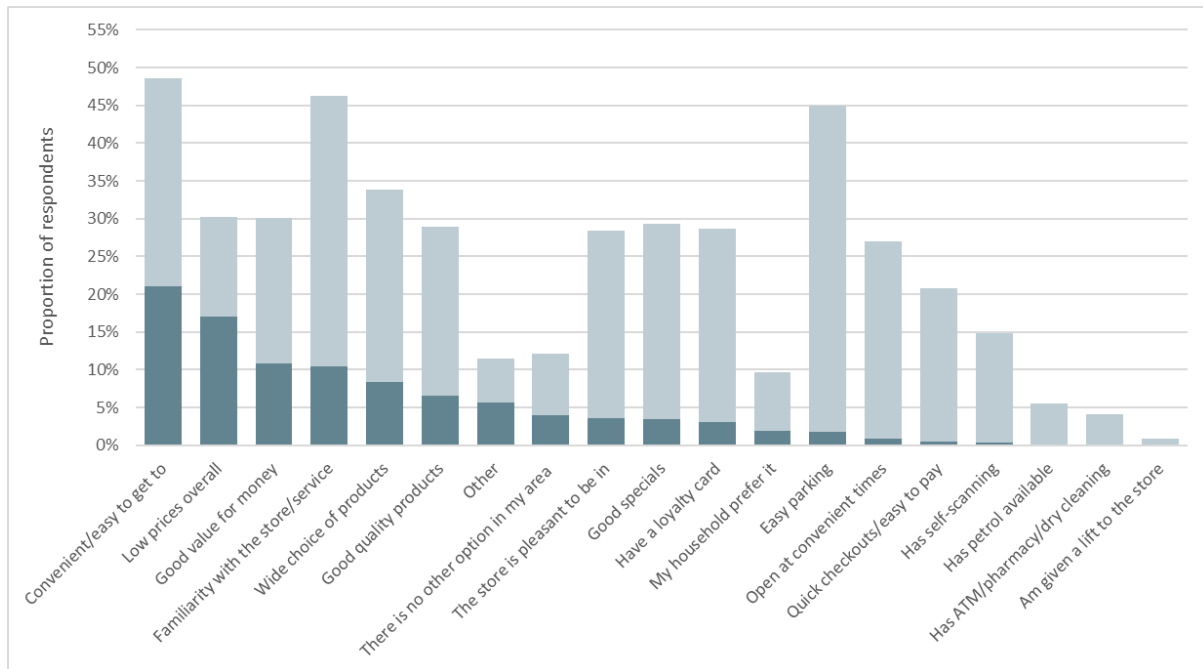
1107 [ ].  
 1108 [ ].

## Why respondents choose to shop at their main store

- F105 We asked respondents to select from a range of 19 options (including a free-text box) to reflect why they choose to shop at their main store. There was a wide range of reasons why respondents said they choose to shop at their main store. However, convenience and low prices were the most common key drivers.
- F106 Figure F20 below shows respondents' stated reasons for shopping at their main store. For this question, respondents could select as many reasons that they felt applied.

### Convenience and low prices are key drivers of store choice

- F107 Many respondents said they value attributes such as easy parking, convenient opening times and good specials. However, very few respondents consider any of these to be the single most important reason they shop at their main store.
- F108 This is illustrated by Figure F20 below. The total bar shows the proportion of respondents who considered the attribute to be a reason for their main store choice, when they could select multiple options (eg, 30% considered "low prices overall" one of the reasons they shop at their main store). The smaller, dark blue bars is the proportion of respondents who considered the attribute to be the single most important reason for their choice of main store (eg, just over 15% considered "low prices overall" the single most important reasons for their main store choice).
- F109 Some drivers of main store choice which are very common when multiple options are allowed, are very uncommon key drivers of main store choice. For example, 45% of respondents said 'easy parking' was one reason for their main store choice, however less than 1% considered it the single most important reason.
- F110 The dark blue bars show that convenience and low prices were the most common key drivers of main store choice. For this question, respondents could only select the single most important reason why they choose to shop at their main store.

**Figure F20 Why respondents said they shop at their main store**

Source: Commission analysis based on data from our consumer survey, n=11,880.<sup>1109</sup>

### There is some geographic variance in the key drivers of store choice

F111 As shown in Table F3 below, respondents' key drivers of store choice varied depending on where they lived in. Of note:

F111.1 "there is no other option in my area" was the most common key driver of main store choice for those in small urban areas;

F111.2 "convenient/easy to get to" was a more common key driver for those in larger urban areas, such as Auckland, than in smaller urban or rural areas; and

F111.3 a larger proportion of respondents in smaller urban areas selected "Familiarity with the store/service" than in larger urban areas.

**Table F3 Single most important drivers of store choice, by urban-rural**

Ranking	Major urban area	Large urban area	Medium urban area	Small urban area	Rural
1	Convenient/easy to get to	Convenient/easy to get to	Convenient/easy to get to	There is no other option in my area	Low prices overall
2	Low prices overall	Low prices overall	Low prices overall	Convenient/easy to get to	Familiarity with the store/service
3	Good value for money	Familiarity with the store/service	Good value for money	Low prices overall	Convenient/easy to get to
4	Familiarity with the store/service	Good value for money	Familiarity with the store/service	Familiarity with the store/service	Good value for money
5	Wide choice of products	Wide choice of products	Wide choice of products	Wide choice of products	Wide choice of products

Commission analysis based on data from our consumer survey, n=9,047.<sup>1110</sup>

### Where respondents said they would shop if their main store(s) closed

- F112 We asked respondents where they would shop if their main store(s) closed for the foreseeable future. We gave respondents the option to choose up to 12 types of stores, modified to account for their main store as respondents could select “I would go to the same store in a different location, or use the same type of store/service somewhere else.”
- F113 We asked this question to understand which stores respondents considered to be their best alternative if their main store was unavailable. We asked this question to see which stores respondents consider are the closest substitutes to their main store.
- F114 If respondents consider a store to be their best alternative to their current offering, this could be an indication that the two stores are competing closely, at least compared to stores which are not considered close alternatives.
- F115 We considered that it was important to phrase the question based on respondent’s best alternatives if their current store was closed. This was because this was easier for respondents to understand compared to hypothetical pricing scenarios.
- F116 However, this means that while we can understand which stores respondents consider to be the closest alternatives for each other, we are not able to infer that the closest alternatives are competing closely with each other. This is because a consumer might choose to go to a particular store if their current store is unavailable but would not switch store even if faced with a significant reduction to their current offering, such as higher prices.

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<sup>1110</sup>

[ ].

- F117 It is important to note that multiple factors may influence a consumer's choice of store such as location, quality and range and some consumers are more likely to switch stores in response to changes in these factors than others.<sup>1111</sup> We also discuss the limitations of this analysis above in paragraph F41 above.
- F118 Despite this, our analysis can provide information on whether other stores have the potential to be competing with Countdown, New World and PAK'nSAVE based on how many respondents who would shop at Countdown, New World and PAK'nSAVE or other stores if their main store closed. In addition, it can also provide information on our view of the market definition. These are discussed in more detail in Chapter 3 and Chapter 4.
- F119 In addition to looking at respondents' choice of main store by region, we also looked at where respondents would shop if their main store(s) closed by region as these two questions are related.

*Main findings on where respondents would shop if their main store(s) closed*

F120 Our main findings are that:

- F120.1 just over half of respondents would shop at Countdown, New World or PAK'nSAVE if their main store closed. We found this result did not vary across different types of regions;
- F120.2 most respondents who reported one of the major grocery retailers as their main store would shop at the same retail banner in a different location or same type of retail banner, or a major grocery retailer; and
- F120.3 most respondents who said they would shop at the same retail banner in a different location or same type of retail banners as their main store reported New World, Countdown or PAK'nSAVE, or a combination of two of these stores.

F121 These findings indicate that respondents report that they would switch to similar types of stores to their main stores and stores they would shop at in a typical week.

*Which stores respondents would shop at if their main store(s) closed*

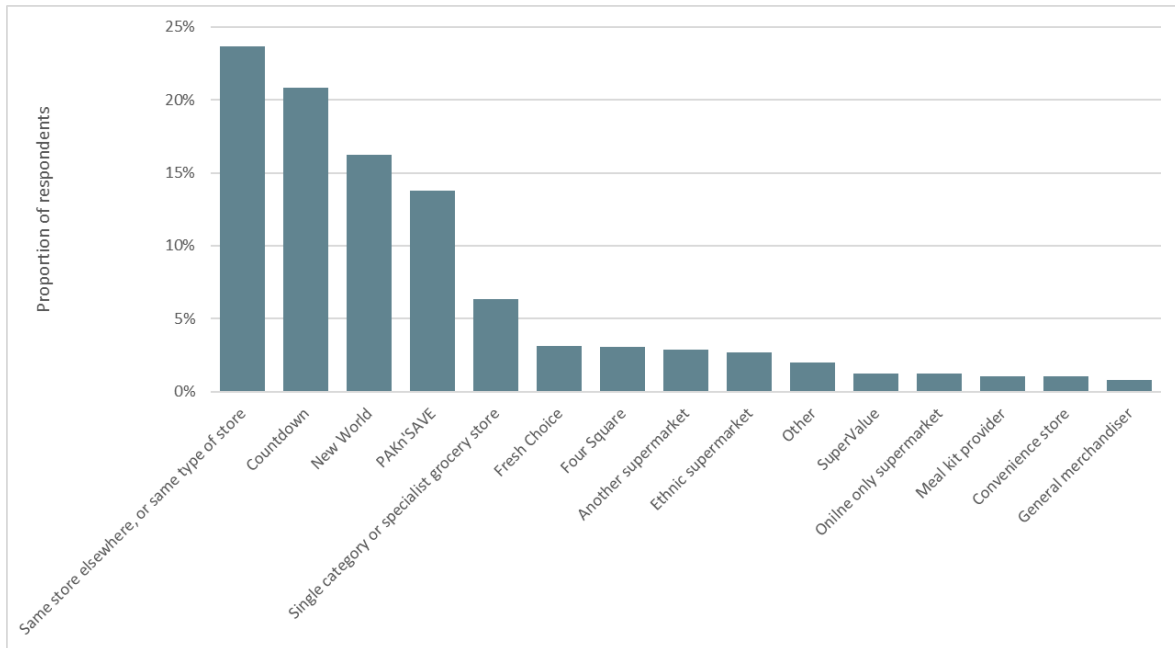
F122 Figure F21 below shows that 51% of respondent would shop at New World, Countdown and PAK'nSAVE if their main store closed, and 24% would shop at the same store or same type of store as their main store.<sup>1112</sup> Same store largely refers to New World, Countdown and PAK'nSAVE as 98% of respondents who told us they would shop at the same store if their main store closed, reported that at least one of their mains store was New World, Countdown and/or PAK'nSAVE.

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<sup>1111</sup> CMA "[Good practice in the design and presentation of consumer survey evidence in merger cases](#)" (May 2018) at 35.

<sup>1112</sup> Respondents could select 'I would go to the same store in a different location or use the same type of store/service somewhere else'.

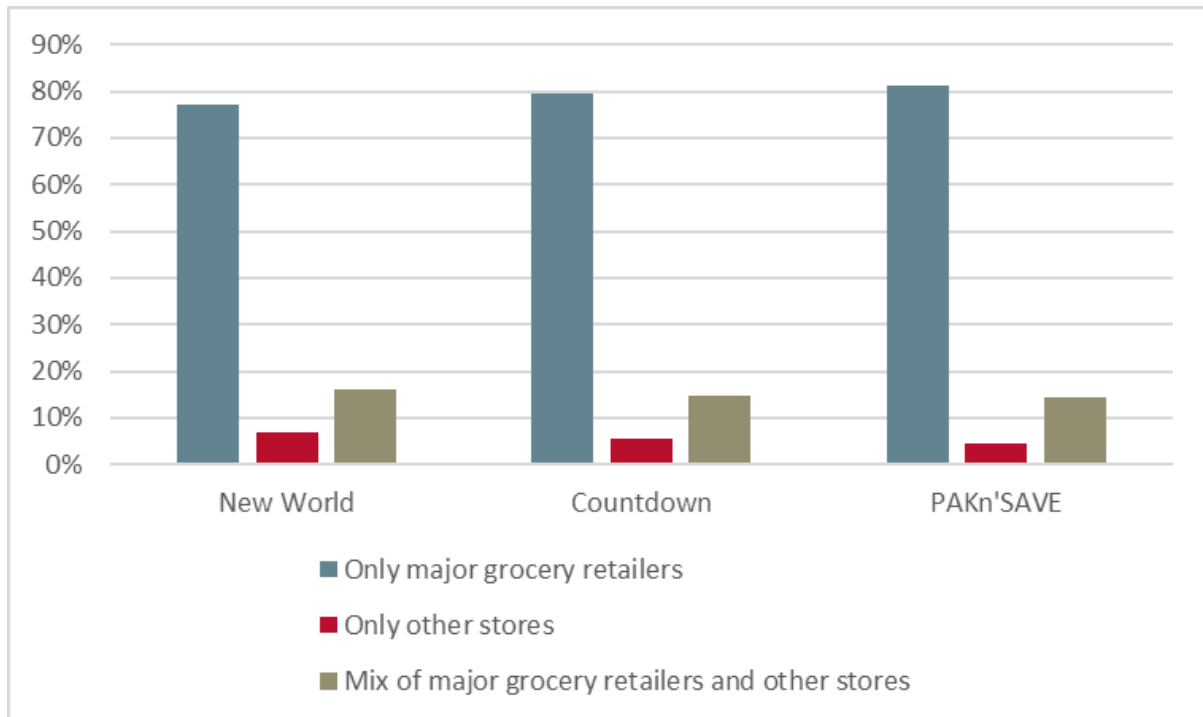
**Figure F21 Proportion of respondents who would shop at a store if their main store(s) closed**



Source: Commission analysis based on data from our consumer survey, n=12,097.<sup>1113</sup>

F123 Figure F22 below shows that over 77% of respondents who shop at a major grocery retailer would switch their shopping to only the major grocery retailers if they reported their main store as Countdown, New World or PAK'nSAVE. This is relevant as most respondents reported these stores as one of their main stores.

