DAY 4 - RETAIL GROCERY MARKET STUDY CONFERENCE

27 October 2021

Session 5: Indicators of competition – international price comparisons and innovation
Session 6: Indicators of competition – principles underlying profitability analysis

Ms Rawlings: Mōrena, tena koutou katoa, ngā mihi, good morning everybody. Welcome back to another day of the Commission's conference into our market study on groceries. Welcome back those who have been with us on previous days and welcome to the couple of people that we have today who haven't joined us previously.

Ko Anna Rawling tōku ingoa, I'm Anna Rawlings, I'm the Chair of the Commerce Commission. As I have for previous sessions, I'm going to make a few quick comments to get started today.

Today's sessions are going to discuss international price comparisons, innovation and that will be followed after the morning break with a session relating to our profitability assessments.

I'm also just going to recap a couple of housekeeping matters.

Again with me today are Commissioners who have been working on the market study: Dr John Small, Dr Derek Johnston and Associate Commissioner Vhari McWha.

A number of Commission staff are also here with us and may be seen from time to time, even if they're not all visible on the screen, they are here working on the study as they have been in recent months.

As you know, the purpose of the market study, is to identify factors affecting competition in the supply or acquisition of groceries in New Zealand and to make recommendations that we consider might improve competition, if required, and if we consider that's it not working as well as it could.

The draft report set out some preliminary views on the state of competition in the grocery market and it identified some options for recommendations that we want to explore further through our consultation process before finalising our report. The discussion so far has been thoughtful and insightful and we're grateful the contributions that people have made. It's provided an opportunity for new issues to be raised for us since our draft report through submission and through discussion at the conference. And it's also enabled you, at this conference, to hear a little more from one another and understand a little bit about the perspectives of others, we hope.

So far, we've discussed the state of competition relevant to the retail sector and we've also looked at consumer-facing issues, including promotions, pricing, loyalty programmes. Yesterday we explored the level of consensus and the further work to be done on the question of a code applying to the relationship between suppliers and grocery retailers.

Today's sessions, as I said are going to cover issues of price, quality, range, service, innovation, international pricing and then profitability. We'll run until 10:45 as we have on other mornings. We'll break for 30 minutes, resume at 11:15 and we're scheduled to finish at around 12:30.

We'll work through the remaining sessions on our agenda in coming days and the agenda can be accessed on our website.

The conference, of course, is not the last chance to have your say as you will have seen in the slideshow running while you waited to join the conference, we have asked for further submissions covering matters that have been raised at the conference or new matters that you'd like to raise by the 23rd of November. We might also seek further information from parties and we'll follow-up after the conference to do that, if we need to.

Our final report is to be made available no later than the 8th of March next year and that's a final deadline for us.

Once again, if you have questions about the process or any other questions about the conference, please do reach out to our team at the Commission market study email address which is marketstudies@comcom.govt.nz and we'll try to get back to you as soon as we can in the course of a session or in breaks during the conference. Any documents or material that you'd like to refer to during the conference sessions, you should go ahead and also submit that through that email address or follow-up with us at a later date.

As has been the case in the last few days, sessions today will be chaired by a Commissioner, today Dr John Small. He will lead the discussion and the questioning, others may have questions as we go ahead, but I'll just ask for all discussion to be directed through him as Chair so that we can continue to maintain an orderly discussion online.

As you can see for those of us joining us for the first time, the conference is run in a webinar format and that means that if you indicated that you'd like to speak in today's session, you will have joined as a panellist to the webinar and you can directly and immediately respond to any questions or make any comments. If you indicated that you'd rather attend as an observer, then you've been joined to the conference as an attendee, but we don't want this to prevent you from contributing to the discussion if something occurs to you and if you'd like to do so as we proceed, and in that case we'd ask that you just raise your hand using the Zoom function and a member of our team will contact you and submit a request for acceptance into the panel where you'll be able to make your comments.

