

# Market study into the retail grocery sector

Final report – Executive summary



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# Executive summary

This report sets out the findings from our study into New Zealand's retail grocery sector. The purpose of this study has been to examine whether competition in the grocery sector is working well and, if not, what can be done to improve it.

Groceries are an essential purchase as well as a major expense for most households. In the year to September 2021, more than \$22 billion was spent at supermarkets and grocery stores. In the year to June 2019, food was the second largest expense for New Zealand households, with an average spend of \$234 a week.

The high level of concentration in the sector, potential competition concerns, and the prices consumers pay for their groceries were reasons cited by the Minister of Commerce and Consumer Affairs for asking us to undertake this study.

We have found that competition is not working well for consumers in the retail grocery sector. If competition was more effective, the major grocery retailers would face stronger pressures to deliver the right prices, quality and range to satisfy a diverse range of consumer preferences. We make a number of recommendations which we consider will improve the conditions for competition in the grocery sector.

The major grocery retailers, Woolworths NZ and Foodstuffs, operate as a duopoly with a fringe of other competing grocery retailers. Competition between the major grocery retailers is a key driver of the prices, quality, range and services offered to New Zealanders.

While the fringe of other grocery retailers is increasingly diverse, they have a limited impact on competition. This is because the major grocery retailers are uniquely placed to best provide what matters most to consumers by offering a wide range of groceries at locations which consumers can easily access (both in store and online) at prices which are generally lower than those offered by other grocery retailers. This offers consumers the convenience of one-stop shopping no matter their shopping mission.

Under current market conditions, we see little prospect of new or expanding rivals being able to achieve the scale and geographic coverage required to compete effectively with the major grocery retailers. Competitors wanting to enter the market or expand face significant challenges, including a lack of suitable sites for store development and difficulties in sourcing wholesale supply of a comprehensive range of competitively priced grocery products.

The best options for improving competition are those that enable an increase in the number of retailers directly competing against Foodstuffs and Woolworths NZ to offer a convenient one-stop shopping option. Our recommendations include:

- freeing up land for supermarket development, through changes to planning laws and prohibiting the use of restrictive covenants on land and exclusivity covenants in leases;
- the major grocery retailers offering wholesale supply to other grocery retailers on a voluntary basis, subject to some limited regulatory measures;
- addressing imbalances in bargaining power between the major grocery retailers and many of their suppliers by introducing a mandatory grocery code of conduct, considering enabling collective bargaining by some suppliers, and strengthening the Fair Trading Act's business-to-business unfair contract terms provisions; and
- helping consumers make more informed purchasing decisions and enhancing competition at the retail level, by introducing mandatory unit pricing, as well as asking the major retailers to ensure that their pricing and promotional practices, and the terms and conditions relating to their loyalty programmes, are simple and easy to understand.

## Focus of our study

Our study is focused on understanding competition in the grocery sector. It does not look at other factors which are unrelated to competition in the sector, such as the impact of GST on grocery prices, or policy matters relating to healthy eating, alcohol consumption or environmental issues.

If competition is working well for consumers in the long term, we would expect to see grocery retailers competing to deliver consumers the range and quality of products at the right price to satisfy their preferences. In a competitive market, businesses are incentivised to innovate and there is ongoing pressure on firms to attract and retain consumers.

Our study focuses on the retail supply of groceries to New Zealand consumers. This includes meat, fruit and vegetables, canned goods, dairy products, and a range of other household products, like toilet paper, cleaning products and pet food. Our study also includes alcohol and tobacco where these are sold by grocery retailers.

The wholesale purchasing of groceries by retailers from growers and other food and grocery producers has also been a significant focus for our study. The major grocery retailers' supermarkets are a critical route to market for many suppliers. Further, consumers benefit from better products when suppliers have the ability and incentive to invest and innovate.

We have not analysed the grocery sector's immediate response to COVID-19 or its short-term effects on competition. However, we have considered whether any issues or practices that have emerged during the pandemic are likely to affect competition in the longer term.

## Industry overview

The retail grocery sector is made up of a variety of retailers catering to diverse consumer needs through a mix of supermarkets, specialist and international food stores, convenience stores, online-only supermarkets and meal kit providers.

Two major operators of nationwide supermarket chains are prominent in the sector: Woolworths New Zealand Limited (Woolworths NZ) and Foodstuffs. These supermarket chains are a significant focus for our study. We refer to them as 'major grocery retailers' throughout this report. Grocery retailers that are not part of these groups are referred to as 'other grocery retailers'.