**Figure F22 Type of stores respondents said they would switch to if their main store closed, grouped by respondents' main store choice**



Source: Commission analysis based on data from our consumer survey, n=3,700 to 4,775. The sample size ranges from 3,700 for New World customers to 4,775 for Countdown customers.<sup>1114</sup>

F124 Figure F23 shows that most respondents would shop at New World, PAK'nSAVE or Countdown if their current main store closed across different regions. These results are similar to respondents' choice of substitute store across New Zealand as shown in Figure F21 and respondents' choice of main store across regions in Figure F16 above.

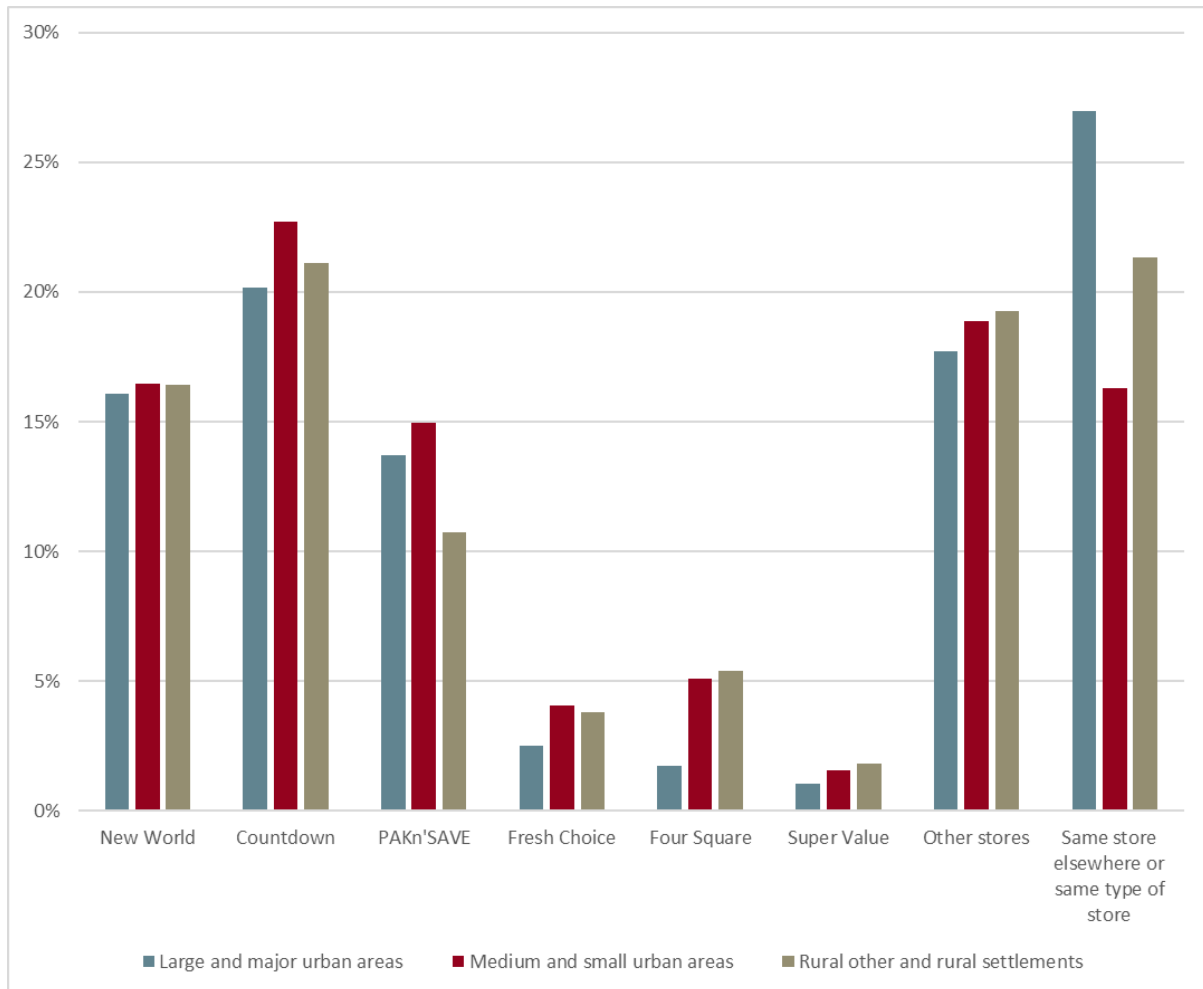
F125 However, there are some slight variations across region:

F125.1 fewer respondents told us they would shop at the same store in a different location or same type of store in small and medium urban areas compared to other areas;

F125.2 fewer respondents told us they would shop at PAK'nSAVE in other rural and rural settlements compared to other areas; and

F125.3 more respondents told us they would shop at Four Square or FreshChoice in urban areas compared rural areas.

**Figure F23 Proportion of respondents who would shop at a store if their main store closed, by region**



Source: Commission analysis based on data from our consumer survey, n=1,515 to 10,818. The sample size ranges from 1,515 in rural other and rural settlements to 10,818 in large and major urban areas.<sup>1115</sup>

## How respondents compare and choose grocery products

F126 We asked respondents some questions about how they choose what products to purchase. These were:

F126.1 how often do you check unit pricing on products (where available)?

F126.2 how often do you usually compare prices between similar products when grocery shopping (eg, three different brands of laundry detergent)?

F126.3 which of these best describes which brands of grocery products you buy?

F127 As discussed at paragraph F39, some respondents may have over-reported the frequency with which they check unit prices or compare prices between products.

<sup>1115</sup> [ ].

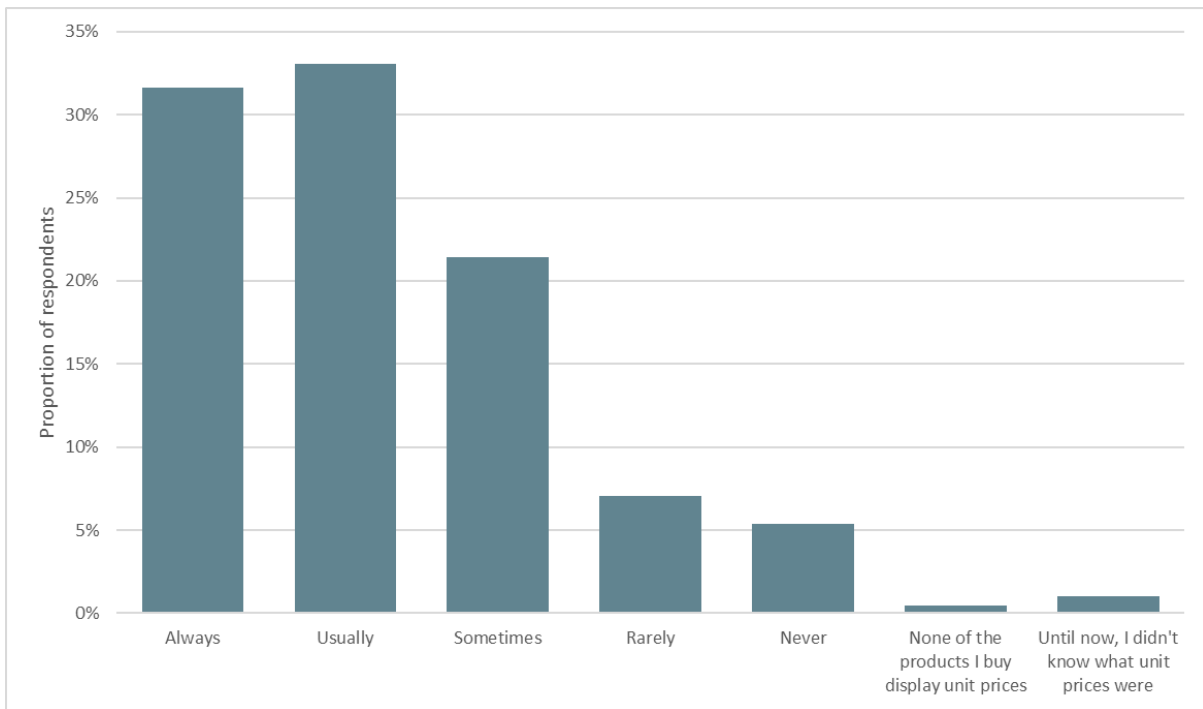


**Respondents report a high rate of checking unit pricing**

F128 Almost two thirds of respondents reported always or usually checking unit pricing, where available, when grocery shopping. A very small proportion of respondents stated they did not know what a unit price was, indicating most respondents had at least a general awareness of the practice.

F129 The question provided an example of unit pricing to ensure respondents would be able to easily understand the question (see Figure F25 below). Therefore, any confusion regarding what is meant by a unit price is likely to be minimal.

**Figure F24 Reported use of unit price**



Source: Commission analysis based on our consumer survey data, n=12,083.<sup>1116</sup>

1116 [ ].

**Figure F25 How the unit price question was displayed to respondents**

**How often do you check unit pricing on products (where available)?**

Never  
 Rarely  
 Sometimes  
 Usually  
 Always  
 None of the products I buy display unit prices  
 Until now, I didn't know what unit prices were

*Here is what unit pricing looks like*

**JASMINE RICE 5 KG \$12.99**  
 26 cents per 100 grams  
 ↑  
 Unit price

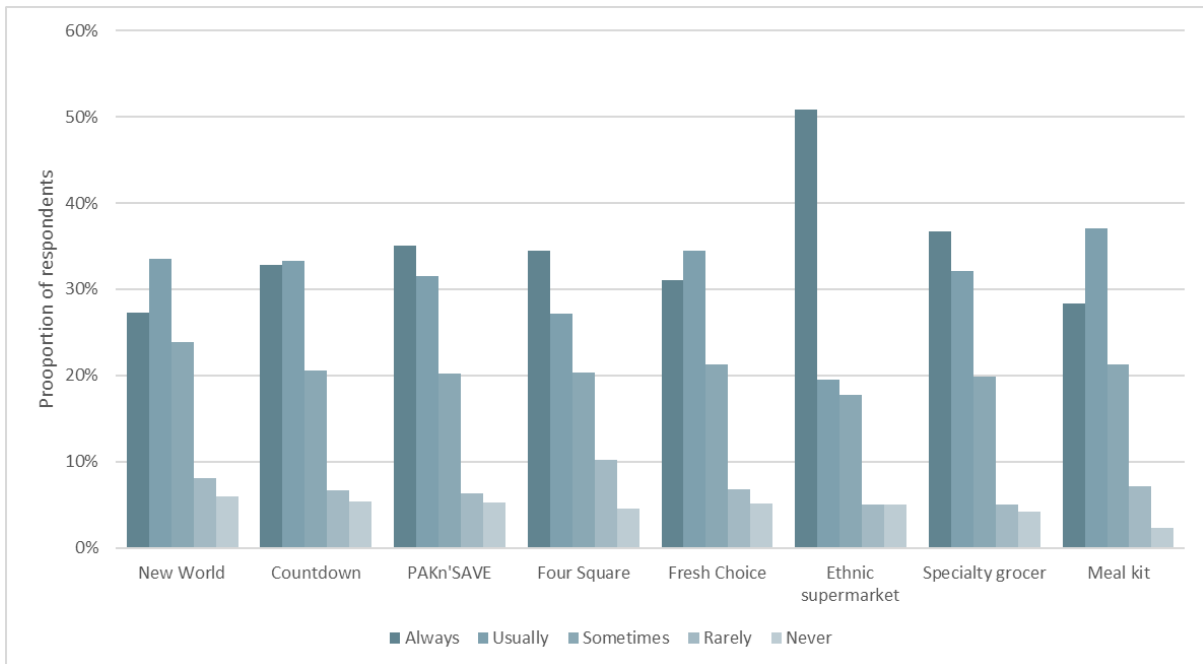
**JASMINE RICE 1 KG \$3.99**  
 40 cents per 100 grams  
 ↑  
 Unit price

[Previous](#) [Next](#)

*Reported use of unit pricing does not vary much between the main retail banners*

- F130 Reported checking of unit price is relatively consistent between PAK'nSAVE, Countdown and New World (albeit slightly less frequent for New World shoppers).
- F131 Reported checking of unit price appears higher for other retailers, for example ethnic supermarkets. However, given the relatively small sample sizes for these groups ( $n < 100$ ), additional care should be taken when reviewing these results.