In that way, we hope that we can provide an opportunity for everyone who wants to comment to do so in the course of the sessions, but if time or if your technology doesn't allow that, then again, we just encourage you to follow-up with us with submissions after the session, or if you'd like to, to contact us for a private discussion covering the matters under discussion.

As you can imagine, a number of the matters in sessions such as this in particular may be commercially sensitive to the parties and our intention is to keep the discussion at a level appropriate for a public forum.

You'll note from your Zoom feed that sessions are recorded and that's for transcription purposes, we don't intend to publish a recording of the conference, but we will publish a transcript as soon as we're able to do that on our website.

And finally I just want to remind everyone that we've welcomed members of the media to the conference. The level of public interest in the grocery study and in our conference has been high, as you will have seen both before and during the conference. And members of the media may come and go as they please. We have asked that the conference sessions are not recorded by third parties.

Thanks very much, I'll handover to Dr John Small to kick off today's session.

Dr Small: Thanks very much Anna and good morning everyone, welcome to day four of the conference which is focused on analysis of indicators of competition. In this first session we're going to discuss price comparisons, particularly international price comparisons, competition indicators that can be derived from looking at innovation and other non-price indicators of competition, which we summarise under QRS (quality, range and service), so things that aren't price, basically. So we start with price, then innovation and then non-price items.

The second session today is going to be about profitability indicators and that will focus on the valuation methods for intangible assets, particularly leases, goodwill, and brands. And these topics have been chosen because they're ones that are germane to our final conclusions about all of these matters, particularly concerning prices and profitability. So we're interested in the methodologies and how to go about these assessments in the best possible way, rather than talking about what answers might have come out so far, either by us, or by submissions to us, of course you're welcome to talk about those if you wish, but we're mainly interested in hearing about how these things should be done and just trying to bottom out some of those issues.

So just before we get started on the main work of the session, I would just like to step back a little bit and note that all of the topics that we're looking at today are indicators of competitive outcomes. And as you know, our responsibility under the terms of reference, is to assess any factors that may affect competition in the grocery sector. This includes not only competitive outcomes, but also the structure of the sector and the competitive processes and the dynamics that operate within the sector. Which you will have seen of course from our draft report and from the earlier conference sessions, we're also looking at quite closely in the course of the study.

So, while we necessarily discuss all of these things individually and analyse them individually, all of them contribute together to an overall assessment as to whether or not competition is working as affectively as it can and if not, what might be able to be done to improve it.

So if, for example it could be determined that profits have been persistently higher than normal, or prices are persistently high compared with suitable comparators, then observing those outcomes can tell us something useful about how well a market is performing and that's relevant to an overall assessment. But as we have noted in the draft report and others have also commented, there are quite significant challenges in assessment whether outcomes are consistent with competitive benchmarks. You can categorise these into two groups really. One is about developing the indicators themselves, what things should we be looking at and the second one is about finding, identifying appropriate and suitable benchmarks to compare them against to say whether or not this is consistent with workable competition or competition that's working well for consumers.

So this is true for all outcomes indicators whether its price, profitability, innovation, QRS, competition, all of these outcome indicators, this is true of. We do not think it's necessary to find conclusively that outcomes are out of line with competitive benchmarks in order to find that a market is not working as well as it could.

The other factors, such as market structure, conditions of entry and expansion, the behaviour of market participants are also important indicators of whether the process, (they're process indicators), whether the process of competition is working well and whether there are recommendations that could be made to improve the competitive process and drive better outcomes for consumers.

That's just trying to set the conversation for today in context, which is a part of our broad assessment of competition in these markets.

So if I go now to the content of session five. As I said before, we want to talk about three things, international price comparisons, innovation and QRS indicators. And just to reinforce that we're mainly interested in methodological questions here, so the fundamental underlying issues that we're keen to discuss is how should we assess these indicators of competition.