Consumers engage in different shopping missions, including:

- a main shop typically 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 for specific products, undertaken at a retailer other than the store the main shop is carried out at; and/or
- a top-up shop for a small number of items, often across different types of grocery retailers.

Most New Zealanders use one of the major grocery retailers for most of their shopping missions. While consumers choose where to shop based on a variety of factors which can vary by type of shopping mission, convenience and price are key drivers of store choice. As noted above, the major grocery retailers are uniquely placed to offer a wide range of items at locations which consumers can easily access (both in-store and online), at prices which are generally lower than other grocery retailers. This offers the convenience of one-stop shopping no matter the shopping mission.

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 FreshChoice stores, which mainly operate in smaller centres.

Foodstuffs operates as two separate co-operatives: Foodstuffs North Island (Foodstuffs NI) and Foodstuffs South Island (Foodstuffs SI). There are more than 400 Foodstuffs retail stores nationwide operating under the New World, PAK'nSAVE and Four Square banners, as well as Raeward Fresh and On the Spot stores in the South Island.

The major grocery retailers also have integrated wholesale functions, but largely only supply themselves and their franchisees. They own and operate central distribution centres which supply their retail stores throughout the country.

There are some independent wholesalers which supply other grocery retailers with some product categories like fresh produce, meat, and international products. The breadth of wholesale supply options available to the other grocery retailers affects the extent to which they can compete with the major grocery retailers.

## Process and engagement

To inform our assessment of whether competition is working well, we have considered a range of observable market outcomes. This includes the prices charged to consumers, the profitability of grocery retailers and the extent of innovation they engage in, as well as the quality, range and services that are offered.

We have also looked at the nature of competition in the retail and wholesale grocery sectors, including the conditions under which entry and expansion can occur and the behaviour of market participants.

While we necessarily discuss and analyse these things individually, all of them contribute together to our overall assessment as to whether competition is working as effectively as it could (and if not, what might be able to be done to improve it).

We have considered the views and evidence provided by many stakeholders when reaching our findings and recommendations, including retailers, suppliers and consumers. 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.

We are also grateful to those who attended our hui Māori for their time and contribution on a number of matters including the importance of kai and its contribution to the wellbeing of Māori, the role of Māori in the grocery sector in the past and present, as well as future aspirations. We acknowledge the importance of these matters, and while some of these fall outside the scope of our study, the Government may wish to consider them further.



## Key findings

We have found that competition in the retail grocery sector is not working well for consumers. During our study we have identified several features of the grocery sector which indicate that competition is not working well. In summary, our findings are:

- there is a market duopoly with a fringe of other competitors;
- the intensity of competition between the major grocery retailers is muted and does not reflect workable competition;
- entry and expansion by other grocery retailers is difficult;
- the profitability of the major grocery retailers appears higher than expected under workable competition;
- prices appear high by international standards;
- the level of innovation appears lower than expected under workable competition;
- pricing, promotional and loyalty practices are limiting consumers' ability to make informed decisions; and
- competition is not working well for many suppliers due to an imbalance in bargaining power.

### Market duopoly with a fringe of other competitors

The structure of the retail grocery sector can best be described as a duopoly with a fringe of other competitors. While there are several different retail banners in New Zealand, the grocery market is dominated by Foodstuffs' and Woolworths NZ's supermarket chains.

The fringe of other competitors is made up of a variety of retailers that provide options for some consumers. However, they have a limited impact on key competitive choices of the major grocery retailers such as ranging, price and store investment decisions.

An important reason for this is that the major grocery retailers are uniquely placed to offer the convenience of one-stop shopping no matter the shopping mission. This reflects the wide range of products the major grocery retailers offer, their stores being located where consumers can easily access them, and the prices they charge generally being lower than other grocery retailers. The major grocery retailers often have a significant price advantage over other grocery retailers, because their scale means they can access lower wholesale pricing from suppliers (for example, due to volume discounts and promotional funding).

Consumers undertake a range of different 'shopping missions' and it is possible that the importance of the main shop is declining. However, most consumers continue to do their grocery shopping with the major grocery retailers, no matter the shopping mission. Our research shows that convenience and price are the main drivers of where consumers choose to shop for groceries.