**Figure F26 Reported use of unit price, by retail banner**

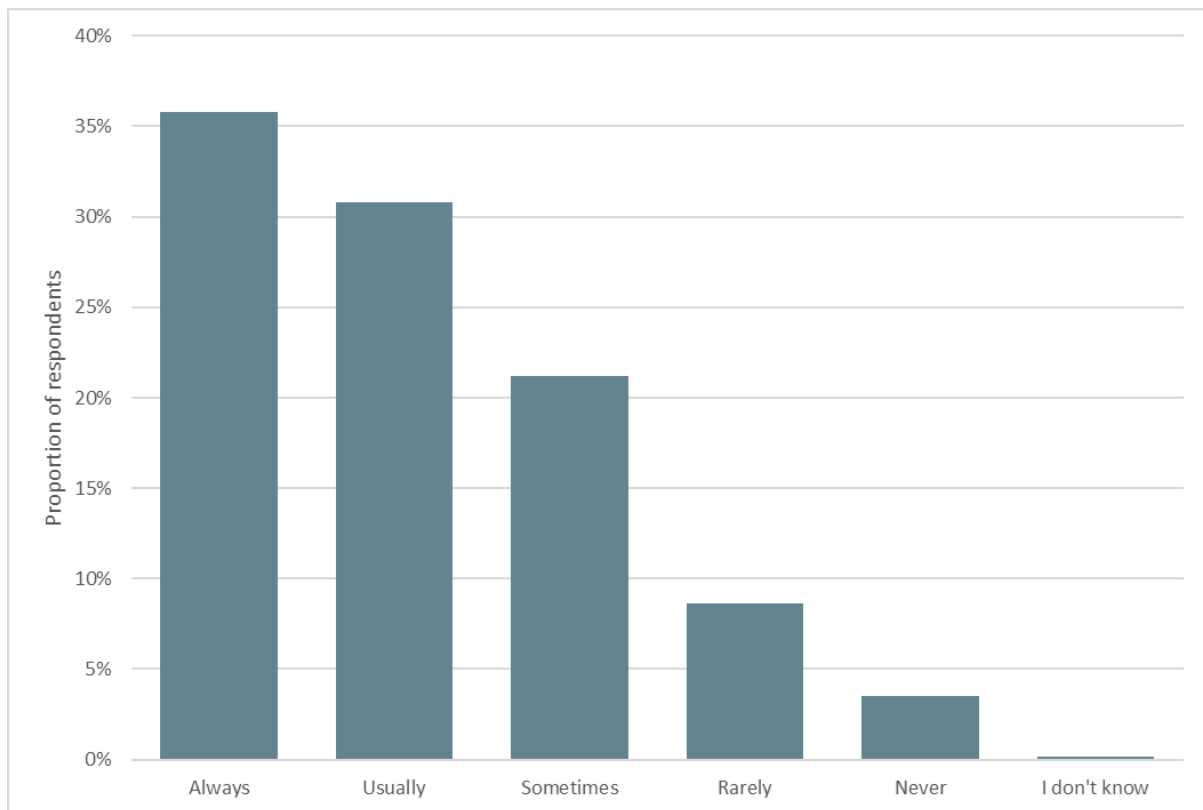


Source: Commission analysis based on our consumer survey data, n=10,287.<sup>1117</sup>

**Respondents also said they often compare prices between products**

F132 Similar to the responses regarding unit pricing, two thirds of respondents said they ‘usually’ or ‘always’ compare prices between similar products when grocery shopping, as shown in Figure F27 below.

1117 [ ].

**Figure F27 Reported checking of prices between similar products**

Source: Commission analysis based on our consumer survey data, n=12,067.<sup>1118</sup>

## What respondents told us about how they use grocery loyalty programmes

**F133** We asked respondents a range of questions about their experiences with grocery loyalty programmes. This included what programmes they were members of, why they signed up for the programmes, and how closely they read the terms and conditions when registering.

**F134** Respondents could select from five options in the survey:

F134.1 Clubcard (New World);

F134.2 Airpoints (New World);

F134.3 Onecard (Countdown);

F134.4 AA Smartfuel (Countdown); and

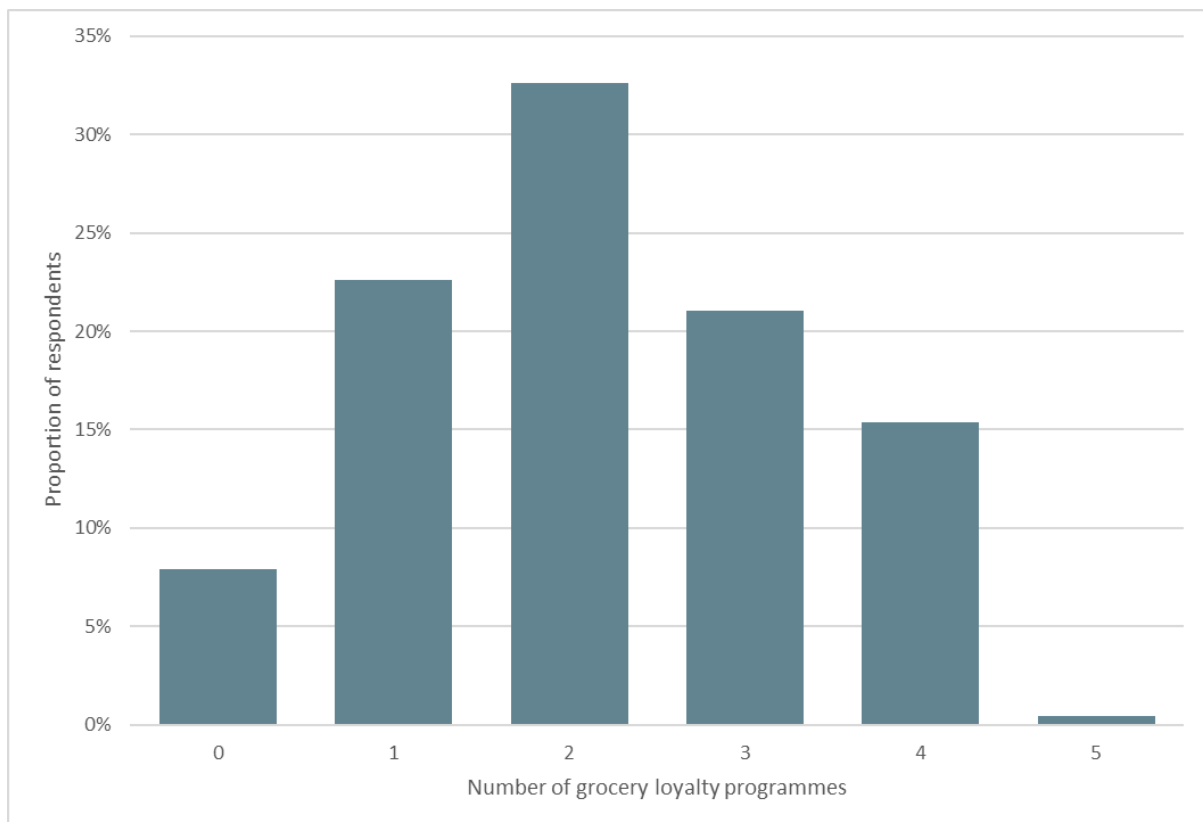
F134.5 Other (free text).

- F135 Flybuys is also an option at New World stores. This option was inadvertently missed from the survey script. Foodstuffs made us aware of this omission in the latter stages of the survey being live; however, by this stage it was impractical to amend the script.
- F136 This omission may have resulted in the under-reporting in the number of respondents who are members of the Flybuys programme. It is possible this may have had some effect on our results, however responses to questions about loyalty programmes did not seem to vary depending on what programmes were a member of. Additionally, respondents had the ability to provide a free-text response regarding what programme they are a member of.<sup>1119</sup>

### Most respondents are a member of a grocery loyalty programme

- F137 Nine in 10 respondents are a member of at least one grocery loyalty programme. On average, these respondents are member of 2.3 programmes. This appears consistent with figures about loyalty programme membership contained in research provided by the major grocery retailers.<sup>1120</sup>

**Figure F28 Number of loyalty programmes respondents are a member of**



Source: Commission analysis based on our consumer survey data, n=12,097.<sup>1121</sup>

<sup>1119</sup> Approximately 78 out of 328 respondents provided “Flybuys” as a free-text response to this question.

<sup>1120</sup> For example: [ ];

[ ].

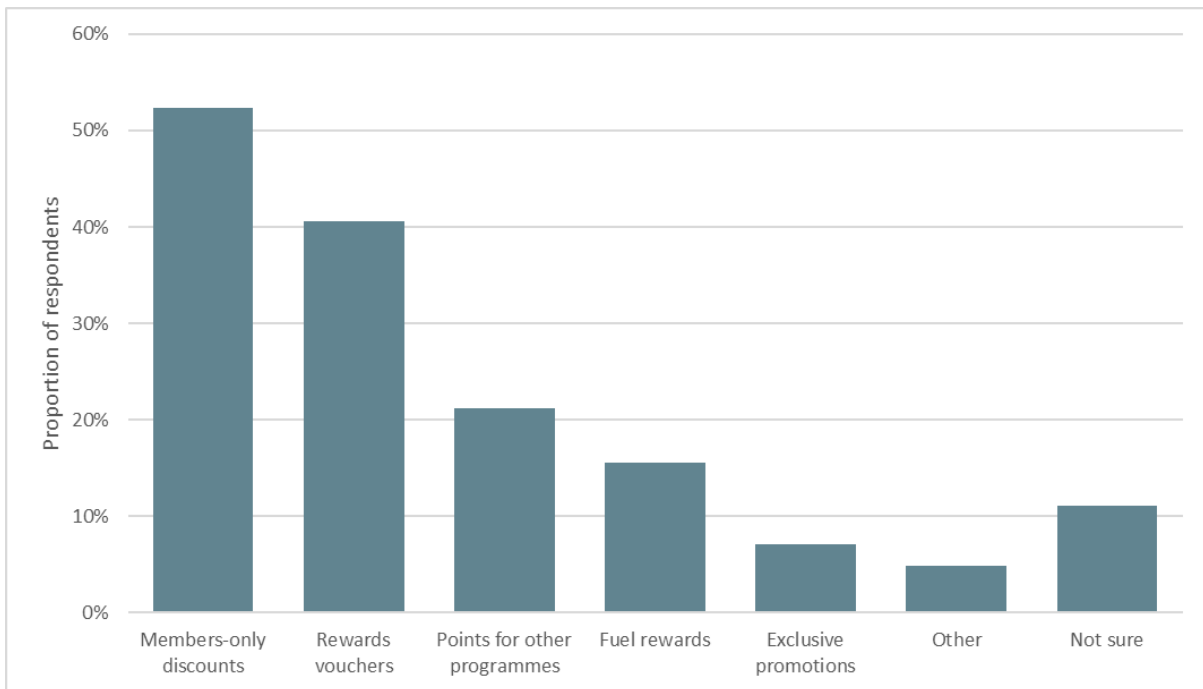
<sup>1121</sup> [ ].

**Member-only discounts were the most common reasons respondents signed up for their respective loyalty programme**

F138 Respondents said they signed up for loyalty programmes for a range of reasons. Figure F29 below shows that the most common reasons why respondents signed up for the grocery loyalty programme they use most often.

F139 For this question, we provided respondents a list of seven reasons why they signed up for the programme they use most often. Respondents could select multiple options or provide a free-text response if their reason was not listed.

**Figure F29 Respondents’ reasons for joining their main loyalty programme**



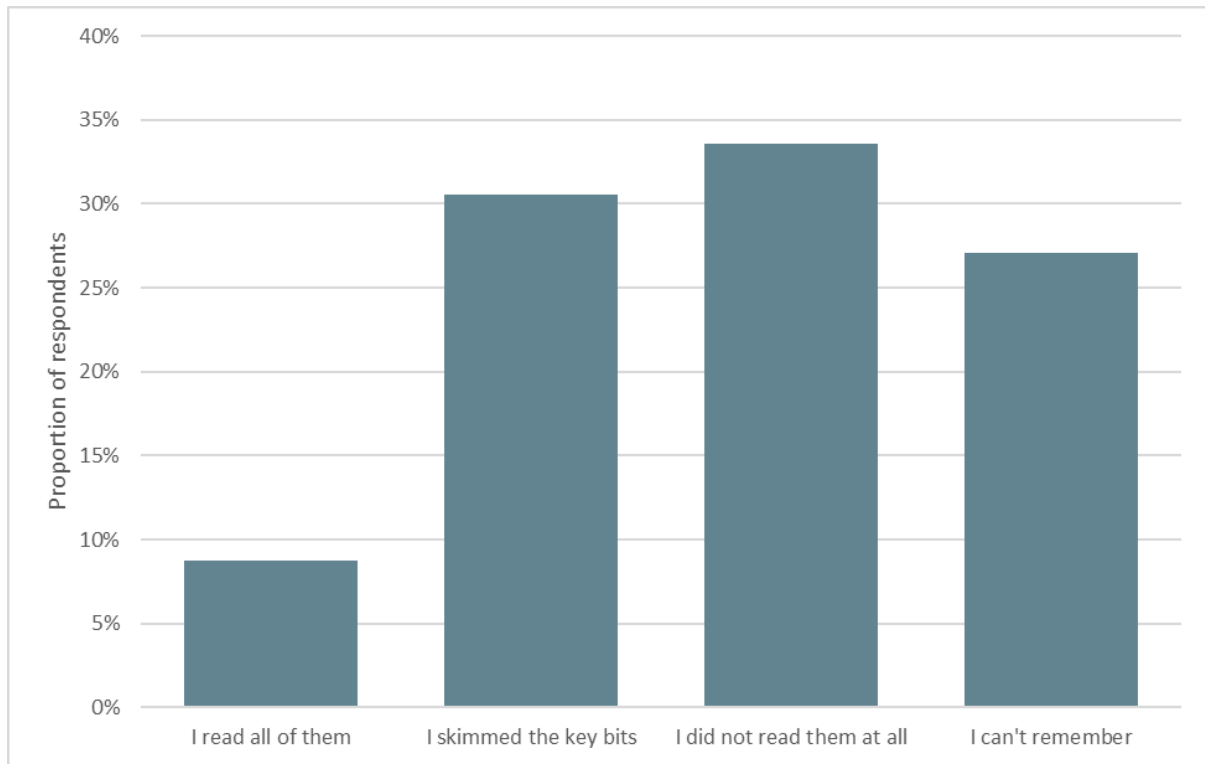
Source: Commission analysis based on our consumer survey data, n=11,141.<sup>1122</sup>

**Less than one in 10 respondents said they read all the terms and conditions of the loyalty programme they use most often**

F140 When respondents who are members of a grocery loyalty programme were asked how closely they read the relevant terms and conditions most did not read all of them or could not remember.

<sup>1122</sup> [ ].