So, in regards to international price comparisons, we're starting on topic one, there have been a lot of price comparison methods discussed so far in this study and indications of price. Many of these of course have been quite informal reports from individuals who told us that they perceive grocery prices to be higher in New Zealand than other countries. Consumer NZ submitted on our preliminary issues paper and they gave us an analysis of 20 private label products sold by Woolworths in Australia and New Zealand.

The Food and Grocery Council also submitted on our preliminary issues paper with a preliminary analysis by Coriolis that suggested a price gap between New Zealand and the USA was somewhere between 2% and 6%.

As we discussed in the draft report, even further, there is a widespread perception that grocery prices are relatively high in New Zealand. It's a frequent topic of media reports, it came through in our consumer research and it also showed up in complaints received through the Commission’s call centre from consumers during the first seven months of the study and we cited that in the draft report.

Other price information of relevance comes from the Frontier report which we commissioned and published along with our draft. That analysed price differences within New Zealand, and it showed two quite interesting facts. One was that prices don’t vary very much between banners, irrespective of where the store is. This is of course the effect of national pricing strategies that were discussed on day one. However, secondly there is more variation on average prices between regions. So, to reconcile those two findings, you need to notice that the banners have different representations across regions. Some regions have, for example, have fewer PAK’nSAVE and more Four Square stores. And so that distribution of stores across regions can drive differences in average prices.

So in this session here though, we want to get above these national price variations and delve a bit more deeply into international comparisons. And in doing so, we note I think it’s common ground between ourselves and the major grocery retailers and their advisors, that international price comparisons are extremely difficult to do well due to a range of challenges and particularly in the grocery sector where we’ve got many products to consider.

I think, perhaps the first, without denigrating the previous material that I’ve referred to, I think the first really serious attempt to tackle these difficult challenges, and this study was a submission by NERA on behalf of Woolworths NZ at the preliminary issues stage, Nera analysed a set of prices collected by the Economist Intelligence Unit and in our draft report, we outlined several reservations that we had about this analysis. They included the fact that the raw data was not collected by official statistics agencies; that the data for cities rather than countries; that the median of ranks method approach to comparisons between cities, doesn’t take account of actual consumer shopping behaviour, it assumes people are basically buying one of each thing, whereas shoppers tend to focus more on things that they’re particularly after. And finally, and most importantly I think, that converting currencies using PPP exchange rates is not appropriate for groceries since they are internationally tradable.

We then developed our own international price comparisons and published these in the draft report. We used data published by the OECD, data from the World Bank’s International Comparison Project (which is ICP) and data from a third-party firm called Numbeo. Of these, we expressed the view that the OECD and ICP data were more likely to be reliable since they were sourced from statistical agencies in the different countries. In analysing this data we converted currencies at market rates, rather than PPP rates, because grocery products are tradable and then we published those results in the draft report.

Turning to submissions on the draft, economists employed by Woolworths and Foodstuffs took issue with our analysis and particularly with our use of market exchange rates. NERA continues to believe that PPP exchange rates are the more appropriate. And Houston Kemp take the same view, but they also refer a couple of times to grocery services. And we found this a useful comment because it helpfully indicates that grocery services and groceries are perhaps different things.

So, we think there may be a way through this difference in view between parties (ourselves and submitters) on international price comparisons and we feel the exchange rate conversion may be the key to resolving most of this issue. So I'd like to explore that now.

I'd like to, if I could engage directly with Houston Kemp and NERA. Obviously, these are parties employed by the major grocery retailers, so providing that's okay with them, we'll just do that and then I'll certainly invite the major retailers themselves to comment at all after that conversation, if that's a reasonable way to go about things.

So if I could start with Houston Kemp. The question is, when you say "grocery services" are you referring, as we think you are, to functions, such as warehousing, distribution and store fitout, rather than the actual products that are on the shelf?

Mr Houston: This is Greg Houston, Houston Kemp, thank you Commissioner Small. The short answer to your question is yes. In referring to grocery services, we have in mind all of the functions and the costs associated with those functions involved in performing in or involved in performing a task of at one end, the acquisition or the purchasing of the grocery products, through to the product on the shelf. So that obviously includes land for retail sites and distribution sites. It includes a lot of labour for all the staff involved in that. And it includes costs associated with the logistical processes, so you can imagine that as transport arrangements and so on.

