MONOPOLY WATCH NZ
market structure matters

Foodstuffs Merger Clearance

Submission Evidence from MWNZ

Monopoly Watch, (MWNZ) has a working relationship with Northelia , both organisations submitted in detail to the 2021 ComCom Grocery Market Study .

Northelia' s submission process was focused on "*what would it take to secure a like for like 3rd Supermarket operator in NZ "*

MWNZ has studied the supermarket industry in NZ , commented on the public accounts of Woolworths NZ and secured case study evidence of the geographic monopoly in food distribution in NZ.

MWNZ has expertise in financial analysis and game theory economics of monopoly break up matters. MWNZ has practical experience in 3rd operator monopoly break up economics and financing.

Rather than fall into the trap of rhetoric and this merger failing the common sense *test we submit to the Commission where the evidence is* , that proves this merger substantially reduces the prospect of competition and increases the barriers to entry , in addition to it not being in the public interest .
We also note and discuss the factual errors and omissions of substance in the Foodstuffs application.

We submit that the FSSI & FSNI merger,

1) Significantly increases the barriers to entry for a 3rd operator challenger.

2) There is no market mechanism for any pass through of merger benefits to consumers, this was proved in the ComCom market study. (no price competition) and therefore will create an extra barrier to entry for any potential entrants

3) Is not intended to take costs out for consumers but merely facilitate a sell down of existing equity. The reason for this proposal is that in the course of this FSSI & FSNI Co-Op trust documents and articles of association of the Co-op will need to be changed, - these changes will allow for the existing Pak n Save Operators to sell out – and pull out capital from the business at existing valuations. (i.e. sell out at full monopoly rent valuation) – nothing wrong with this , as its rational monopolist behaviour , but this is not declared in the application as a reason for the merger .

4) It's not a merger of co-operatives food distribution outlets (called supermarkets) but a 3 to 2 merger of distribution networks .

   With urgency we urge the commission bench mark HHI ratios, not in supermarket chains, but in Distribution centres on an international basis with Sweden , Denmark , Finland , UK , Ireland and Norway to focus the Commission's attention on the outrageous structural barriers that are being created to a potential 3rd operator .

The Major matters discussed by MWNZ are.

- What is the evidence that proves this merger will most likely fracture the prospect of competition, is against the public interest and will not deliver any benefits to consumers?
- Why has this deal been presented to the Commission?
- Comments on the Foodstuffs submission.
- Comments on the ComCom Statement of Preliminary issues
- What is going on in secondary market trading of Supermarket stores (and where there is the evidence)
- Why the NZ Minister of Finance's comments "*we would like to see a 3rd supermarket operator "* is strategic , a government policy request should be made using the powers of the Commerce Act to seek clarification of this request .
- Why is the Supermarket public policy enquiry in Australia relevant to NZ?
- What is the Context of the Australian Prime Ministers comment of a possible break up of Australian Supermarkets?
- What we recommend the Commission research before this application is considered (list included in this submission)

The Monopoly Watch Position

1) **What is the evidence that proves this merger will most likely fracture the prospect of competition, is against the public interest and will not deliver any benefits to consumers?**

   Evidence that this will fracture the prospect of competition.
   This merger is not a merger of retail stores, these are geographically diverse, its merger of large, capital intensive, scalable intensive distribution centres, currently there are 3 in NZ , if this merger proceeds there will be 2 .

   This shrinkage will reduce by 1/3 the availability of industrial clannish skills in running and operation of a distribution centres, which inevitability would be available to a 3rd network operator.

   The consolidation of these 2 Distribution centres would turbo charge the power of in house brands, Notably "Pams" – (already NZ's largest vertically integrated Brand by revenue and market share) ,

We note the comments in the 2021 grocery Market study of the damage that market power in home brands does to supplier negotiating power.

"According to [independent research commissioned by the New Zealand Food Grocery Council in 2021](), "[g]given the high concentration of the retail market in New Zealand…private labels are likely to accentuate and entrench the strong imbalance of bargaining power held by retailers for many grocery suppliers."