**Figure F30** How closely respondents reported reading the terms and conditions of the programme the use most often

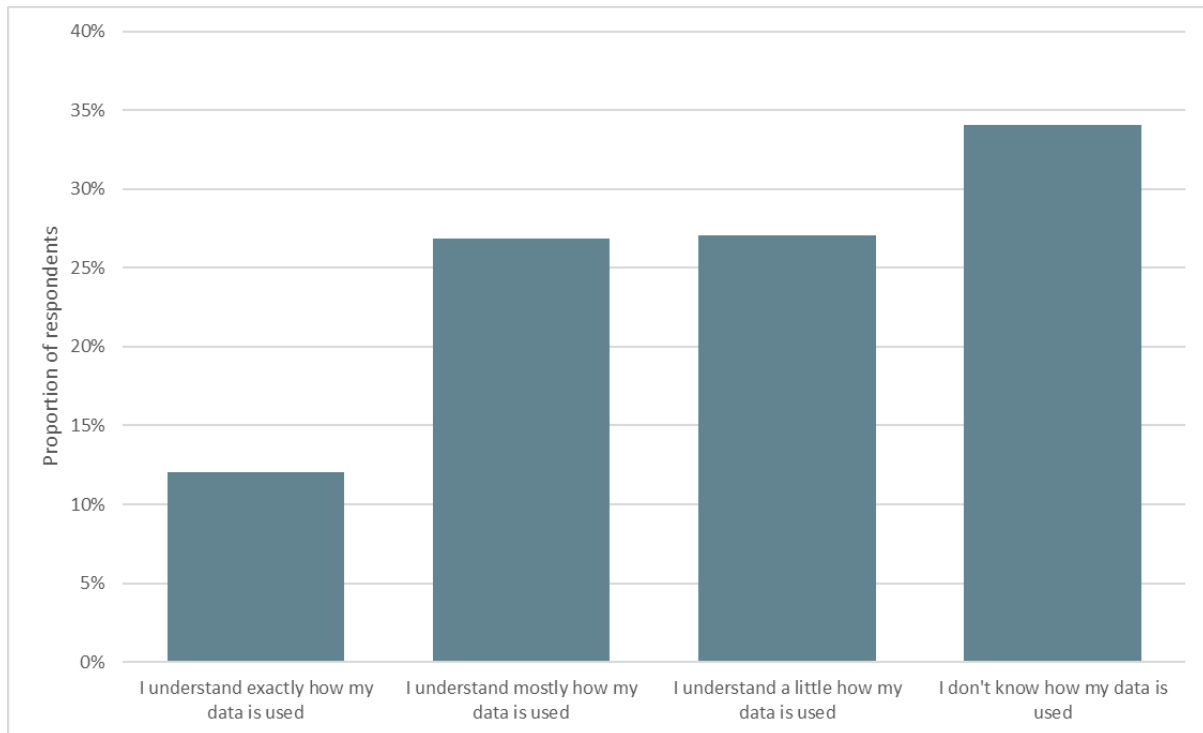


Source: Commission analysis based on data from our consumer survey, n=11,039.<sup>1123</sup>

### **A third of respondents said they do not know how their data is used**

**F141** When respondents who are members of a grocery loyalty programme were asked about their awareness of how their data was used by the operator of this programme, most said they did not know exactly how their data is used.

**Figure F31 How respondents described their awareness of how their grocery loyalty programme uses the data it collects**



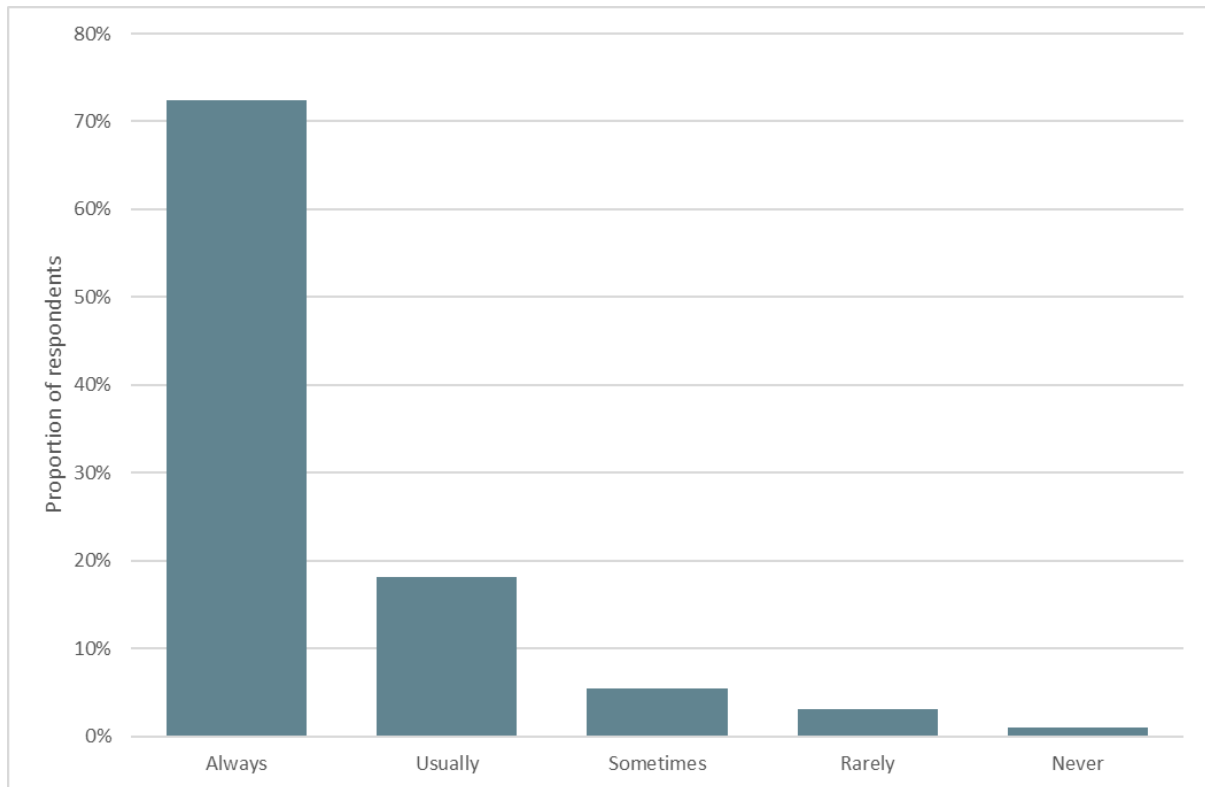
Source: Commission analysis based on data from our consumer survey, n=11,105.<sup>1124</sup>

### **Almost three quarters of respondents said they always scan their loyalty card**

**F142** When respondents who are a member of a grocery loyalty programme were asked how often they scan their card when making a purchase, almost all respondents said they usually or always scan or swipe their card.



**Figure F32 How often respondents said they swipe or scan their loyalty card when making a purchase**



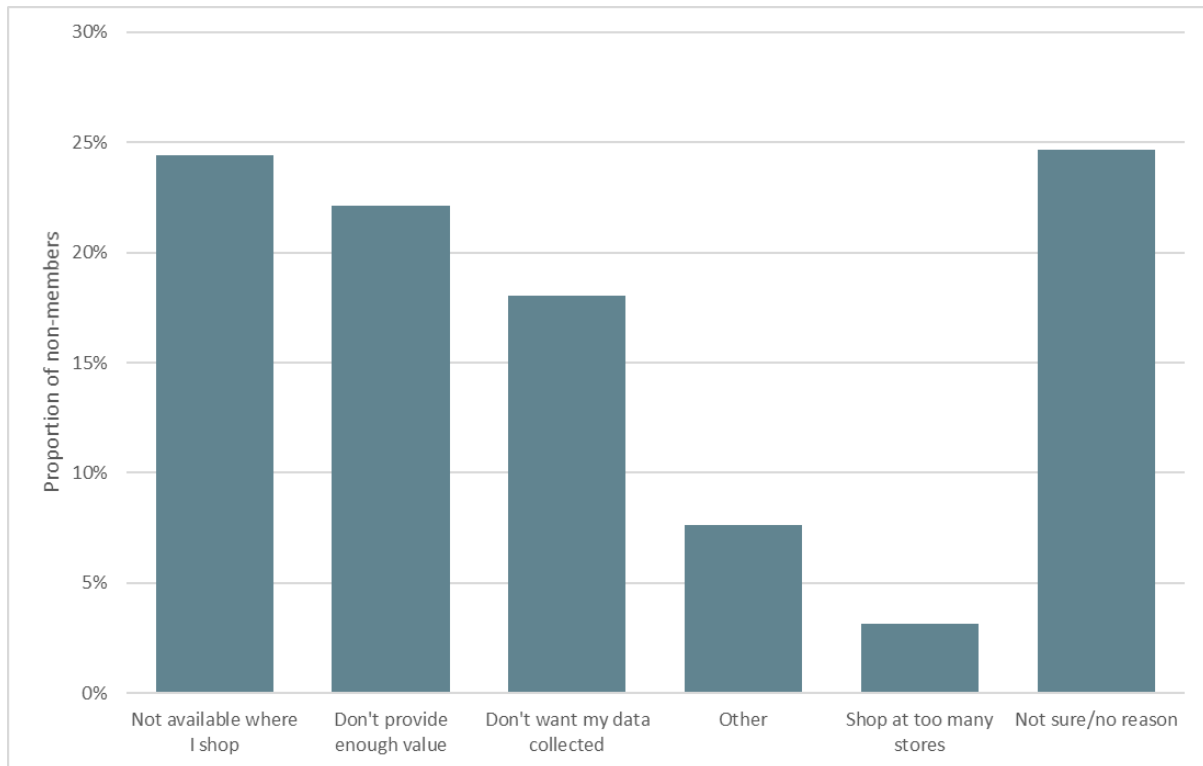
Source: Commission analysis based on data from our consumer survey, n=10,505.<sup>1125</sup>

**The reasons why some respondents were not members of a loyalty programme varied**

F143 About 8% of respondents reported not being a member of any programme. The most common reason for this was that a loyalty programme is not available where they shop. However, there did not appear to be any strong reasons why these respondents were not members of any programme.

F144 It also possible that a proportion these respondents are actually a member of the Flybuys programme but did recall they were a member, due to the omission of Flybuys as an option.

**Figure F33 Why respondents said they are not a member of any grocery loyalty programmes**



Source: Commission analysis based on data from our consumer survey, n=953.<sup>1126</sup>

### What respondents told us about their experiences shopping for groceries

F145 We received 6,617 free-text responses to the question “Is there anything else you would like to tell us about your experiences shopping for groceries?”. We read each of these comments to identify themes and common narratives. These are discussed in detail below. A wide range of themes were represented in these comments and respondents often raised many different points in their response.

F146 We conducted this analysis to capture and present what respondents told us, using this to identify common themes and narratives. Given respondents did not provide any personally identifiable information, we are unable to contact any respondent to verify, or further understand, what they have told us.

F147 The Ipsos report, which is published alongside this report, provides detailed qualitative research into many of the themes and comments raised by respondents. Our consumer survey was not designed with the intent of conducting in-depth qualitative research.

### How we conducted our analysis of the free-text responses

F148 Responses that contained text, but were non-responses (eg, “no comment”, “n/a”, etc.) were removed to yield 6,617 free-text responses.

- F149 We then categorised these responses, using keywords, into eight main themes. For example, responses which contained words such as “price” or “cost” were categorised within the Price theme.
- F150 We then read each response to:
- F150.1 ensure the themes assigned using key words were accurate (and removing them if they were not);
  - F150.2 add any other main themes which were relevant;
  - F150.3 add relevant sub-themes; and
  - F150.4 identify any emerging narratives from the responses.
- F151 Table F4 below shows the themes and sub-themes we assigned the responses against.
- F152 Responses were coded with a sub-theme if they related to a specific matter. For example, a response discussing pricing labels will have already been assigned under ‘Price’, but this would additionally be assigned under the sub-theme ‘Pricing labels and discounts’.
- F153 This categorisation was completed by following defined sub-themes.<sup>1127</sup> This was done to minimise definition shift during the code process, to ensure consistency.
- F154 Once we completed the coding, some key themes were selected to analyse in further detail. These were selected as we considered them particularly relevant to our study. Responses related to these themes were then summarised, and peer reviewed for consistency.

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<sup>1127</sup> For example, the ‘Dietary requirements’ sub-theme was defined as comments on ‘The range of products stocked by grocery retailers which cater to various dietary requirements (eg, gluten free, vegan, free-from)’.