And I think the first observation we'd make about that is the vast majority of those costs will be those costs that incurred in New Zealand, non-tradable assets essentially, land and labour.

Dr Small: Thank you, that's the way we interpreted it as well and I think we'd agree with you that those costs, those functions, and the financial resources used in them and the prices of those resources, so those resources themselves are not readily tradable and so I think we would agree with you. It sounds reasonable to convert those things using PPP exchange rates since they're not tradable.

But what about groceries themselves? I mean we do import quite a few grocery lines and we also export grocery line, they seem to be tradable, so would you agree that there's a distinction here between the products on the shelf and all the other things that we've just spoken about?

Mr Houston: Well, I think I'd agree there's a distinction, but I think it's a big unknown as to what extent the proportion of products on the shelves, which roughly we know, there's two thirds of the cost of the retail price. It's a big unknown as to what extent those products are sort of tradable versus non-tradable. Obviously, some are tradable, some proportion, and some is not. But I think we have very little information as to what that proportion should be. I don't think it's right to assume that a hundred percent of those products that are procured are procured at a sort of internationally traded price. But clearly it's right that some proportion is. And I think, so far, there's been very little information that I've seen that would be able to inform that proportion, it's not one hundred percent that's tradable, it's not zero, it's something in-between and from what I've seen, we're all guessing or would be guessing to offer much in the way of opinion on that.

Dr Small: So, you are talking there about tradable rather than traded, I presume? You're not suggest, I don't think, that we should look at just restricting this to products that are actually traded. Isn't it the case that virtually all of them are tradable, I mean fruit and vege seems to be tradable and that seems to be one of the harder ones, I would have thought, to trade, dry goods are much less perishable and seem more easily tradable. I mean perhaps you could helps us with some examples of things that you think might not be tradable.

Mr Houston: Well I think there's a distinction whether something that is, can be traded, which I think you're drawing attention to in something that is traded and if things are tradable, but not routinely exported or imported, then that would, I think as a matter of principle, cause someone to be a bit cautious in assuming that it should be treated as tradable. Because if it's not traded, that suggests that there's a reason for that. Likely to be that it's more efficient to produce that locally, in which case, and it's not exported, it's not imported, that suggests that the local costs are going to be most relevant. And then clearly there are some things, I mean dairy and meat would be just very obvious examples, which are traded routinely and I think therefore a different principle would apply.

So I don't think "able to be traded" tells you much about how you should think about the right sort of exchange rate conversion because if something's not traded then usually there's a reason for that.

Dr Small: Thank you, well perhaps we could come back to that in a few minutes. But it sounds as though, if I'm reading it right, that in principle you'd be amenable to and would actually endorse, a split approach to exchange rates whereby the non-tradable grocery services were converted at PPP and groceries, to the extent that they're tradable, were converted at market rates.

Would you, in principle, setting aside these measurement issues that you're raising, would you agree that that would be a reasonable way to go?

Mr Houston: Yes, I think in principle it would be. So let's just give an example. We know that roughly 1/3rd of the costs are the retailing costs are, let's say, 100% local. The remaining 2/3rds you might form a view, and at the moment I think there's no material to form that view, but you might form a view that ½ is traded, so that would leave you with that one remaining 2/3rds you might apply a PPP to half of that and a market exchange rate to the other half. So in concept that would seem to me to be quite reasonable. But obviously, one needs to do some work on whether that proportion of the 2/3rds of the input products, what the right proportion is for the untraded/traded extent.

Dr Small: Yeah sure, let's come back to that. I think it might be useful to bring NERA into the conversation at this point and just check in with NERA regarding this point which does seem quite material to the whole concept of, or the outcome at least, of international price comparisons. So, James Mellsop's on the line, are you able to comment on anything that you've heard so far, James, regarding the conceptual merits of a split approach?