Although there is currently a wide variety of retailers operating in the New Zealand grocery sector, there are no large-scale competitors able to compete effectively with the one-stop shopping offered by the major grocery retailers. Other grocery retailers may provide some constraint in local markets, but limited geographic coverage and scale weakens their ability to compete.

## **The intensity of competition between the major grocery retailers is muted and does not reflect workable competition**

There is some competition between the major grocery retailers on both price and non-price elements of the retail grocery offer. Price competition focuses mainly on promotional pricing which is often funded by suppliers.

However, the intensity of competition between them is muted and we consider that it does not reflect workable competition. This is because a combination of market features reduces the incentive for the majors to compete more intensely with each other (particularly on price).

- The major grocery retailers are each other's closest competitors and have similar competitive strategies which are well known.
- They closely monitor each other, and the high degree of transparency means they can quickly detect and respond to any changes in their closest rival's competitive strategy. This limits the gains that might be made from more intense competition, particularly price competition.
- The market is relatively stable. The retail grocery sector is highly concentrated and the market shares of the major grocery retailers have been relatively high and stable over time. Other grocery retailers face difficulties entering and expanding. The demand for groceries is also relatively stable and predictable, largely reflecting population growth. These features limit the scope for significant disruption to the major grocery retailers' existing competitive strategies.

We expect that competition would be more intense at the retail level if there were more large-scale grocery retailers offering one-stop shopping to compete for a wide range of consumer shopping missions.

## **Entry and expansion by other grocery retailers is difficult**

Competition tends to be weak in a duopoly, unless it is easy for rivals to enter and/or expand to a scale sufficient to directly compete with the duopolists.

Entry and expansion by rivals is difficult in the New Zealand grocery sector for a range of reasons. This reduces the ability for other new and existing grocery retailers to compete effectively with the major grocery retailers. Two reasons are particularly important.

### **Lack of suitable sites for development of retail grocery stores**

First, there is a lack of suitable sites for store development. This may be partly because land is not physically available, due to geography or existing patterns of urban development. However, the effect of planning laws has been to significantly reduce the availability of urban land for development of retail grocery stores. Planning laws can also impose cost, delay and uncertainty in areas where development is not altogether prohibited.

A lack of available sites is also aggravated by the major grocery retailers lodging restrictive covenants on land and including exclusivity covenants in leases to prevent their rivals from opening stores. For example, we have identified:

- more than 90 land covenants entered into by the major grocery retailers, at least 60 of which are not time limited or have a term of more than 20 years; and
- more than 100 instances of exclusivity covenants being used in lease contracts, a majority of which are still active, with more than 90 instances having a term of more than 20 years (taking into account the right of renewal).

## Difficulties in obtaining competitively priced wholesale supply of grocery products

Second, smaller grocery retailers face difficulties in sourcing a comprehensive range of grocery products at prices which enable them to compete effectively. This hinders their ability to achieve necessary scale. Lack of wholesale supply appears to be an issue particularly for dry groceries.

At present, any large-scale entrant into grocery retailing would need to source products separately from a large number of individual suppliers and organise related logistics, including for temperature-controlled goods. This is a much greater challenge for smaller grocery retailers, who lack the resources to separately negotiate with a large number of suppliers.

Smaller grocery retailers, such as convenience stores and dairies, frequently find that their best option is to buy groceries from supermarkets for resale.

Smaller grocery retailers are generally charged less competitive prices than the major grocery retailers when purchasing from suppliers directly, due to differences in scale. For example, the major grocery retailers are able to negotiate volume discounts through bulk buying and access significant funding from suppliers to support retail promotions. There may also be minimum order quantities which make it difficult for smaller grocery retailers to purchase directly from suppliers.

## Other factors affecting entry and expansion

Other factors that may affect the conditions for entry and expansion include:

- potential uncertainty, complexity, and delays associated with foreign-owned grocery retailers seeking approvals for overseas investment;
- current alcohol licensing laws result in differing availability of alcohol in grocery stores, limiting the ability of some existing or potential stores to effectively compete with the major grocery retailers (given consumers value having a wide range of products in one place); and
- strategic behaviour from established grocery retailers, such as exclusive supply agreements, which may limit other retailers' ability to access the grocery products they need to compete.

## There is little prospect of entry or expansion constraining the majors under current conditions

A range of developments are improving choices, but only for some consumers. There have been several smaller-scale new entrants in the retail grocery sector. There is an increasing trend towards online grocery shopping and meal kit providers have emerged. Costco is also due to enter in Auckland in 2022.