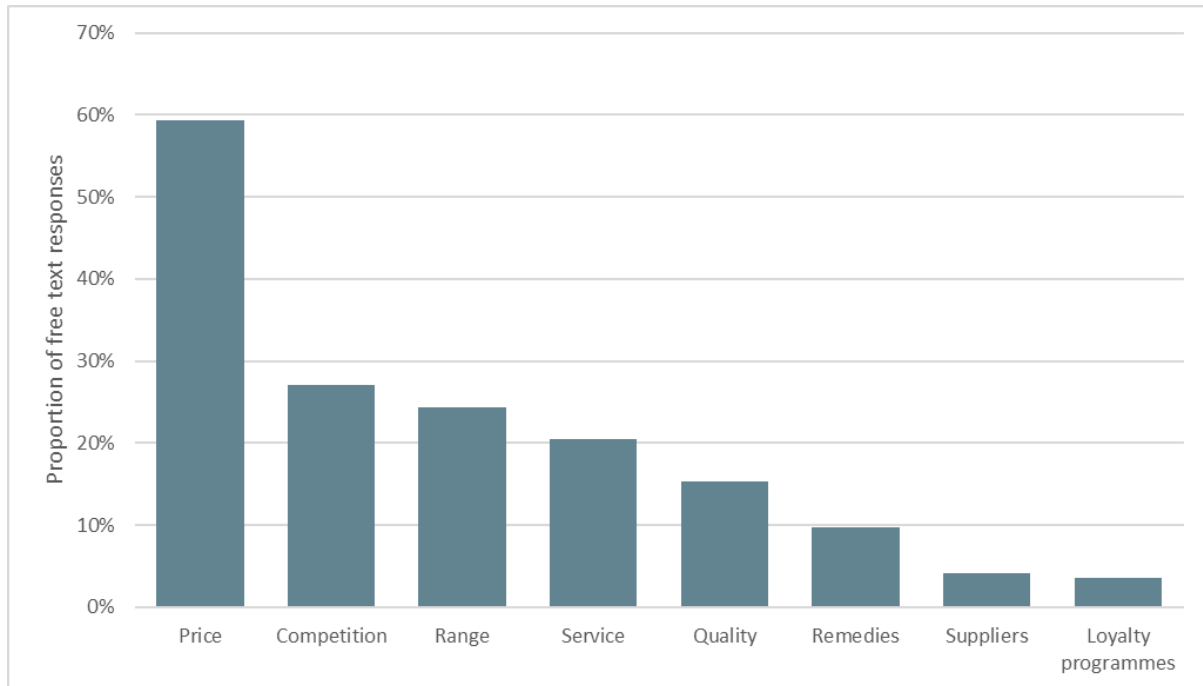
**Table F4 Themes and sub-themes used to categorise the free-text responses**

<b>Price</b>	<b>Quality</b>	<b>Range</b>	<b>Service</b>	<b>Competition</b>	<b>Suppliers</b>	<b>Loyalty programmes</b>	<b>Remedies</b>
Price change due to COVID-19 pandemic	Sustainability/environmental	Dietary requirements	Store cleanliness			Data collection/privacy	Tax
High prices/poor value	Bakery	Choice of products	COVID-19 pandemic procedures			Loyalty discounts	Price controls
Low prices/good value	Meat/seafood	Availability of products	Staff and checkouts			Consumer benefit	New entrant
Pricing labels and discounts	Fresh produce		Convenience				Consumer information
Price integrity							Country of origin
Promotions							

### Overview of the themes from the responses

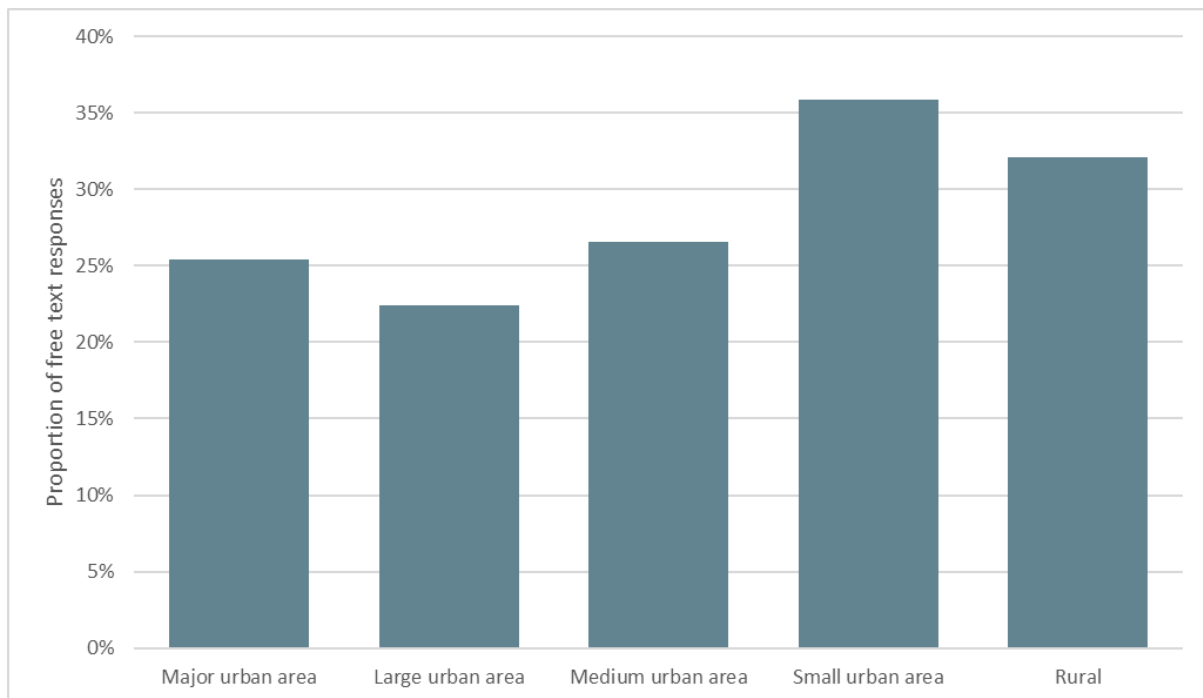
F155 Figure F34 below shows the prevalence of the themes people talked about in their free-text responses. Price was the most discussed theme. However, it is clear respondents care about a range of things beyond price when grocery shopping.

**Figure F34 Themes of free-text responses**



Source: Commission analysis based on data from our consumer survey, n=6,617.<sup>1128</sup>

F156 In general, the prevalence of these themes did not tend to vary significantly depending on region or other demographic variables. However, there were some differences. For example, as shown in Figure F35 below, comments about competition appeared to be more prevalent in smaller urban and rural areas.

**Figure F35 Where people who discussed competition live**

Source: Commission analysis based on data from our consumer survey, n=6,058.<sup>1129</sup>

### Respondents' perceptions

F157 As shown in Figure F34 above, over half the responses we received discussed price. Of these, the most common comment was about the perception of high prices (or poor value) of groceries in New Zealand.

#### *What respondents said about prices*

F158 Roughly one third of feedback about prices was that the price of groceries in New Zealand is high or poor value, particularly in comparison to other countries. Respondents also commented how the cost of groceries has increased relative to their income. These types of comments appeared to be more prevalent among respondents in younger age brackets.

F159 Some respondents said they are more likely to purchase products that are on special and may avoid buying products that are at full price.

F160 Some respondents identified factors that make it harder for them to base their decisions on price and made it harder to compare prices. These reasons include:

F160.1 products can be advertised as “special” where there is no discount or special offer;

F160.2 the standard price and discounted prices change rapidly, and prices can vary between different stores under the same retail banner;

F160.3 perceived discrepancies between the shelf price and the checkout price (either an error or member-only discount);<sup>1130</sup> and

F160.4 unit pricing is not used consistently and is often missing on promotional price labels.

*What respondents said about product quality*

F161 Many respondents also provided feedback on the quality of products that the supermarkets provide. Typically, feedback focussed on quality across three broad areas: bakery, meat and seafood, and produce.

F162 Some respondents that discussed quality told us that the quality of meat, seafood and produce at the major grocery retailers is poor. Some respondents would visit specialist stores such as green grocers, butchers or farmers markets for better quality products.

F163 Some respondents that discussed quality identified that better quality products (such as meat) are produced in New Zealand but exported rather than sold in local stores.

*What respondents said about the range of products available*

F164 The range of products available in store was a key theme for roughly a quarter of respondents. These respondents provided feedback about the range of products available at any given store or retail banner, as well as how many stores were accessible to them and near where they live.

F165 Some consumers reported that they have noticed that there are fewer brands to choose from for some products, and that branded products may be discontinued if a private label alternative is introduced. Private label products were described generally as a cheaper alternative to branded products.

F166 Respondents who would prefer to do all their shopping at one supermarket told us that the range of products available was a key factor for their decision to shop elsewhere as well.

F167 For respondents that identified a specific dietary requirement (such as gluten free), the range available at a given supermarket heavily influenced which store they visited. Several respondents noted that the range of diet-specific products available can be particularly limited.

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<sup>1130</sup> Approximately 200 respondents discussed concerns relating to the perceived consistency of prices between advertisements/in-store, shelf prices/till prices, etc.

*What respondents said about service and convenience*

- F168 Many respondents told us how many supermarkets were nearby, or the travel time to their nearest store. Consistent with the responses in the previous section, in the free-text responses respondents told us that they found supermarkets nearby to be more convenient, and told us that this was likely to impact which supermarket they decided to visit, and how often they shop each week.
- F169 Our feedback indicated that when a consumer has several shops nearby, they are likely to target a specific store that offers the best value to them (a combination of price, quality or range), for a large weekly shop. They will supplement the single shops with smaller shops at whichever supermarket is closest to access.
- F170 Some respondents that used online shopping indicated they would shop with only one shop once they had initially compared the quality of each online website. The decision was based more on the quality of the online store and delivery cost rather than groceries value.

*What respondents said about loyalty programmes*

- F171 A small number of respondents (less than five percent) commented on loyalty programmes. Feedback was mixed between the benefits (or lack there-of) of the cards and the requirement to have a card to access discounts.
- F172 Some respondents expressed frustration at the requirement to be a loyalty programme member to access a discount. Some respondents appeared to not like the fact that retailers use loyalty cards to collect data about their purchase information. Feedback also included frustration at missing out on discounts if the respondent did not have a card on them for a particular visit.
- F173 For the respondents that provided feedback, it appeared as though a key driver for joining loyalty programmes was to access the member-only discounts rather than the programmes other rewards (such as fuel discounts or points). When a respondent did refer to the benefits, they typically found the benefits (other than access to member-only discounts) negligible.

*Respondents' suggestions and views about potential recommendations*

- F174 Approximately 10% of respondents made recommendations to the issues that they raised in their feedback.
- F175 In the context of high prices for healthy foods, some respondents suggested GST should not apply to some foods. This was primarily suggested for fresh produce and was also suggested for other core food items such as meat. Other feedback that identified the low price of processed foods suggested a sugar tax.



- F176 The most suggested recommendation was the entry of a new retailer to address a lack of competition, with approximately 180 respondents making comments to this effect. Many of these comments suggested that a grocery retailer, such as Aldi, should be encouraged to enter New Zealand. Other respondents noted they felt there was limited competition in their area and expressed a desire for more options. This feedback identified the lack of competition as a reason for high prices, limited range, or poor quality.
- F177 Many of these respondents had previously lived overseas and made comparisons to international groceries markets (such as the UK or Australia), and specific competitors such as Aldi or Costco.
- F178 Some respondents were concerned with the current lack of visibility of a product's country of origin. These respondents would prefer to see better information about where a product's ingredients are sourced, and whether they are produced ethically and sustainably.

## Question script for our consumer survey

### Introductory page

#### Kia Ora and Welcome

Thank you for clicking through to our survey, it should take you around five to 10 minutes to complete.

This survey will help us understand how New Zealanders typically shop for groceries. When completing the survey, please think about how you typically shop for groceries (ie, at Alert Level 1), rather than how you might shop due to any COVID-19 pandemic restrictions.

Your response will be used by the Commission as part of our study into New Zealand's grocery sector. We will not share your response with third parties unless required to do so by law.

Your response will be grouped with others and we may publish a summary of these grouped results on our website.

If you need to provide the Commission with confidential, commercially sensitive or personal information, please email us at [marketstudies@comcom.govt.nz](mailto:marketstudies@comcom.govt.nz) to discuss the best way to do this.

The Commission has also published a factsheet [hyperlink] which outlines the purpose of the study and what we are looking at, the process we are following, what the potential outcomes can be, and how and when you can take part.

To go directly to the survey please click on the 'Next' button at the bottom of the page.

Begin Survey

## Survey questions

### First, some questions about how you shop for groceries

*By groceries, we mean meat, fruit and vegetables, canned goods, dairy products and other types of food and drink, as well as other household products, like toilet paper, cleaning products and pet food. These products can usually all be purchased at a supermarket, but are often available through other shops as well.*

**1. How involved are you in the grocery shopping for your household?**

*By your 'household' we mean the people you shop for groceries for and who live in the same place as you*

- a. Main shopper
- b. Shared with others
- c. Not usually involved in the grocery shopping

[if c, skip to Q25]

**2. INCLUDING YOURSELF, how many people do you generally shop for?**

- a. 1
- b. 2
- c. 3
- d. 4
- e. 5 or more

**3. How do you usually buy most of your groceries?**

- a. In store
- b. Online and delivered to me
- c. Ordered online and collected in store

**4. Which of the following best describes how you usually shop for groceries each week?**

- a. I tend to make one or two large shop(s)/get one or two large order(s)
- b. I tend to do one or two larger shop(s)/order(s) and a few smaller shop(s)/order(s)
- c. I do several smaller shops/orders
- d. None of these, I usually do less than one shop a week

[if 3d go to Q9, otherwise continue to Q5]

**For the next few questions, think about your shopping during a typical week**

*We want to understand how you usually shop under normal conditions when not affected by restrictions due to Alert Levels 2 or 3. If you are not sure what a typical week is for you, think about how you shopped for groceries in the most recent week you can remember at Alert Level 1.*

- 5. During a typical week, which of these stores/services do you buy groceries from?**
- New World
  - Countdown
  - PAK'nSAVE
  - Four Square
  - FreshChoice
  - SuperValue
  - An ethnic supermarket (eg, Tai Ping, Japan Mart, Yogijis Food Mart)
  - Another supermarket (eg, Farro Fresh, Moore Wilson's, Bin Inn)
  - A single-category or specialist grocery store (eg, greengrocers, butchers, bakeries)
  - A general merchandiser (eg, The Warehouse)
  - A convenience store (eg, dairies, petrol stations, Night n Day)
  - A meal kit provider (eg, Hello Fresh, My Food Bag)
  - An online-only supermarket (eg, The Honest Grocer)
  - Other (please state)

[Questions 6 to 8 are provided for all stores selected at Q5]

- 6. During a typical week, how many times would you shop with [store response to Q5]?**

Number of times [ ]

- 7. During a typical week, how much in total would you spend with [store response to Q5]?**

- \$0-10
- \$10-25
- \$25-50
- \$50-100
- \$100-200
- \$200-300
- \$300+

- 8. During a typical week, what would you buy from [store response to Q5]?**

***Please select all that apply***

- Fresh fruit or vegetables
- Meat, poultry or seafood
- Dairy or eggs (eg, milk, cheese, eggs)
- Frozen food (eg, frozen vegetables, ice cream, pizza)
- Chilled food (eg, sauces, dips, soups)
- Deli goods (eg, salads, small goods, cooked meats)
- Baked goods (eg, bread, muffins)
- Confectionery, nuts or snacks (eg, chocolate, potato crisps)
- Other food (eg, pasta, tinned vegetables, breakfast cereals, flour)
- Alcohol
- Non-alcoholic drinks
- Pet supplies (eg, pet food)
- Cleaning products and other household supplies (eg, dishwashing detergents and powders, paper towels)
- Personal care products (eg, toothpaste, shampoo, deodorant)
- Other (please specify)

**These questions are about how you usually do your main shop**

9. Which of the below is usually your MAIN grocery store/service (the one you spend the most at, or do most of your grocery shopping with)?