Challengers in the supermarket industry are looking at the business case for a 3rd operator, capital providers recently pulled out of a competitive offering (Supie Nov 2023) Capital providers to challengers suffered the indignity of having incumbent operators buy 20% of the Warehouse and leverage don't supply to them in 2007 – this creates capital market scar tissue .

A 2 to 3 merger in distribution centres would further stall provision of capital as it more than incrementally increases barrier to entry. A successful merger application will undoubtedly increase the cost of capital for a 3rd and 4th operator.

We Refer the Commission to discuss with Northelia – what the financial model looks like for a price based competitor in NZ , We urge the commission to develop its own model of at what level of scale a 3rd operator needs to have consumer prices forced down , and nutrition and sustainability competition ignited.

Its fantasy to consider that anything less than 20% revenue market share in urban areas will cover the significant fixed operating costs for a 3rd operator challenger . It's the scale of distribution centre operator, but also scalable purchasing to offer suppliers as a reason to supply that needs further evidential review by the commission .

We urge the Commerce Commission to answer the Minister of Finances question of "*What it would it take for a 3rd operator which would create price competition*"

We urge the Commission to complete a HHI ratio for DC centres relative to NZ's OECD peer group of countries (not nonsensical Australia) but Ireland , Denmark , Finland ,Sweden , Norway , UK , Slovenia , Croatia .

Evidence that this Merger will not create pass through benefits for consumers.

We urge the commission to publish its own HHI rations for Geographic monopolisation of supermarkets within 5 km radius in urban areas for the 86 % of NZ's population which is urbanised .

The evidential impact of these ratios are that they will prove that there is no market force to allow any savings for consumers. so that the merged DCs benefits will not be passed through to consumers because there is no price competition

Such is the significance of the publication of these ratios could lead to NZ being credit downgraded (see discussion & 3rd party evidence of this in the ComCom Grocery Study Conference)

These ratios are so substantial, they could possibly lead to Transparey international directors of NZ having to resign as they have created the low integrity decision making which allowed not only a 3:2 merger but also bullied politicians and policy makers into sliding into the interests of monopolists rather than kiwi consumers .

The reputational damage of this cartel must not be overlooked or underestimated as a reputational stain on the integrity of NZ governments.
This is particularly the case as the Australian supermarket problem gets more coverage internationally in not just financial markets but also in economic literature . NZ is the Australian problem on steroids and the numbers speak for themselves in higher net margins and more extreme geographic monopolisation.

It makes sense for the Commission to pass judgement in their merger application that there is a lack of correctly funded public interest groups to assist them in their work and balance the well-funded , well resourced , lawyer driven incumbents that drive this monopolisation of consumer retailers . The ComCom is continually bullied by incumbents lobbying power at all levels of government . Simply put there are no consumer facing organisation maintaining a balance in the public arena, as a consequence not only is capitalism breaking down, but so is consumer democracy, the void of this balance is notable in this and many other NZ merger applications .(ie National Bank/ ANZ , Caltex / Z energy , Countdown/ Foodtown etc)

We believe that should a merger take place not 120 stores will be need to be divested to create a 3rd operator but 180

We evidence the strategic point from incumbents Foodstuffs in their submission to the ComCom Market study that Adi was coming to NZ and that they had successful been in Australia. This has now proved to be faulty ,with the Australian Prime Minister now involving himself on the price gouging enquiry In Canberra .

We submit to the commission of just how dangerous pyrrhic competition is . Australians have been duped for over 15 years that Adi was a competitor.

This illustrates to NZ regulators, policy makers and politicians , just how dangerous pretend competition is , and how serious the problem is and how Tough the problem is to fix .

Adi was invited in and was given a market segment and small incremental market share every year in Australia, to become, Adi's ,most profitable market .

This has not created competition, or removed the market power to abuse suppliers in Australia . We note that the Current Australian supermarket industry problems is noteworthy for the NZ ComCom in this merger application as Adi has clearly not fixed the competition problem in Australia but rather disguised it for a number of years.