However, it appears unlikely under current market conditions that any new grocery retailers (or existing grocery retailers seeking to expand) will be able to achieve scale and geographic coverage comparable with the major grocery retailers in the foreseeable future. Without this scale and coverage, other grocery retailers are unable to compete effectively for the majority of shopping missions.





## The profitability of the major grocery retailers appears higher than expected under workable competition

Our analysis indicates that the major grocery retailers have achieved higher levels of profitability than we would expect in a workably competitive market for a period of at least the five years prior to the COVID-19 pandemic.

Our estimates of return on average capital employed (ROACE) for the major grocery retailers, averaged across 2015 to 2019, are 12.7% for Woolworths NZ, 12.8% for Foodstuffs SI and 13.1% for Foodstuffs NI. ROACE measures a company's operating earnings as a percentage of the capital employed in generating those earnings.

These ROACE estimates are well above our estimate of a normal rate of return for grocery retailing in New Zealand of 5.5%. We estimated a normal rate of return based on the weighted average cost of capital (WACC) for New Zealand grocery retailers. We consider that the WACC is the best available benchmark of returns expected under workable competition.

Our ROACE analysis has been modified in response to submissions and additional information which was not available at the time of our draft report. For example:

- Our ROACE estimates for Foodstuffs NI and Foodstuffs SI are now calculated on a 'whole of business' basis. Whole of business ROACE estimates are for the entirety of Foodstuffs NI and Foodstuffs SI's businesses, including the centralised functions provided by the co-operatives and ownership of property used for retail stores. In the draft report, our focus was on the individually owned and operated stores that directly engage in grocery retailing.
- For Woolworths NZ, we have now included right of use assets reflecting the value of leased property. Woolworths NZ leases most of the land and buildings used for its retail stores. Including right of use assets for leases in capital employed is consistent with standard financial practice.

As part of our profitability assessment, we also examined:

- the returns that the major grocery retailers expected to make on investments in new and refurbished stores, contained in a selection of business cases produced between 2014 and 2019; and
- profit to sales margins for the major grocery retailers, compared to a sample of overseas grocery retailers.

Our analysis of business cases shows that a selection of investment projects undertaken by some major grocery retailers were well above the hurdle rate which is our workable competition benchmark. However, it was not possible for us to draw any inference regarding the overall profitability of their businesses from the assessment of those business cases we analysed.

Our analysis shows that profit to sales margins for New Zealand's major grocery retailers are broadly consistent with the sample of overseas grocery retailers. However, it is difficult to draw firm conclusions regarding whether the major grocery retailers' profit margins are consistent with workable competition by comparing them with overseas grocery retailers.

## Prices appear high by international standards

Consumers told us that they consider grocery prices in New Zealand to be high and that they are higher than those they have experienced overseas.

While it is difficult to compare grocery prices internationally accurately, it appears that New Zealand prices are relatively high by international standards. We have undertaken international price comparisons using a range of data sources and a mix of market exchange rates and purchasing power parity (PPP) exchange rates, to ensure that our findings are robust to different inputs.

New Zealand was the fifth most expensive grocery market in the OECD in 2017, when comparing prices using a combination of market exchange rates (66% weighting) and PPPs (34% weighting). This is based on the two data sources we consider to be the most reliable, the OECD and International Comparisons Program (ICP) datasets.

New Zealand also ranked highly in the OECD in terms of the amount spent on groceries. In the three datasets we analysed, New Zealand ranked at least the fifth highest spend per capita on grocery products in the OECD in 2017.

## The level of innovation appears lower than expected under workable competition

While it is difficult to benchmark, the scale and pace of innovation in the New Zealand retail grocery sector appears lower than we would expect under workable competition.

There has been significant investment in innovations in products, formats and supply chain efficiencies in the New Zealand grocery sector. These innovations can benefit consumers when they respond to their preferences. For example, investment and innovation by grocery retailers in New Zealand includes:

- innovations aimed at improving consumers' in-store shopping experience (for example, Scan&Go technology, and smaller 'metro' stores);
- investments aimed at improving supply chain efficiencies (for example, new distribution centres);
- innovations in new private label brands (for example, Pams Finest and Macro); and
- innovations in digital technologies and online grocery shopping (for example, online-only supermarkets, click and collect and delivery services, and smartphone apps).