*If you have more than one main store/service, select the two you use most often*

- a. New World
- b. Countdown
- c. PAK'nSAVE
- d. Four Square
- e. FreshChoice
- f. SuperValue
- g. An ethnic supermarket (eg, Tai Ping, Japan Mart, Yogiji's Food Mart)
- h. A specialty supermarket (eg, Farro Fresh, Moore Wilson's, Bin Inn)
- i. A single-category store (eg, a butcher, baker, greengrocer or farmers' market)
- j. A general merchandiser (eg, The Warehouse)
- k. A meal kit provider (eg, Hello Fresh, My Food Bag)
- l. An online-only supermarket (The Honest Grocer)
- m. A convenience store (eg, a dairy, petrol station, Night and Day)
- n. Other [text box]
- o. I don't have a main shop

[If 4b, 9k or 9l, go to Question 12]

[If 9o, go to Question 15]

[Questions 10 to 13 are provided for all stores selected at Q9]

***These questions are about your main shop with [FOR EACH] main store in Q9***

**10. How do you usually get there?**

- a. Drive
- b. Walk
- c. Bus/train
- d. Bicycle/scooter
- e. Taxi/rideshare
- f. Other: please explain

**11. How long does it usually take you to get there?**

- a. 0-5 mins
- b. 5-10 mins
- c. 10-15 mins
- d. 20-25 mins
- e. 25+ mins

**12. Why is it your main grocery store/service?**

*Please select all that apply*

Randomise order

- a. Convenient/easy to get to
- b. Good value for money
- c. Low prices overall
- d. Good specials
- e. Good quality products
- f. Wide choice of products
- g. Familiarity with the store/service
- h. Easy parking
- i. Quick checkouts/easy to pay
- j. Have a loyalty card
- k. My household prefer it
- l. Open at convenient times
- m. Has self-scanning
- n. Has ATM/pharmacy/dry cleaning
- o. The store is pleasant to be in
- p. Has petrol available
- q. Am given a lift to the store
- r. There is no other option in my area
- s. Other: explain

**13. Please choose the single most important reason why [main store in Q9] is your main grocery store/service:**

[auto populate list from selections at Q12]

**14. If your main grocery store/service(s) closed for the foreseeable future, which store/service(s) would you use instead?**

*If you would replace your main shop(s) with many smaller ones, please select all stores you would visit*

[Delete Q9 response(s) from list (i.e. if 9a hide 14b)]

- a. I would go to the same store in a different location, or use the same type of store/service somewhere else.
- b. New World
- c. Countdown
- d. PAK'nSAVE
- e. Four Square
- f. FreshChoice
- g. SuperValue
- h. An ethnic supermarket (eg, Tai Ping, Japan Mart, Yogijis Food Mart)
- i. Another supermarket (eg, Farro Fresh, Moore Wilson's, Bin Inn)
- j. A single-category or specialist grocery store (eg, greengrocers, butchers, bakeries)
- k. A convenience store (eg, dairies, petrol stations, Night n Day)
- l. A meal kit provider (eg, Hello Fresh, My Food Bag)
- m. An online-only supermarket (eg, The Honest Grocer)
- n. Other (please state)

**Now, some questions about how you decide what groceries to buy**

- 15. Which of these best describes how you decide which grocery products to buy?**
- I usually have preferred brands I look for
  - I have preferred brand for some products, but for others I decide each time I shop
  - I don't really have preferred brands; I decide each time I shop
  - I always decide each time I shop
- 16. How often do you usually compare prices between similar products when grocery shopping (eg, three different brands of laundry detergent)?**
- Never
  - Rarely
  - Sometimes
  - Usually
  - Always
  - I don't know
- 17. How often do you check unit pricing on products (where available)?**  
*Here is what unit pricing looks like*



- Never
- Rarely
- Sometimes
- Usually
- Always
- None of the products I buy display unit prices
- Until now, I didn't know what unit prices were

**These questions are about how you use grocery loyalty programmes**

- 18. Which of the following grocery loyalty cards do you belong to?**

*Select all that apply*

- Clubcard (New World)
- Airpoints (New World)
- Onecard (Countdown)
- AA Smartfuel (Countdown)
- None
- Other (please state)

[if 18, skip to Q24]

[if more than one selected, continue to Q19]

[if only one selected, skip to Q20]

- 19. Which do you use most often?**
- [auto-populate based on selections at Q18]

**20. How often do you swipe or scan your [card selected at Q19 (or Q18 if only one selected)] when making a purchase?**

- a. Never
- b. Rarely
- c. Sometimes
- d. Usually
- e. Always

**21. Why did you join [card selected at Q19 (or Q18 if only one selected)]?**

*Select all that apply*

- a. To get access to members-only discounts
- b. To collect rewards points which allow me to get vouchers
- c. To collect points for other programmes (e.g. Flybuys)
- d. To enter the exclusive competitions and promotions
- e. To get members-only discounts on fuel
- f. I don't know/can't remember
- g. Other reason [text box]

**22. Which of these best describes your awareness of how [card selected at Q19 (or Q18 if only one selected)] uses the data it collects when you swipe or scan it?**

- a. I understand exactly how my data is used
- b. I understand mostly how my data is used
- c. I understand a little how my data is used
- d. I don't know how my data is used

**23. When you signed up for [card selected at Q19 (or Q18 if only one selected)], which statement best describes how you read the terms and conditions?**

- a. I read all of them
- b. I skimmed the key bits
- c. I did not read them at all
- d. I can't remember

[only if 18e]

**24. Please select the statement that best describes why you are not a member of any grocery loyalty programmes:**

- a. I don't want grocery stores to collect my data
- b. I shop at too many stores for it to be worthwhile
- c. They don't provide enough value
- d. No particular reason
- e. Not available where I shop
- f. I'm not sure
- g. Other [free text]

### **Your experience shopping for groceries**

**25. Is there anything else you would like to tell us about your experiences shopping for groceries?** [free text]

*This could include your views on the grocery options available to you or anything else you think we should be aware of.*

## A bit about you

### 26. How old are you?

- Under 16 years
- 16 to 25 years
- 25 to 40 years
- 40 to 65 years
- 65 years and over
- Prefer not to say

### 27. What suburb/region do you live in?

[Conditional drop-down boxes:]

Chapter 1	Regions
Chapter 2	District/Cities
Chapter 3	Cities/Suburbs, depending on region selected
Chapter 4	Suburbs (for five most populous cities)

### 28. Which of the following best describes your household?

*By your 'household' we mean the people you shop for groceries for and who live in the same place as you*

- a. Single, living alone
- b. Group flatting (single or with a partner)
- c. Couple, no kids living in household
- d. Household with children
- e. Single parent
- f. Household with multiple generations
- g. Prefer not to say

### 29. What ethnicity(ies) do you identify with?

*Please select as many that apply*

- a. New Zealand European
- b. Māori
- c. Samoan
- d. Cook Islands Māori
- e. Tongan
- f. Niuean
- g. Chinese
- h. Indian
- i. European
- j. Other, please state: [text box]
- k. Prefer not to say

### 30. What is the total annual income of your household?

- a. Less than \$15,000
- b. \$15,001 - \$45,000
- c. \$45,001 - \$75,000
- d. \$75,001 - \$105,000
- e. \$105,001 - \$135,000
- f. \$135,001 - \$165,000
- g. More than \$165,000
- h. Prefer not to say



**Final page**

**Thank you for taking the time to complete our survey.**

The information you have provided will help us in our study into whether competition is working well in the retail grocery sector.

If you want to be kept up to date with progress on the study, please subscribe to our mailing list [\[here\]](#).

## Attachment G            Supplier survey

- G1     This attachment provides further information about our supplier survey.
- G2     In early 2021, we conducted a supplier survey to help to build our understanding of how well competition is working for the acquisition of groceries. We sought views on suppliers' trading relationships with grocery retailers and wholesalers.
- G3     We received 126 responses to our supplier survey.<sup>1131</sup> These respondents supplied across a range of grocery retailers and product categories.
- G4     The responses we received have informed our analysis of competition for the acquisition of groceries by retailers, as discussed in Chapter 8 of this draft report.
- G5     The sections in this attachment are:
- G5.1    how we designed and conducted our supplier survey;
- G5.2    our approach to confidentiality of suppliers' information;
- G5.3    who responded to our supplier survey;
- G5.4    how we have used the results of our supplier survey; and
- G5.5    question script for our supplier survey.

### How we designed and conducted our supplier survey

- G6     Our supplier survey was conducted online and hosted on our website. The survey was available from 4 March to 25 March 2021.
- G7     The survey included 31 questions in total, but none of the respondents were asked all of these.<sup>1132</sup> The questions respondents were asked depended on their answers to previous questions.
- G7.1    Respondents who indicated that they currently supply grocery retailers or wholesalers in New Zealand were asked either 17 or 18 questions.<sup>1133</sup>
- G7.2    Respondents who indicated that they do not currently supply grocery retailers or wholesalers in New Zealand, but have done so in the past, were asked 11 questions.<sup>1134</sup>

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<sup>1131</sup> [ ]

<sup>1132</sup> The full question script for our supplier survey is included in pages 503 to 513 below.

<sup>1133</sup> See: Q1-Q17 and Q31 in pages 505 to 513 below. Q9 only applied to respondents who currently supply major grocery retailers.

<sup>1134</sup> See: Q1, Q18-Q26 and Q31 in pages 505 to 513 below.

- G7.3 Respondents who indicated that they do not currently supply grocery retailers or wholesalers in New Zealand, but either hope to in the future or have no intention of doing so in the future, were asked 6 questions.<sup>1135</sup>
- G8 The initial questions were designed to get an overview of the respondents' business, including the products they supply and who they supply to.<sup>1136</sup> Tick-box options were provided for many of these questions.
- G9 Subsequent questions focussed on respondents' trading relationships with New Zealand grocery retailers and wholesalers, or their role in the supply chain.<sup>1137</sup> Respondents were generally only able to provide free-text responses to these questions.
- G10 Topics covered in questions regarding respondents' trading relationships with New Zealand grocery retailers and wholesalers included:
- G10.1 the form of supply agreements and terms of trade;
- G10.2 suppliers' views on their bargaining power relative to that of the grocery retailers and wholesalers they supply; and
- G10.3 any specific behaviour or conduct which may be positively or negatively affecting the respondents' business.
- G11 We sought to frame the questions using neutral language, to allow suppliers to freely provide their views.
- G12 We promoted the survey to seek input from a wide range of suppliers, including publishing a media release and adding a link to the survey on the home page of our website.<sup>1138</sup> We also engaged with a range of industry associations, asking them to help promote the survey to their members through their communication channels.<sup>1139</sup>

### **Our approach to confidentiality of suppliers' information**

- G13 We were conscious that some of the information suppliers wanted to share with us could be commercially sensitive and highly confidential.
- G14 Respondents were able to either complete the survey anonymously or share their details with us. Of the 126 responses received, 58 provided their details and 68 remained anonymous.<sup>1140</sup>

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<sup>1135</sup> See: Q1, Q27-Q30 and Q31 in pages 505 to 513 below.

<sup>1136</sup> See: Q1-Q9, Q18-21 and Q27-Q28 in pages 505 to 513 below.

<sup>1137</sup> See: Q10-Q17, Q22-Q26 and Q29-Q30 in pages 505 to 513 below.

<sup>1138</sup> Commerce Commission "Media release – Surveys launched to help suppliers and consumers inform grocery market study" (4 March 2021).

<sup>1139</sup> [ ].

<sup>1140</sup> [ ].

- G15 The option to respond anonymously was included given concerns had been raised regarding the potential reluctance of suppliers to share their views with us.<sup>1141</sup>
- G16 We implemented additional information handling measures for information provided to us by suppliers, including restricting the number of our staff who have access to the information. The identities of suppliers have also been protected with code-names.
- G17 We have published limited details regarding responses received due to the highly sensitive nature of the identities of survey respondents and the information they provided. Given that many of the substantive survey questions required free-text responses from respondents, it is difficult to provide details of the responses received without risking identifying individual suppliers.