Mr Mellsop: Sure, thanks John. Yeah, James Mellsop here from NERA at the request of Woolworths. Certainly in telecommunications, the Commission has taken a split approach to this task, which I think we referred to in our report. At the end of the day, this study is about competition in grocery retailing, right? That's actually what we're thinking about here. And clearly the service of retailing is not tradable and hence, that's something Statistics New Zealand says, that's why we use PPP in our first report. And I think, I suspect that's not a controversial statement.

Then there's this question what about the SKUs, which as Greg has said, is made up 2/3rds of the costs. And I suppose the question is, if we effectively convert those at market exchange rates, what is that telling us about competition at retail when the price of SKUs to the supermarkets is set by a negotiation between the retailers and the suppliers. So I guess I'm just questioning the concept of a hybrid, when converting the cost of SKUs at market exchange rates, won't tell us anything about the competitiveness of retailing, which is a service to where SKUs are in input.

Does that make sense John?

Dr Small: Well, I think I can hear what you're saying there James but I mean, in this component, and we're here talking about prices of food, prices of groceries and you know, so the price of the groceries we've just agreed on the shelf is roughly made up 2/3rds/1/3rd between the actual product, which I think is largely tradable, but we can get into that later, cause you know, Greg has an issue on that, and the services, say the other 1/3rd which we agree isn't tradable, so if you're looking at the actual price of the product, that's what the consumer pays, so why doesn't it make sense to decompose these things in this way?

I mean, unless you don't think that we should be doing price comparisons at all, that's not informative about competition, that's a reasonable approach and you know, be keen to hear an argument on that if you've got one –

Mr Mellsop: I do.

Dr Small: - but, okay, so maybe that's your argument actually.

Mr Mellsop: I'm not actually completely sure of the answer John, I suppose, but it just seems to me that consumers are not buying the 63c that, for example, Woolworths, say at 63c in the $1 is made up of what they pay to suppliers. Consumers don't pay that, right. Consumers pay the 98c –

Dr Small: The dollar.

Mr Mellsop: - yeah, the dollar, that's correct. So what we're interested in is that dollar, how does that compare to what people overseas. And that's all I'm questioning that if we apply a market exchange rate to one of the inputs, is that actually telling us about the competitiveness of that dollar. Does that help in articulating?

Ms McWha: James, I wonder if what's it doing by kind of isolating just the service portion, which, on your numbers, is 37c –

Dr Small: Say, a $1/3^{rd}$.

Mr Mellsop: Yep.

Ms McWha: So, we're effectively controlling for the fact that 2/3rds of it is tradable and we're, therefore, isolating the kind of competitiveness of that remaining service portion. So to me it kind of actually helps us to think about the competitiveness of the service part.

Mr Houston: Perhaps if I can offer observation. I think, we do need to focus on why it is that we're performing this analysis and what our purpose is. And you know, the purpose that the Commission has drawn attention to is to help draw inferences about the effectiveness of competition.

So I think the first observation and it's important to make, is that the, in terms of profitability, which is the other very important finding of the Commission, that actually these comparisons are very insensitive to any reasonable level of profitability. It actually doesn't really make much difference to rankings at all.

So that, to me, straightway should ring some alarm bells as to just whether we should be putting much effort into this task at all. I accept that there may be an alternative reason which is just people would like to know, the consumers would like to know where New Zealand ranks in the OECD and that's a reasonable purpose. But the difficulty is then taking that information and using it to draw inferences in relation to competition.

And I think to be absolutely simple, highly insensitive to the way you do the analysis to any level of profit. So it just tells me that this isn't very informative at all for competition.

So if we could sort of put that aside then we can have an intellectual discussion about well how might you want to do this in an ideal world? And I think if you really wanted to do this well, you would go to all – and this I think is impossible – but you would go to all of the other countries and you would look at what proportion of the grocery charges there accounted for by the retailing service and whether it's 35c or 55c or 15c in the dollar, and you would compare that. But that, I think is likely to be a task where there just isn't information.