However, the major grocery retailers appear to be largely adopters of other retailers' or suppliers' innovations, rather than generating their own innovations. Their strong negotiating position can also weaken suppliers' incentives to invest in new products. In addition, the benefits of supply chain efficiencies may not be shared with consumers to the same extent as would be likely if competition were stronger.

Some major grocery retailers have been slow to introduce online sales channels, without consequences for market share or profits. Growth in online sales has accelerated during the COVID-19 pandemic. However, much of this growth has accrued to the major grocery retailers, whose online supply appears complementary to their existing physical networks.

Currently, other online grocery retailers are small. It seems unlikely that growth of online sales will significantly undermine the necessity for, or viability of, bricks-and-mortar retail grocery stores for the foreseeable future.

## **Pricing, promotional and loyalty practices are limiting consumers' ability to make informed decisions**

Consumers are confident and more inclined to shop around when they can compare product offerings both within store and between retailers, enabling them to gain an accurate perception of value to help choose where they would like to shop. This in turn incentivises retailers to compete to meet consumers' needs such as through offering new products and services and/or reducing prices.

We have found that consumers can be confused by the following.

- The array of pricing and promotional practices used by the major grocery retailers, and their frequent use. These include short-term specials, multi-buys providing a discount when a specified number of items is purchased, discounts provided only for members of loyalty programmes, and a pricing strategy based on offering a 'low' price for an extended period.
- The complexity of the reward structures and terms and conditions relating to their loyalty programmes. 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.
- Difficulty comparing prices between similar products with different pack sizes. Unit prices are expressed using standard units of measurement (for example, per litre or per kilogram), helping consumers to compare pricing between products of different sizes. While the major grocery retailers display unit pricing for many products they offer, it is not consistently used or displayed.

These practices make it more difficult for consumers to compare prices and make informed purchasing decisions (both when deciding where to shop and which products to buy), reducing the effectiveness of price competition between the major grocery retailers.

We also find that, even when provided with some information, 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 may not make fully informed choices about whether to participate in loyalty programmes, affecting competition for those consumers between the major grocery retailers.

## **Competition is not working well for many suppliers due to an imbalance in bargaining power**

Suppliers such as farmers, growers, manufacturers and processors of grocery products play a critical role in the grocery sector, by producing the products sold by grocery retailers.

Many suppliers have few options outside of major grocery retailers and are reliant on them to sell their products.

- With only two major grocery retailers, which between them have a high market share, in many instances there is limited competition for the purchase of suppliers' products. This can create an imbalance in bargaining power for suppliers.
- There are a range of factors which can affect a supplier's bargaining position. Some suppliers will be in a relatively strong bargaining position – particularly large multi-national suppliers of well-known brands. However, many suppliers are small and are likely to be in a weaker bargaining position.
- The major grocery retailers can use their buying power to shift costs and risks onto suppliers, insist upon uncertain terms of supply, and limit suppliers' dealings with other grocery retailers. This includes the threat of suppliers having their products removed from supermarket shelves if they do not agree with the major grocery retailer, for example, on contract terms, margins or pricing.

The supply terms (both actual and prospective) resulting from this imbalance of bargaining power can reduce suppliers' incentives to invest and innovate, ultimately leading to lower quality goods and reduced choice being available to consumers. There is also a risk that prices will rise in the long term if suppliers decide to exit the market, reducing competition.

Suppliers who encounter difficulties when trading with grocery retailers appear to currently have limited ability to resolve disputes. While the major grocery retailers have supplier charters, relatively few complaints are made. It appears that suppliers may be reluctant to raise complaints or enforce their rights due to fear of retribution.

The overall long-term impact of private labels (home brands) on outcomes for New Zealand consumers is unclear. Consumers may benefit from private label products through lower prices and greater choice. However, some conduct in relation to private labels could harm competition – particularly given the New Zealand retail grocery sector is highly concentrated. For example, there is a risk of retailers favouring their private label products over other supplier branded products when making ranging decisions or allocating shelf space.

## Recommendations

We have identified a range of recommendations to improve competition and produce better long-term market outcomes for consumers. A list of these recommendations is provided at the end of this executive summary.

Where possible, we have made high-level judgements about the likely scale of costs and benefits of our recommendations. However, we consider that formal cost-benefit analysis falls outside the scope of our study. There may be other costs and benefits, or policy considerations, that we have not considered as they are outside the scope of our study and do not relate to competition. This analysis may be undertaken by policy makers when considering our final report.