Prime Minister Anthony Albanese's comments of "*no 1970s soviet style intervention* ",(Feb 2024) are relevant to this merger application ,because the Australian , NZ and Soviet governments of the Brezhnev era all have the same problem in 2024 Food Distribution monopolies) were not serving the people efficiently .

In NZ Minister Bayley has the same problem as Brezhnev (as Soviet General Minister) both Ministers are dealing with monopolies that are not telling them the truth ! . And both Bayley and Brezhnev had regulated industries! with broken markets to contend with. Regulation such as the GICA perpetual the problem not solve the problem . Making the issues very similar to the Soviet legislation on central planning.

2) Why has this deal been presented to the Commission

Comments on the Foodstuffs submission.

This brazen merger application has been presented to the Commission as a scheme to alter the trust deed and the foundation documents of the Foodstuffs organization, This change will allow the 57 trapped investors in Pak n Save franchises (38 in NI and 19 in SI) to exit their business at the top of the market .

The fundamental problem Pak n Save investors have is the same one as Telecom Investors in 2007, (how to get out with capital valuations based upon monopoly rents) Ironically it's some of the same management team .

We urge the commission to revisit the revenue and profit pool of these Pak n save business versus the rest of the 4 Square business in the Foodstuffs organisation – it will prove the point ,calculate the value destruction if margins go from the currently monopoly margins to OECD benchmarks , it means a Pak in Save goes from being worth Circa $150M To $200m to only being worth $15m ,

We urge the Commission to evidence the secondary market sales of countdown buildings (this illustrates the destruction of value when monopoly rents get removed , or as in this case are threatened to be removed . because Its inevitable there will eventually be some sort break up , it has created an urgency to exit the business at current values.

The merger does allow again for a further improved scale with all the benefits accruing to existing shareholders and it also increases barriers to entry, this means increased profitability and an improved story for investors during the exit of the existing investors

3) Comments on the ComCom Statement of Preliminary issues

On the Commission's point of 5.2 identify further competition issues which should be investigated further we urge the commission to review the issue paper its published

Page 2 – "the Parties "

1) **The most important point is hidden** – The first point is the merger of the distribution centres, removing a 3rd ecosystem of DC skills and infrastructure, further consolidating supplier interface.

2) **Use of Data.** the Power of the ecosystem of data collection is much under rated and under stated in the review. The data collection impact of the amalgamation and the network effects of this data create a much more serious barrier to entry, particularly with the potential for drone delivery and other ecosystems of further securing" *Adjacencies*" in product sales . (socks , Stationary, kitchenware , etc). It is noteworthy MWNZ and Northelia both called for a unbundling of consumer supermarket data similar to APIs in banking to allow for a 3rd operator to start .

3) **Page 4 Our framework** the key point here is the difference in the counterfactual for a new like for like 3rd and 4th operator , and what level of scale their business case breaks even . We urge the Commission to publish some sort of Strawman/Women model of the 3rd operator and at what level of revenue it breaks even. MWNZ numbers show a requirement for circa 18-22% revenue share and 3 DC centres (AK , Palmy , & Chch) & NZD $1,2bn of equity capital .

4) **Decision impact on new operator:** the cost of capital is directly and indirectly impacted by this merger application, we urge the ComCom to select 2 or 3 investment banks to look at this cost and the impact the merger decision makes .

5) **Impact of "Own Brands"** Pams is advertised as NZ's largest brand , we note that this branding strategy , is statistically similar to the Soviet Union's strategy in the late 1970s . We urge the Commission to consider the similarity in problems that Lenard Brezhnev had to Minister Bayley – as in economics terms , consumer welfare and sustainably – they are the same problems within the supermarket ecosystem. The only difference is that in 2024 other areas of the NZ economy work substantially better than 1970s Soviet Union .

    a. However if Pams tipped and went to over 25% market share , suppler chain ecosystem would start to break , innovation would end and NZ as a international bespoke food supplier would start to fracture .