### Who responded to our supplier survey

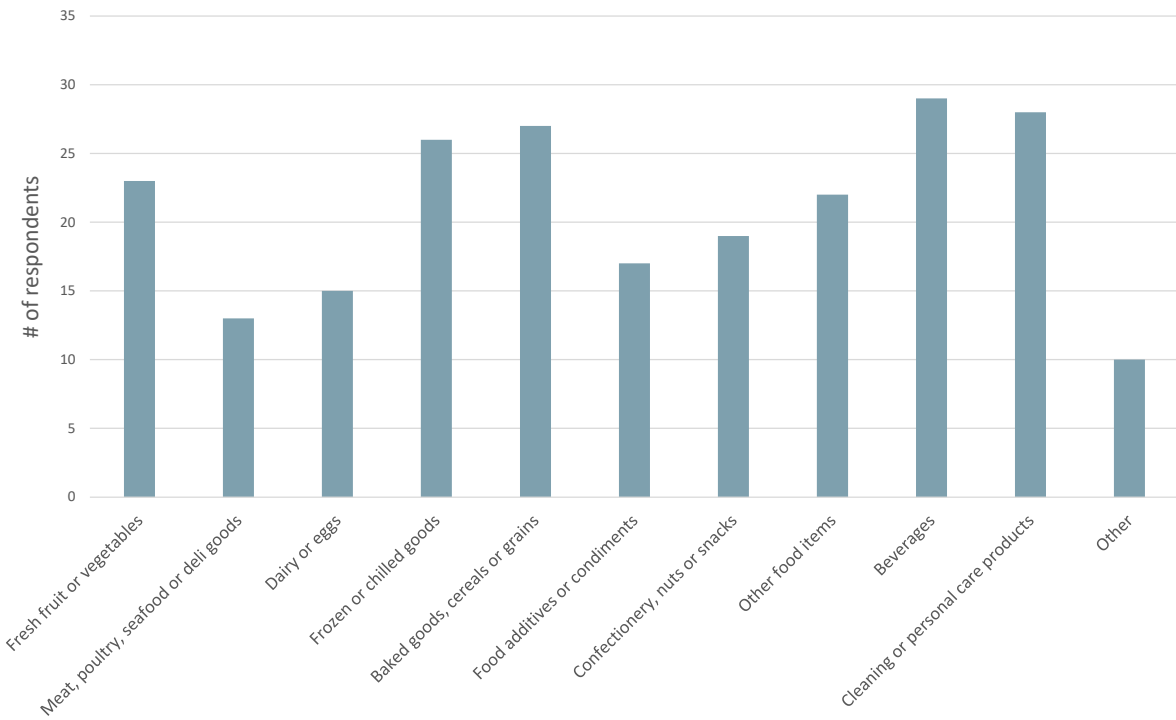
- G18 Of the 126 responses we received, 110 indicated that they are current suppliers to grocery retailers or wholesalers in New Zealand.<sup>1142</sup> The remaining 16 respondents indicated that they do not currently supply grocery retailers or wholesalers in New Zealand, but either:
- G18.1 have done so in the past;
  - G18.2 hope to in the future; or
  - G18.3 have no intention of doing so in the future.
- G19 Responses received from the 110 current suppliers indicated that they supply across a range of product categories, as shown in Figure G1 below.

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<sup>1141</sup> For example, the NZFGC submitted: "...given the concentrated nature of the industry, [the Commission] will face significant challenges obtaining evidence. Much of the conduct is purposefully not committed to writing, and suppliers will be naturally reticent to comment on such a small market". NZFGC "Submission by the New Zealand Food & Grocery Council" (4 February 2021) at [10(c)].

<sup>1142</sup> [ ].

**Figure G1 Product categories supplied by survey respondents**



Source: Commerce Commission analysis of responses to our supplier survey.<sup>1143</sup>

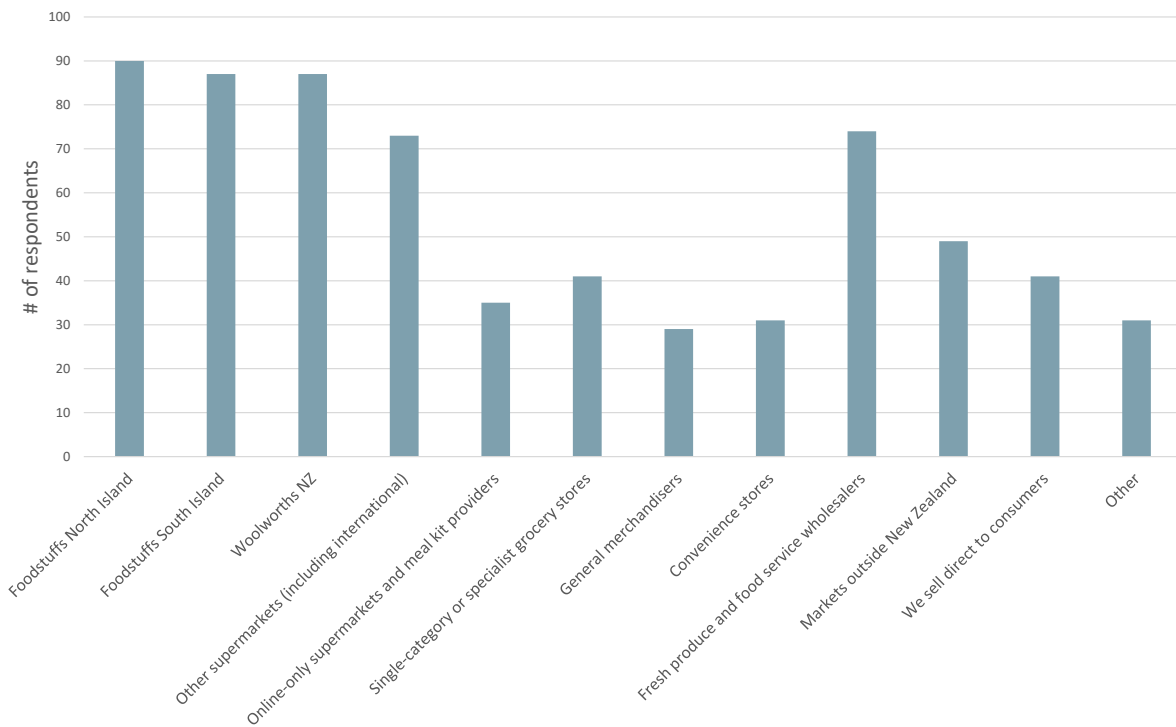
Note: Some respondents supply products across multiple categories, so the number of responses in Figure G1 above is greater than 110.

**G20** These 110 respondents also indicated that they supply across a range of New Zealand grocery retailers and wholesalers, as shown in Figure G2 below.

1143

[

].

**Figure G2 NZ grocery retailers and wholesalers supplied by survey respondents**

Source: Commerce Commission analysis of responses to our supplier survey.<sup>1144</sup>

Note: Some respondents supply across multiple retailers and wholesalers, so the number of responses in Figure G2 above is greater than 110.

## How we have used the results of our supplier survey

- G21 Our supplier survey enabled us to seek the views of a wide range of suppliers. We were able to identify common themes by reviewing the responses received. These themes are described in Chapter 8 of this draft report, as part of our analysis of competition for the acquisition of groceries by retailers.
- G22 The survey was not designed to be statistically representative. Rather, it was intended to be a simple way of gathering the views of a range of suppliers within a short period of time.<sup>1145</sup>
- G23 Follow-up meetings were held with some respondents to our supplier survey to seek clarification or further details regarding comments they had made. We were not able to meet with all survey respondents, so we met with a sample of suppliers of different sizes across a range of product categories.

<sup>1144</sup> [ ].

<sup>1145</sup> Across the 126 responses we received to our supply survey, the average combined number of words provided in response to all questions which required a free text response was 394.  
[ ].

## Question script for our supplier survey

### Introductory page

#### Kia ora and welcome

Thank you for clicking through to our supplier survey – it should take you up to 30 minutes to complete (potentially longer if you choose to provide particularly detailed comments).

You have options at the end of the survey to either share your details with us or to remain anonymous.

We have published a [factsheet](#) with more information on why it is important we hear from suppliers, what we want to know, and how we may be able to protect the confidentiality of information you supply us.

We may publish a summary of supplier feedback received via this survey. However, the information will be anonymised and, if we consider there is any risk that information specifically relating to you could identify you, this will be discussed with you prior to publication.

If you wish to provide us with information outside of using the survey or have any questions about the confidentiality of information you want to provide us, please contact us at [marketstudies@comcom.govt.nz](mailto:marketstudies@comcom.govt.nz) or ring Market Studies Project Manager Karen Smith on 04 924 3863 to discuss further.

Please note:

- this survey is designed to be completed using a PC or laptop
- if you would prefer not to answer a question, you can click 'next' at the bottom of the page
- if you wish to pause and complete the survey later, your responses will be stored as long as you keep the survey open.

**Click 'Begin' below to start the survey.**

**Begin**

## Definitions page

### Before you begin, here is an overview of some terms used in this survey

**Groceries or products** means a range of food and drinks, including meat, fruit and vegetables, canned goods and dairy products. Groceries also include a range of other household products, like toilet paper, cleaning products and pet food. These products can usually all be purchased at a supermarket, but are often available through other shops as well.

**Grocery retailers** means businesses which sell grocery products directly to final consumers in New Zealand. Examples include:

- Major grocery retailers (eg, Foodstuffs North Island, Foodstuffs South Island, Woolworths NZ)
- Ethnic supermarkets (eg, Tai Ping, Japan Mart, Yogijis Food Mart)
- Other supermarkets (eg, Farro Fresh, Moore Wilson's, Bin Inn)
- Single-category or specialist grocery stores (eg, greengrocers, butchers, bakeries)
- General merchandisers (eg, The Warehouse)
- Convenience stores (eg, dairies, petrol stations, Night n Day)
- Meal kit providers (eg, Hello Fresh, My Food Bag)
- Online-only supermarkets (eg, The Honest Grocer).

**Major grocery retailers** means:

- Foodstuffs North Island (New World, PAK'nSAVE, Four Square, Gilmours)
- Foodstuffs South Island (New World, PAK'nSAVE, Four Square, Raeward Fresh, On the Spot, Trents)
- Woolworths NZ (Countdown, SuperValue, FreshChoice).

**Grocery wholesalers** means intermediaries who on-sell products to grocery retailers. Examples include:

- fresh produce wholesalers/distributors (eg, Turners & Growers, MG Marketing, Fresh Direct)
- food service wholesalers (eg, Bidfood).

<b>Next</b>
-------------



## Survey questions

### First, some questions about your business

#### 1. Do you currently supply products to grocery retailers or wholesalers in New Zealand?

*(Tick the option which most accurately describes your business.)*

- 1.1 We currently supply grocery retailers or wholesalers in New Zealand
- 1.2 We do not currently supply grocery retailers or wholesalers in New Zealand, but have done so in the past
- 1.3 We do not currently supply grocery retailers or wholesalers in New Zealand, but hope to in the future
- 1.4 We do not currently supply grocery retailers or wholesalers in New Zealand, and have no intention of doing so in the future

[If 1.1 is ticked, go to Q2]

[If 1.2 is ticked, go to Q18]

[If 1.3 or 1.4 are ticked, go to Q27]

#### 2. Which of the following categories of products do you supply to grocery retailers or wholesalers in New Zealand?

*(Tick all relevant product categories below.)*

- 2.1 Fresh fruit or vegetables
- 2.2 Meat, poultry or seafood
- 2.3 Dairy or eggs (eg, milk, cheese, eggs)
- 2.4 Frozen goods (eg, frozen vegetables, ice cream, pizza)
- 2.5 Chilled goods (eg, dips, soups, sauces)
- 2.6 Deli goods (eg, salads, small goods, cooked meats)
- 2.7 Baked goods (eg, bread, muffins)
- 2.8 Cereals or grains (eg, flour, rice, breakfast cereals, pasta products)
- 2.9 Food additives or condiments (eg, sugar, dried herbs, mayonnaise, olive oil)
- 2.10 Confectionery, nuts or snacks (eg, chocolate, nuts, potato crisps)
- 2.11 Other food items (eg, canned food, spreads, baby food)
- 2.12 Alcoholic beverages (eg, beer, wine, cider)
- 2.13 Non-alcoholic beverages (eg, coffee, soft drinks)
- 2.14 Pet supplies (eg, pet food)
- 2.15 Cleaning products and other household supplies (eg, dishwashing detergents and powders, paper towels)
- 2.16 Personal care products (eg, toothpaste, shampoo, deodorant)
- 2.17 Other (please specify): [Free text box]

**3. Do you supply private label products (eg, home brands or own brands, such as Pams and Essentials) to grocery retailers or wholesalers in New Zealand?**

*(Tick the option which most accurately describes your business.)*

- 3.1 No, we do not supply any private label products
- 3.2 Yes, some of the products we supply are private labels
- 3.3 Yes, about half of the products we supply are private labels
- 3.4 Yes, most of the products we supply are private labels
- 3.5 Yes, all of the products we supply are private labels

**4. Approximately how many different individual products (stock keeping units) do you supply to grocery retailers or wholesalers in New Zealand?**

*(Please type your best estimate in the box using numbers only (ie, not letters or a range).)*

[Reponse box (restricted to numbers only)]

**5. Who do you supply your products to?**

*(Tick all relevant options below)*

- 5.1 Foodstuffs North Island (New World, PAK'nSAVE, Four Square, Gilmours)
- 5.2 Foodstuffs South Island (New World, PAK'nSAVE, Four Square, Raeward Fresh, On the Spot, Trents)
- 5.3 Woolworths NZ (Countdown, SuperValue, FreshChoice)
- 5.4 Ethnic supermarkets (eg, Tai Ping, Japan Mart, Yogijis Food Mart)
- 5.5 Other supermarkets (eg, Farro Fresh, Moore Wilson's, Bin Inn)
- 5.6 Single-category or specialist grocery stores (eg, greengrocers, butchers, bakeries)
- 5.7 General merchandisers (eg, The Warehouse)
- 5.8 Convenience stores (eg, dairies, petrol stations, Night n Day)
- 5.9 Meal kit providers (eg, Hello Fresh, My Food Bag)
- 5.10 Online-only supermarkets (eg, The Honest Grocer)
- 5.11 Fresh produce wholesalers (eg, Turners & Growers, MG Marketing, Fresh Direct)
- 5.12 Food service wholesalers (eg, Bidfood)
- 5.13 Processors/manufacturers who use your products as an input when producing other grocery products
- 5.14 Markets outside New Zealand (eg, exports)
- 5.15 We sell direct to consumers (eg, we have own our outlet/website)
- 5.16 Other (please specify): [Free text box]

**6. Approximately how much annual revenue do you earn from sales of your products in New Zealand?**

*(Please type your best estimate in the box. When answering this question, please consider a typical year – avoiding the impact of significant global events such as the COVID-19 pandemic which may have distorted revenue or costs.)*

\$(Free text box)

**7. Approximately what proportion of your total revenues are generated by sales to New Zealand's major grocery retailers?**

*(When answering this question, please consider a typical year – avoiding the impact of significant global events such as the COVID-19 pandemic which may have distorted revenue or costs.)*

7.1 Don't sell to major grocery retailers

7.2 0-20%

7.3 20-40%

7.4 40-60%

7.5 60-80%

7.6 80-100%

**8. Please give a brief description of where your products are grown, manufactured, or processed.**

*(For example, are the products you supply 100% grown in or manufactured in New Zealand, do you import products and use these to manufacture others?)*

[Free text box]

[If any of 5.1, 5.2 or 5.3 were ticked, go to Q9. If not, go to Q10.]