### Improving conditions for entry and expansion

We consider that the best way to improve competition in the retail grocery sector is through measures that are likely to improve the conditions for entry and expansion. Improving the conditions for entry and expansion is likely to be particularly beneficial for consumers where this enables a greater range of grocery retailers to offer a convenient one-stop shopping option.

We consider that the New Zealand market could sustainably accommodate at least one more large-scale rival, and that reducing current constraints on entry and expansion would help to facilitate this. In the long term, actual entry or expansion is likely to be the greatest driver of competition.

There are two main areas where we consider changes would be desirable to help facilitate an increase in the number of grocery retailers that compete effectively with the major grocery retailers:

- freeing up sites for retail grocery stores; and
- improving access to groceries for resale.

We also recommend considering the impact of overseas investment rules and alcohol licensing laws on competition in the retail grocery sector the next time the relevant legislation is reviewed, and monitoring strategic conduct by grocery retailers.

We expect that making more sites available, and enabling greater voluntary wholesale supply of groceries, would significantly improve the conditions for entry and expansion in the retail grocery sector. These changes may also support the aspirations we heard from many Māori and other stakeholders regarding their desire to participate further in the retail grocery sector.

## Freeing up sites for retail supermarkets

Freeing up sites for supermarkets is important for facilitating direct competition with the existing major grocery retailers. We recommend:

- a range of possible amendments to planning laws and instruments to ensure sufficient land is available for new supermarkets to be built, increase certainty for those seeking to develop new retail grocery stores, and limit the grounds on which new developments can be declined;
- prohibiting (and making unenforceable) the use of restrictive covenants on land and exclusivity covenants in leases that impede the development and operation of retail grocery stores; and
- monitoring of land banking by the major grocery retailers, given the potential for restrictions on use of covenants to lead to an increase in land banking.

## Improving access to groceries for resale

We consider that competition would be enhanced by one or more of the major grocery retailers offering wholesale supply of groceries to other retailers on a voluntary basis, subject to some limited regulatory measures including:

- an obligation to consider requests for wholesale supply in good faith;
- transparency over the rules, criteria or procedures adopted by major grocery retailers in considering such requests, as well as their terms and conditions of wholesale supply; and
- a dispute resolution mechanism (excluding disputes over price or quantity of goods supplied).

Wholesale supply of groceries on reasonable terms could provide a stepping stone for larger-scale new entrants, as they grow and develop their own direct relationships with suppliers. Wholesale supply could also enable other fringe competitors to compete more effectively on product range and quality on a more enduring basis.

We consider that major grocery retailers offering wholesale supply to other retailers is likely to be the most successful long-term solution for improving access to groceries for resale. There is unlikely to be sufficient demand to support a viable independent wholesaler over the longer term. Large grocery retailers throughout the world typically source and distribute products to their own retail stores, rather than purchasing from a wholesaler. This is also true for New Zealand's major grocery retailers, and some larger-scale potential entrants.

We considered other options such as a regulated wholesale access regime and vertical separation of the major grocery retailers (which would require their wholesale businesses to be run separately from their retail businesses). However, we do not recommend these options because:

- introducing a regulated wholesale access regime for groceries would be very complex due to the wide range of products and dynamic nature of the sector; and
- there are significant efficiencies associated with integrated retail and wholesale grocery operations, and there would be a range of practical challenges and transaction costs associated with separation.

Therefore, we recommend that the major grocery retailers be given the opportunity to negotiate commercial wholesale supply arrangements with other retailers, with the regulatory oversight described above. The major grocery retailers have publicly stated that they are open to, or are exploring, the possibility of negotiating commercial wholesale supply in certain circumstances.

## Reviewing overseas investment rules and alcohol licensing laws

We also recommend that other potential regulatory factors affecting the conditions of entry and expansion be considered the next time relevant legislation is reviewed. In particular, we recommend government consider whether the impediments the Overseas Investment Act 2005 approval process and Sale and Supply of Alcohol Act 2012 may impose on entry and expansion in the retail grocery sector are justified by other policy considerations and, if not, how these impediments could be addressed.

## Monitoring strategic conduct by the major grocery retailers

We recommend monitoring the extent to which the major grocery retailers engage in strategic conduct that may affect the conditions of entry and expansion. This includes the use of 'best price' clauses and exclusive supply agreements.