6) **We refute that Wholesale food regulatory regime helps a scalable 3rd entrant .** To solve the broken market its essential there is a level of DC competition, because this helps innovation , sustainability and Nutrition competition, We urge the commission to not get bamboozled by the ridiculous merger application claims that because the new merged entity is committed to wholesaling , that the Market structure will fix itself .

7) **Without the merger**

   a. Lower cost of capital for challenges
   b. Lower threshold of scale for a 3rd operator
   c. Higher salaries and wages for DC staff and procurement people
   d. Incrementally more competition for suppliers
   e. A rethink of how to recycle capital inside Pak n Save franchises and have them sell out.
   f. Better terms for marginal suppliers who can game both players
   g. Possible higher regulatory costs , as there is 2 regulated wholesalers

4) **What is relevant in the Foodstuffs application points that are worthy of comment)**

Page 3 executive summary point 5

FS "*The proposed transaction would not affect local store ownership, which would remain in he individual co -op members hands* " – This completely under states and confuses the commission on what the problem in grocery stores is – It's the power of the DC duopoly in NZ turbo charged with the geographic monopolisation of store location . The merger incrementally increases the barrier to entry here and further entrenches the inability of the store to change DC operator.

8.2 "*Proposed transaction will not result in any further volume acquired by the parties" However* , it creates further concentration and at the margin is a decision which deters challengers from being anything other than choice competition.

13.1 quote "*the continuing legal entity ( ) in any event will be a continuation* ***so this point is not material to substantive Analysis* "** MWNZ vigorously refute this claim by the FSNI and FSSI , because it's the change in structure which is material to the Commission and the entire motivation behind the deal , 57 Pak n Save franchise have an estimated $5.7 billion of Gross shareholder value worth . Which makes this transaction as large as approx. top 5 NZX companies and larger than Spark /Telecom. It helps illustrate the true intention of this merger when looked at in that context .

The Commission must note that if NZ grocery margins where to return to those generally accepted in UK, Denmark , Ireland or Sweden , then that $5,7 billion of value becomes $700m ,

re (*aka MP Craig Foss 2007 "I want to know why $8bn of shareholder value has disappeared from Telecom*) when the business was structurally separated and regulated by the incumbent .

13.1 is a smoking gun for the Commission to review and itself is a reason to postpone the merger application.

We urge the commission to review voting at the co-op and the sales process for stores and also note the wealth transfer from 4 Square owners to Pak n Save owners. – It's a substantial issue that the Commission understand that Brand split up , whereby New world is split from Pak n Save or 4 square is not the answer to solving the problem , but rather geographic monopolisation split of all related brands and a new start to brand configuration .

We urge the Commission to refresh its math on the competition in NZ with Danish , Swedish, UK , Ireland and US

1) Nutrition competition in supermarkets
2) Sustainability competition
3) Range competition
4) Bespoke innovation (from suppliers)

This is relevant, because this merger will help none of those , because there is no pass through of supplier pricing benefits .

The Grocery industry Competition Act GICA 2023 statements by Foodstuffs in its application is a false and misleading narrative, . The GICA is reflects a reform which is that of a select committee who didn't have momentum to break up the cartel.

It's a sensible interim step , but doesn't resolve the fundamental problem of inefficient failed market structure at the DC level . We urge the commission to ignore the marginal and inconsequential impact of the GICA in the evolution of real like for like 3rd operator competition.

The FSSI & FSNI make erroneous claims as to the potential of it , while simultaneously improving their market structure and scale , which further creates a moat around their business .

We note the FFSI comments about competition, sadly Supie is not with us as it was used extensively in the Market study to ensure competition was coming. Its childish by FFSI to suggest , Farros , Diaries , The Warehouse , Costco , Moors Wilsons , Bin in & Huckleberry's stores compete or are likely to compete in real terms on price or sustainability in this $25bn industry.