Dr Small: So, okay, look okay I take your point that there's a question about to what use do we put this analysis. And it's fine if you just don't want to talk about it, that's okay, I don't mind that either. But if you do want to talk about it, then it would be useful to know, I mean I think Greg you did accept that a split exchange rate approach would be a reasonable way to go about it. I don't think James is there on that point yet, so maybe James, would you like to help us on that.

Mr Mellsop: To be honest I'm not quite sure. I'm just raising a conceptual issue, I guess that it just seems a bit strange when our focus is the competitiveness of retail to convert one of the inputs in a certain way and everything else in another. To me the SKUs are an input, as a wages, as a land, etc, and we care about the final dollar.

Dr Small: Yeah we do.

Mr Mellsop: But I also, you know, as we said in our report, I accept that in the past the Commission has done a hybrid in the telco space. At some point, John, it would be good if I could make those comments about –

Dr Small: You may as well do it now James.

Mr Mellsop: - okay. The comment I wanted to make is that in a sense - and maybe this sort of segues from what Greg was saying – the Commission's enquiry, we, per se, don't really care how high New Zealand prices are or are not compared to overseas. What actually matters is where they are high, it's because of a competition problem. And what I think is quite intriguing is when we take the Commissions market exchange rate methodology using the PLIs across the entire economy, it turns out that actually on that methodology, everything in New Zealand is expensive, and groceries don't stick out. It's about sixth or seventh, it's around the same.

So that to me is the reason why I'm not – I'm very happy to talk about PPP versus overseas market exchange rates, but I do query actually how far it's going to take us here. And I think the comment I've just made is actually relevant to two or three of the topics in the agenda today, does that make sense John?

Dr Small: Yeah, yeah I noted that point in your submission, it goes to something about wider, about competition in markets well beyond us, doesn't it? I mean basically what you're saying is that grocery's not out of line when you look across New Zealand on that particular measure. Which is fine, I mean you can interpret that in any way you want really or in a couple of ways anyhow.

Mr Mellsop: And obvious explanation would be that we're a costly country cause we're at the end of the world.

Dr Small: Yeah, sure.

Mr Mellsop: Okay, thank you.

Dr Small: No that's fine, thank you. I see Alex Sundakov has got his hand up, so Alex would you like to make a comment on this?

Mr Sundakov: Thanks very much John. I think the argument that James is making is that international price comparisons are not a perfect indicator of competition, or competitive processes or competitive outcomes. And he is saying that therefore they should be ignored. I think that to me is kind of scientifically wrong. You can have something that's not a perfect indicator, but still contain some valuable information that you can interpret in the context of other indicators. And clearly, the final price that consumers pay embeds in both the cost of the service and the cost of the goods. And so it will have some - the price difference is particularly when the goods are tradable, will have some implications or give you some indicators to understanding the cost of the service and the competitiveness of the service.

So I think it's definitely worth making these comparisons, so if I could just comment on the methodology. I think a split exchange rate methodology does make sense, but we also have to be a little bit careful. I mean I think the market exchange rate makes a lot of sense when applied to the tradable part of the goods and I think the gap between what's tradable and what's traded is very, very small. I mean for instance, veges get traded all the time, as you said, there are really very, very few consumer products that don't get traded, at the very least between Australian and New Zealand, but much, much further afield.

But, I think that applying the purchasing power parity exchange rates to the non-traded part is, we need to be a little bit cautious. Because the PPP index is designed, well first of all the outcome of the PPP calculation is based entirely on the chosen basket of goods. And typically the PPP comparison are designed to try to assess the difference in the standard of living, take into account, you know, the basket of goods takes into account the goods that matter for consumers across, kind of, the entire range of their consumption types. And so one of the reasons why NZ, on NZD on PPP basis tends to be a lot stronger than on market price basis is because, say, medical services and many other kind of social type services in NZ that are provided free by the Government, don't include the out of pocket cost for New Zealand consumers as they do in many other countries.