## Improving competition for the acquisition of groceries

To address imbalances in bargaining power between the major grocery retailers and many of their suppliers, we recommend:

- introducing a mandatory grocery code of conduct;
- considering enabling collective bargaining by some suppliers; and
- strengthening the business-to-business unfair contract terms regime.

## Introducing a mandatory grocery code of conduct

We recommend introducing a mandatory grocery code of conduct, based on the Australian Food and Grocery Code. We think an effective code of conduct would need to be determined by Government, rather than industry self-regulation.

Key features of a mandatory New Zealand grocery code of conduct should include:

- an overarching principle of good faith;
- requirements aimed at improving the upfront transparency of terms of supply;
- limits or prohibitions on certain conduct (for example, unilateral or retrospective variations of terms of supply, circumstances under which products can be delisted); and
- access to a dispute resolution process, which is independent, affordable, timely, confidential, and informed by specialist expertise.

## Enabling collective bargaining by suppliers

We recommend that the Government consider a statutory authorisation or exception for collective bargaining by grocery suppliers. The process would need to be limited to ensure that collective bargaining did not facilitate anticompetitive conduct, and only applies to the business and circumstances where it would likely be beneficial.

## Improving the enforcement mechanisms for the business-to-business unfair contract terms regime

In addition, we recommend amending the Fair Trading Act's provisions relating to unfair business-to-business contract terms in standard form contracts to allow for private action, and to simplify the mechanism under which penalties or other remedies could be imposed. We also recommend considering whether changes should be made to increase the number of grocery supply agreements that are captured by the regime. These changes would complement a grocery code of conduct.

## Improving consumers' ability to make informed decisions

We recommend measures directed at improving some of the information provided to consumers. These measures include:

- ensuring that pricing and promotional practices are simple and easy to understand;
- introducing mandatory unit pricing;
- ensuring disclosure relating to loyalty programmes and data collection and use practices is clear and transparent; and
- co-operation with price comparison websites.

We expect that these measures would help consumers make more informed purchasing decisions and improve consumers' confidence. This in turn should enhance competition in the retail grocery sector.

### Ensuring that pricing and promotional practices are simple and easy to understand

We recommend that the major grocery retailers ensure that their pricing and promotional practices are simple and easily understood by consumers by, for example:

- ensuring that the number of different promotional mechanisms and their use in combination does not result in consumer confusion;
- using different tickets for different mechanisms to clearly indicate the type of mechanism being used;
- ensuring that the usual price is accurate and consistently and clearly displayed alongside the promotional price; and
- ensuring that member-only discounts are clearly labelled and easily distinguishable from other pricing and promotional mechanisms.

### Providing for consistent display of unit pricing

We recommend that certain grocery retailers be required to display unit pricing in a specified consistent format. Key features of the unit pricing regime should include:

- minimum standards regarding display of unit prices (including in terms of size, proximity, and legibility);
- standardised units of measurement for each category of products to be covered by the requirements;
- exemptions for some product categories from a requirement to display a unit price, where the unit price would not provide useful information; and
- the requirements applying to in-store display and advertising in print media and online where the selling price is displayed.



## Ensuring disclosure relating to loyalty programmes and data collection and use practices is clear and transparent

We consider that there would be benefits from the major grocery retailers ensuring that the presentation of the reward structures and terms and conditions applying to their loyalty programmes is clear, transparent and readily understandable by consumers.

We also recommend that the major grocery retailers ensure that they are providing consumers with appropriate relevant information to make informed decisions about data collection and use practices relating to loyalty programmes.

## Co-operation with price comparison websites

We recommend that the major grocery retailers co-operate with existing or potential price comparison services in New Zealand. Price comparison websites for the retail grocery sector are in their infancy in New Zealand, and demand for such services from consumers is unclear. However, price comparison websites can promote competition by making it easier for consumers to make well-informed decisions when choosing between goods and services.



## Ongoing monitoring and enforcement of competition issues in the grocery sector

Finally, we recommend changes to provide ongoing oversight of the sector and allow the impact of our recommendations to be assessed. In particular, we recommend:

- establishing a new grocery sector regulator and dispute resolution scheme; and
- undertaking a review three years after the Government has implemented any reforms that it chooses to proceed with as a result of our recommendations.

### Establishing a new grocery sector regulator and dispute resolution scheme

To give effect to many of the recommendations described above, we recommend that both a grocery sector regulator and a dispute resolution scheme be established. A sector-specific regulator could have responsibility for general oversight of the retail grocery sector. This could include monitoring and reporting on its performance, both publicly and to government.