We urge the commission to publish turn over numbers , HHIs and revenue market share numbers in there report in a chart or bar graph format to refute this misleading suggestion .

We suggest simple comparisons on Net & gross Margin differentials in restaurants also be looked at against OECD benchmarks to prove the impact of the wholesaler dominance in NZ restaurant supply chain ecosystems of Trent's , Gilmour's & BidVest

5) Why the Minister of Finance's comments " we would like to see a 3rd supermarket operator is strategic " and a government policy request should be made by the ComCom.

The owners of foodstuffs are sophisticated operators, this statement from the Minister of Finance scares the hell out of them , and prevents them from being able to sell their business to new players . The commission needs to complete an age of ownership review , (the average weighted age by revenue is 64 years old , very close to retirement) this further illustrates the problem that Foodstuffs is trying to solve with the merger (too many Pak n Save owners are wanting to retire and sell up . (they can't do this at full value because no new investors are available in the current ecosystem , only PE and institutional investors (like those on the share register of wool worths , would consider buying into Foodstuffs.)

6) Why is the Supermarket public policy enquiry in Australia relevant to NZ

1) FSNI & FSSI **,** preached that ADI was coming to NZ , the Australian problem illustrates that this organisation is part of the problem , not the solution, as it has not ignited real price competition in nearly 20 years of operation .

2) The Investors in Woolworths and Coles continue to explain Australia has the worlds highest supermarket margins (NZ is higher) and luxurious market structure . Notably Goldman Sachs & UBS continues to talk about "visible Alpha " in analysis , which is the monopoly rent component of excess profitability over the cost of capital . – we urge the commission to read the investment banks research reports from the last 5 years , particularly the break out sections on Woolworths NZ

3) Australia mate ship has extended to market structure in banking (4 pillars policy of Keating govt) , to the roll up of Coles and Woolie , with a fringe of competition in direct business of Met Cash and Adi

4) Australia has had a competition market study and productivity commission review into their food distribution industries and almost 20 years ago and they are better resourced and have more bandwidth, What is notable is the Allan Fells (ex ACCC head) , comments that the supermarket revolution is over and they are now bottleneck industries . (see MWNZ submission last page in ComCom Mkt study Nov 2021)

5) Australian's have more financial analysis in the ASX listed companies and better comparisons with OECD benchmarks , this helps expose these differences . **.**

7) What we recommend the Commission research before this application is considered.

1) DC centre HHI ratio benchmarks
2) Valuation market cap of the Pak n Save stores , v Counterfactual 3 or 4 operator market
3) Net margins in Australia v OECD benchmarks
4) Impact of Nutrition and sustainability competition from OECD benchmarks in Europe
5) Change in the capital costs of a 3rd and 4th operator if the merger were to proceed.
6) Remodel what a 3rd operator looks like to secure price competition.
7) How capital is extracted from supermarkets in NZ and where the profitability is hidden (ie Property leases , intercompany loans , intercompany IT expense , Capital payments , dividend streams , supply arrangements etc
8) An Actual Cost of build and Scale required to operate – Effective DC's for a 3rd operator

Under what conditions MWNZ would support the merger,

1) Divestment of 85 stores selected on an geographic HHI basis to a qualified 3rd institutional supermarket operator, *using ComCom* Attachment *F of Mergers and acquisitions Guidelines published in May 2022*

2) Foodstuffs buy 23 Countdown/ Woolworths store in geographically monopolised Woolworths areas (Ie in the pocket of central west AK where there are 8 continuous Woolworths stores foodstuffs must buy 2) and pro rata around geographically monopolised areas.

3) 1 distribution centre is divested from Foodstuffs to the new 3rd operator (as per Attachment F process inside the M& A guidelines published by the commission)

4) Woolworths commits to divesting 60 stores simultaneously and also 1 distribution centre to the same qualified institutional supermarket operator.

5) Woolworths commits to buying 14 Foodstuffs stores in geographically monopolised Foodstuffs areas (west Auckland Pak N Save ecosystem)

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