So using the same basket of goods for comparing the value of the grocery services, I think, can be misleading. So, I agree that using the market exchange rate could also be misleading, but the truth probably lies somewhere in-between rather at the extreme of using the PPP.

Dr Small: Thanks for that Alex, that's really helpful. There's a couple of more hands here, so I'll go to Giles Barker first and then to you Josh Gluckman.

Mr Barker: I'd like to thank Alex for his comments, it pretty much covered anything I was going to say, except that the argument seems to be made with this – I think it's a bit spurious, personally, the split between the service and the product. And my real concern with it, is that it seems to be that there's no understanding that the nature of the two supermarket groups to sell to actually has an amazing impact on the number of suppliers in the market, which in the end, has an impact on the price of the products that they pay. New Zealand is getting less and less suppliers because if you're not supplying you really can't even be in the market. So, their place in the industry, it's the essential role between the producers and the consumer and only having two of them is actually reducing competition of supply.

So, to then say that we can't do it because the producers cost a lot, is sort of, yes, they're being distorted as well. Does that come across at all?

Dr Small: Yeah, I hear that.

Mr Barker: The nature of it distorts that end as well, it's not just that New Zealand – New Zealand is a high-cost country, yes, I agree with all of that. But we can't just sit there and say that.

Dr Small: Thanks for that Giles, that's helpful. Josh, to you please.

Mr Gluckman: Thank you Commissioner and mōrena and kia koutou katoa, Josh Gluckman from Woolworths NZ.

From a Woolworths NZ standpoint, certainly we do have a number of issues with the international price comparisons contained in the draft report and I suppose the benefit of the draft report being a draft and the consultation conference being what it is, it provides us with an opportunity to provide that view, so we're very appreciative of it. I mean I'm sure we'll spend more time on it, on innovation and returns later on where similarly we do have some views contrary of the draft report.

But I guess, as we've noted a few times, we think one of the key indicators here is the fact that grocery prices have fallen in real terms over the past decade. So grown below CPI and despite rising input costs, and we think that's strong indicator of price competition and we also similarly think that high levels of cross-shopping are strong indicators of high levels of price competition.

And when it comes to international comparisons, I guess, from our perspective, we don't see any evidence that if prices are high in New Zealand, this is due to competition issues, in fact, very, very clearly there are many other factors at play, beyond competition. And I think we all agree that as interesting as they are, (because they are, you know, on a personal level quite interesting) international comparisons are fraught and have really significant limitations and I think that's, you know, why we certainly have observed that other competition authorities such as in the UK or in Australia have dismissed placing any significant weight on them as part of equivalent analyses historically and it's because of the significant limitations they have.

I mean, we note that the Commission themselves in their draft report have noted that the analysis doesn't consider a range of factors which may be impacting grocery prices, such as GST, which is an obvious example when New Zealand has one of the most onerous GST regimes in the world when it comes to food at 15% on everything sold as opposed to Australia is GST is not only 10% but many items, fresh food items and basics are actually entirely GST exempt. Or different freight costs, different labour costs, different operating costs and more.

And we know that the factors that make, you know, international comparisons difficult, you know, extend to include different seasonal variations, different biosecurity requirements, different electricity and input costs. I could on but I won't be teaching anyone anything new there, I think, in terms of the limitations that exist. But they are significant, and you know, I guess, the reality that even if it were to be the case that grocery prices in New Zealand were expensive, it more likely reflects the fact that New Zealand is a small island on the end of the earth and it has small scale and is expensive overall. And indeed, in our view, that's what we consider the analysis in the Commission's draft report actually does demonstrate, as I think James Mellsop previously touched on.

And we all agree the majority of what the customers pay in our supermarkets is impacted by what we have to pay to suppliers in 63c in every dollar spent. But, really importantly, in the context of competition analysis, for every dollar spent in a supermarket, our profit is only 2.4c. And we also note that analysis that has been undertaken by Woolworths Group across a not insignificant sample of 7500 barcode matched lines, illustrates and demonstrates that we have to pay 10% more for the exact same products in here in New Zealand.