**9. Please describe what you would do if all of the major grocery retailers you supply were no longer able or willing to stock your products.**

*(For example, what options would you have for selling any excess stock? What would the impact on your business be?)*

[Free text box]

**Next, some questions on your trading relationships with grocery retailers and wholesalers in New Zealand**

**10. What form do your supply agreements with New Zealand's grocery retailers and wholesalers typically take?**

*(Tick the most applicable option.)*

- 10.1 We generally have individualised written supply agreements with each retailer or wholesaler
- 10.2 We generally supply under each retailer's or wholesaler's standard written terms of trade
- 10.3 We generally supply under our own standard written terms of trade
- 10.4 We generally supply under informal, unwritten, arrangements
- 10.5 Other (please specify): [Free text box]

**11. Please describe your experience regarding whether the terms on which you supply New Zealand grocery retailers or wholesalers clear and predictable.**

*(For example:*

- *how are the prices and quantities you supply set, and to what extent is this known in advance?*
- *what happens if there are unexpected events (eg, differences in product quality or quantity)?*

[Free text box]

**12. Please describe your experience regarding New Zealand grocery retailers' promotional schedules, including any input or influence you have on promotions.**

*(For example:*

- *how often are your products on promotion?*
- *what are the benefits and costs of your products being on promotion (eg, payments you make, how your products are displayed)?*

[Free text box]

**13. Please describe your experience regarding where your products are placed on New Zealand grocery retailers' shelves, including any input or influence you have on this.**

*(For example:*

- *where are your products typically located on the shelf?*
- *do you make payments to retailers to access preferred shelf space or displays?*

[Free text box]

- 14. Please describe your experience negotiating with the New Zealand grocery retailers and wholesalers you supply, including whether you are able to negotiate and, if so, on what terms?**

*(Please explain your views, including any impact this has on your business.)*

[Free text box]

**Nearly done, next are some questions on the impact of grocery retailers' and wholesalers' behaviour on your business**

- 15. Please describe any behaviour from New Zealand grocery retailers or wholesalers which has positively affected your business, including approximately how often this has occurred and the impact it has had on your business.**

*(For example, this behaviour could relate to displays/promotions, distribution logistics etc. In your response, please specify the retailer(s) whose behaviour you are referring to.)*

[Free text box]

- 16. Please describe any behaviour from New Zealand grocery retailers or wholesalers which has negatively affected your business, including approximately how often this has occurred and the impact it has had on your business.**

*(For example, this behaviour could relate to terms of supply agreements, payment terms, product stocking and display, pricing negotiations etc. In your response, please specify the retailer(s) whose behaviour you are referring to.)*

[Free text box]

- 17. Are there any New Zealand grocery retailers or wholesalers you have had particularly positive or negative experiences with?**

*(Please explain, including examples where possible.)*

[Free text box]

[Go to Q31]

[Introductory questions continued, for respondents who ticked 1.2]

**18. Which of the following categories of products did you previously supply to grocery retailers or wholesalers in New Zealand?**

*(Tick all relevant product categories below.)*

- 18.1 Fresh fruit or vegetables
- 18.2 Meat, poultry or seafood
- 18.3 Dairy or eggs (eg, milk, cheese, eggs)
- 18.4 Frozen goods (eg, frozen vegetables, ice cream, pizza)
- 18.5 Chilled goods (eg, dips, soups, sauces)
- 18.6 Deli goods (eg, salads, small goods, cooked meats)
- 18.7 Baked goods (eg, bread, muffins)
- 18.8 Cereals or grains (eg, flour, rice, breakfast cereals, pasta products)
- 18.9 Food additives or condiments (eg, sugar, dried herbs, mayonnaise, olive oil)
- 18.10 Confectionery, nuts or snacks (eg, chocolate, nuts, potato crisps)
- 18.11 Other food items (eg, canned food, spreads, baby food)
- 18.12 Alcoholic beverages (eg, beer, wine, cider)
- 18.13 Non-alcoholic beverages (eg, coffee, soft drinks)
- 18.14 Pet supplies (eg, pet food)
- 18.15 Cleaning products and other household supplies (eg, dishwashing detergents and powders, paper towels)
- 18.16 Personal care products (eg, toothpaste, shampoo, deodorant)
- 18.17 Other (please specify): [Free text box]

**19. Did you previously supply private label products (eg, home brands or own brands, such as Pams and Essentials) to grocery retailers or wholesalers in New Zealand?**

*(Tick the option which most accurately describes your business.)*

- 19.1 No, we did not supply any private label products
- 19.2 Yes, some of the products we supplied were private labels
- 19.3 Yes, about half of the products we supplied were private labels
- 19.4 Yes, most of the products we supplied were private labels
- 19.5 Yes, all of the products we supplied were private labels

**20. What year did you stop supplying your products to grocery retailers or wholesalers in New Zealand?**

[Free text box]

**21. Who do you currently supply your products to?**

*(Tick all relevant options below.)*

- 21.1 Processors/manufacturers who use your products as an input when producing other grocery products
- 21.2 Markets outside New Zealand (eg, exports)
- 21.3 I no longer supply grocery products, my business has been sold
- 21.4 I no longer supply grocery products, my business has closed
- 21.5 We sell direct to consumers (eg, we have own our outlet/website)
- 21.6 Other (please specify): [Free text box]

**Next, some questions on your previous trading relationships with grocery retailers and wholesalers in New Zealand**

**22. Please explain why you no longer supply your products to grocery retailers or wholesalers in New Zealand.**

[Free text box]

**23. Please describe your experience negotiating with the New Zealand grocery retailers and wholesalers you previously supplied, including whether you were able to negotiate and, if so, on what terms?**

*(Please explain your views, including any impact this had on your business.)*

[Free text box]

**24. Please describe any behaviour from New Zealand grocery retailers or wholesalers which positively affected your business, including approximately how often this occurred and the impact it had on your business.**

*(For example, this behaviour could relate to displays/promotions, distribution logistics etc. In your response, please specify the retailer(s) whose behaviour you are referring to.)*

[Free text box]

**25. Please describe any behaviour from New Zealand grocery retailers or wholesalers which negatively affected your business, including approximately how often this occurred and the impact it had on your business.**

*(For example, this behaviour could relate to terms of supply agreements, payment terms, product stocking and display, pricing negotiations etc. In your response, please specify the retailer(s) whose behaviour you are referring to.)*

[Free text box]

**26. Were there any New Zealand grocery retailers or wholesalers you supplied which you had particularly positive or negative experiences with?**

*(Please explain, including examples where possible.)*

[Free text box]

[Go to Q31]

[Introductory questions continued, for respondents who tick 1.3 or 1.4]

**27. Who do you supply your products to?**

*(Tick all relevant options below.)*

- 27.1 Processors/manufacturers who use your products as an input when producing other grocery products
- 27.2 Markets outside New Zealand (eg, exports)
- 27.3 We sell direct to consumers (eg, we have own our outlet/website)
- 27.4 Other (please specify): [Free text box]

**28. Which of the following categories of products do you supply?**

*(Tick all relevant product categories below.)*

- 28.1 Fresh fruit or vegetables
- 28.2 Meat, poultry or seafood
- 28.3 Dairy or eggs (eg, milk, cheese, eggs)
- 28.4 Frozen goods (eg, frozen vegetables, ice cream, pizza)
- 28.5 Chilled goods (eg, dips, soups, sauces)
- 28.6 Deli goods (eg, salads, small goods, cooked meats)
- 28.7 Baked goods (eg, bread, muffins)
- 28.8 Cereals or grains (eg, flour, rice, breakfast cereals, pasta products)
- 28.9 Food additives or condiments (eg, sugar, dried herbs, mayonnaise, olive oil)
- 28.10 Confectionery, nuts or snacks (eg, chocolate, nuts, potato crisps)
- 28.11 Other food items (eg, canned food, spreads, baby food)
- 28.12 Alcoholic beverages (eg, beer, wine, cider)
- 28.13 Non-alcoholic beverages (eg, coffee, soft drinks)
- 28.14 Pet supplies (eg, pet food)
- 28.15 Cleaning products and other household supplies (eg, dishwashing detergents and powders, paper towels)
- 28.16 Personal care products (eg, toothpaste, shampoo, deodorant)
- 28.17 Other (please specify): [Free text box]



**Next, some questions on your role in the New Zealand grocery supply chain**

- 29. Please explain why you do not currently supply your products to grocery retailers or wholesalers in New Zealand.**

[Free text box]

- 30. Please describe the extent to which your products offer an alternative to those sold by grocery retailers or wholesalers in New Zealand.**

[Free text box]

[Go to Q31]

**Finally, any other views you would like to share**

- 31. Is there anything else regarding New Zealand's grocery sector that you think we should be aware of?**

*(Please provide details where possible.)*

[Free text box]

[Go to final page]

**Final page**

**Please click 'Submit' below to finalise your response**

Thank you for taking the time to complete our survey.

We would like you to identify yourself to us if you feel you can. Identifying yourself improves our ability to investigate any comments you have provided.

Further details regarding how we may be able to protect the confidentiality of information you supply us are contained in our supplier [factsheet](#).

- 32. If you are comfortable with the Commission knowing your identity and potentially contacting you, please provide your details. If not, you may leave this blank.**

32.1 Organisation: [Free text box]

32.2 Contact person: [Free text box]

32.3 Email address: [Free text box]

32.4 Phone number: [Free text box]

**Please click on the 'Submit' button to record your responses.**



- H6 We have subsequently calculated the number of supermarkets in each of these categories per million people in New Zealand using population data estimates from Statistics New Zealand, which estimated that New Zealand’s population was 5,116,300 at 31 March 2021.<sup>1148</sup>
- H7 Our results indicate that, per million people in New Zealand, there are approximately:<sup>1149</sup>
- H7.1 88 supermarkets which are 400 square metres or larger (all Small supermarkets, Large supermarkets and Hypermarkets as defined in the Nielsen report);
  - H7.2 68 supermarkets which are 1,000 square metres or larger (all Large supermarkets and Hypermarkets as defined in the Nielsen report); and
  - H7.3 25 supermarkets which are 2,500 square metres or larger (all Hypermarkets as defined in the Nielsen report).

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<sup>1148</sup> “Estimated population of NZ” [ [https://www.stats.govt.nz/indicators/population-of-nz?gclid=EAlaIqObChMIqYnQ1ae08AIVwrWWCh16VQmvEAYASAAEgLPivD\\_BwE](https://www.stats.govt.nz/indicators/population-of-nz?gclid=EAlaIqObChMIqYnQ1ae08AIVwrWWCh16VQmvEAYASAAEgLPivD_BwE).

<sup>1149</sup> [ ].

H8 Table H1 below compares these New Zealand numbers with the numbers for 19 European countries.

**Table H1 Comparison of number of stores per million people**

Country	Stores 400 sqm and above per million people	Stores 1,000 sqm and above per million people	Stores 2,500 sqm and above per million people
New Zealand	88	68	25
United Kingdom	105	56	26
Hungary	127	80	17
Portugal	142	58	9
Greece	158	60	5
Czech Republic	160	41	31
Italy	178	41	9
France	190	79	33
Poland	191	9	9
Sweden	208	84	21
Spain	209	91	10
Ireland	214	86	19
Finland	216	144	28
Belgium	240	84	5
Switzerland	242	116	31
Netherlands	275	105	3
Germany	333	94	25
Denmark	438	85	18
Austria	441	46	10
Norway	501	115	10

Source: Commerce Commission analysis of supermarket density.<sup>1150</sup> The New Zealand data was estimated by the Commission, and all other data was taken from a Nielsen report.<sup>1151</sup>

H9 Out of the 20 countries listed in Table H1, New Zealand has:<sup>1152</sup>

H9.1 the lowest number of supermarkets (400 square metres and above) per million people; and

H9.2 the sixth-equal highest number of supermarkets that are 2,500 square metres and above per million people.

<sup>1150</sup> [ ].

<sup>1151</sup> Nielsen “Nielsen Grocery Universe 2017” (2017) at 56, available at: <https://www.nielsen.com/wp-content/uploads/sites/3/2019/04/nielsen-grocery-universe-2017.pdf>.

<sup>1152</sup> [ ].

- H10 We note the following qualifiers in relation to this analysis, noting that as discussed at paragraph H3, this analysis is not intended to be a comprehensive comparison of store densities.
- H10.1 We have attempted to estimate the number of supermarkets in New Zealand using data which is available to us (primarily provided by the major grocery retailers). These are approximate numbers which we use for the purposes of this comparison and may not include every supermarket that may fall within the size categories.
- H10.2 Some of this data has been provided to us at different points in time (between December 2020 and June 2021), and may not account for subsequent store openings or closures.
- H10.3 The Nielsen store density data we have used as the basis for our comparison is dated 2015, while the New Zealand store data we have used for comparison was received between December 2020 and June 2021.
- H11 The comparison was only conducted in relation to a selection of European countries, and results may differ if a wider range of countries are used for the purposes of this comparison.