The regulator could be responsible for enforcing the grocery code of conduct in situations where dispute resolution is not appropriate or is not leading to satisfactory outcomes. It could also be responsible for enforcing unit pricing regulation and prohibitions on the use of covenants.

Given the benefits that monitoring and information disclosure can have by improving sector conduct and performance, at low regulatory cost, a sector-specific regulator could also have a role in monitoring matters such as industry progress regarding voluntary wholesale supply arrangements, use of exclusive supply agreements and best price clauses, and the major grocery retailers' pricing and promotional practices and loyalty programme terms and conditions.



## Undertaking a review three years after implementation of our recommendations

We have considered other options which could directly stimulate retail competition by offering consumers additional one-stop shopping options. This includes facilitation or sponsorship of entry by government, or requiring the major grocery retailers to sell some of their stores to create additional major grocery retailers.

Many consider that such initiatives are necessary, because New Zealand is a challenging market for a new entrant and no large-scale competitors can be expected to grow from the existing fringe of other grocery retailers under current market conditions. We recommend options intended to improve the conditions for competition and we consider that they should be implemented and tested before further considering whether other initiatives may be required.

Given this, we propose that a further review of the state of competition in the retail grocery sector be undertaken three years after the government has implemented any reforms that it chooses to proceed with. Information on how competition has developed would be available at this point.

To facilitate a successful review, and to support the grocery regulator's general monitoring and enforcement functions, we recommend robust information gathering powers for the grocery regulator, and that consideration be given to introducing an information disclosure regime for the major grocery retailers in the interim. This would require the major grocery retailers to collect and supply information to a new grocery sector regulator (or another part of government) in a consistent and specified format.

The information collected under the information disclosure regime would be intended to allow further analysis to be undertaken of matters such as market shares, store locations, information to inform assessments of profitability, wholesale supply volumes, the proportion of retail sales that are private label products, and consumer complaints. This would sit alongside other information that we would expect the regulator to collect as part of its monitoring and enforcement functions described above.

If competition is still not working as well as it could after three years, the review could consider whether other initiatives are required.

## Other matters of interest to us

Some information we have collected during our study also could indicate conduct that merits further consideration under the Fair Trading Act or other parts of the Commerce Act prohibiting anti-competitive conduct.

Independent of the outcomes of this study, we will continue to consider the appropriate use of the full range of our compliance, investigation and enforcement functions and powers under these Acts. We have identified some instances where we either:

- intend to open investigations into compliance with legislation we enforce;
- are continuing to consider whether to open investigations; or
- could open investigations in the future if we become aware of conduct that may contravene legislation we enforce.

# List of recommendations

## Recommendations to improve conditions for entry and expansion

- **Recommendation 1:** Improve the availability of sites for retail grocery stores under planning law
- **Recommendation 2:** Prohibit restrictive and exclusive covenants that inhibit retail grocery store development, and monitor land banking by the major grocery retailers
- **Recommendation 3:** Require the major grocery retailers to consider requests for wholesale supply in good faith, and meet associated disclosure obligations
- **Recommendation 4:** The next reviews of the Overseas Investment Act and Sale and Supply of Alcohol Act should consider whether they unduly impede entry or expansion by grocery retailers
- **Recommendation 5:** Monitor strategic conduct that affects the conditions of entry or expansion.

## Recommendations to improve competition for the acquisition of groceries

- **Recommendation 6:** Introduce a mandatory grocery code of conduct to govern relationships between the major grocery retailers and their suppliers
- **Recommendation 7:** Consider a statutory authorisation or exception for collective bargaining by grocery suppliers
- **Recommendation 8:** Amend the Fair Trading Act to strengthen the business-to-business unfair contract terms regime.

## Recommendations to improve the ability of consumers to make informed decisions

- **Recommendation 9:** The major grocery retailers should ensure their pricing and promotional practices are simple and easy to understand
- **Recommendation 10:** Mandate the consistent display of unit pricing
- **Recommendation 11:** The major grocery retailers should ensure disclosure relating to loyalty programmes and data collection and use practices is clear and transparent
- **Recommendation 12:** The major grocery retailers should co-operate with price comparison services.

## Other recommendations

- **Recommendation 13:** Establish a grocery regulator and dispute resolution scheme
- **Recommendation 14:** Review the state of competition in the grocery sector three years after implementation of our recommendations, and collect information in the interim to support this review.