And as a further interesting thought experiment and it is a thought experiment, even if we were to make zero profit, which is clearly an unsustainable position, for us or any retailer, the Commission's calculations or the calculations in the draft report wouldn't see New Zealand's relative price ranking change much at all. So again, clearly there are many factors beyond competition at play.

And I think the materiality here is also something that we just wanted to note, or in fact the lack of materiality here, is something that we wanted to note. And it's certainly worth keeping in mind when it comes to some of the quite significant negative costs and impacts that are likely to be association with some of the more extreme interventions that have been entertained by the Commission in the draft report which I'm sure we'll discuss over coming days. Because those more extreme options, with their negative impacts on our vertical integration efficiencies or the negative impacts on our scale economies are actually likely to lead to higher prices, which obviously would be an own-goal in the context of what this market study is seeking to achieve.

So, you know, I think we could spend quite a bit of time discussing the debates of methodology A versus methodology B, and those are interesting exercises to do, but in our view the question is not are grocery prices high in NZ. It's actually to what extent is there evidence that if grocery prices are high in NZ that competition is contributing towards that. And that's not something where we consider that there is strong evidence that exists.

So I think that probably summarises the Woolworths NZ view, thank you.

Dr Small: Thanks for that. As you mentioned, innovation and QRS are high on our agenda and we're sort of halfway through the session, so I feel like we need to get to those and plus, I think we've had a good methodological discussion, there's been a lot of useful stuff ventilated. So what I propose to do is ask Foodstuffs if anybody would like to make a comment on this particular issue of international price comparisons and then I propose to move on to talking about innovation and we'll have to take other information that you want to supply, (I can see there's still a couple of hands up) we'll have to take that, I'm afraid, either by email to our email address or in a cross-submission.

So, could I just ask Foodstuffs whether you'd like to make any comment on this topic?

Ms Allan: Hi, Jo Allan, Foodstuffs North Island. I think we concur, Josh, with your comments, and in particular worth noting that the analysis that we've done is that ultimately if we reduced our profits to be the same returns as you conclude to be normal, which is WACC, essentially it would have 2c shift in the dollar shelf price. So it has a very immaterial impact on the shelf price to the consumer.

I think in terms of the tradability, of in terms of the comments that have been made around the tradability, what I would note that on the supplier side my estimate would be at least 50% of that would be tradable and we do need to consider that. And ultimately go through that category by category, because it's obviously not a one size fits all.

That's all that I have to comment and equally if Foodstuffs SI has anything further to add, I'll hand over.

Dr Small: Yes, that would be good if anyone from South Island Foodstuffs, Mark or Tim perhaps.

Mr Marsh: No, it's Nathan Marsh here, I'm the CFO of Foodstuffs SI and I do again, concur with Josh's statement and certainly with Jo's statement. And again, some of the important points here are particularly around the fact that we're a small nation at the end of the world with a very difficult geography, large piece of water in-between. So supply chain is incredibly expensive to run in NZ.

For example, Ireland has a population of 5.9 million people and they are 2/3rds of the size of NZ, yet that's used as a comparison.

For us to recover supply chain cost, over a very small volume in a distributed market, is very, very difficult. It's one of the key contributors to the increase price. But also the GST, I don't think we can ignore that, that is an important contributor to our cost, which is prevalent in many of the other markets when you're comparing international price.

So, I'd just like to add that, and I thank you for the opportunity to speak.

Dr Small: Thanks Nathan, that's helpful. Okay so I am going to move on now, I know Tex has got his hand up, but I'm sorry Tex we'll have to move on to innovation.

And this is another indication of competition, of course. It's kind of an outcome and a process indicator I think cause innovations are of course intended to increase the profits for the innovator, but in a workably competitive market, those extra profits will only last for as long as it takes for rivals to catch up and you know, either copy or develop an alternative to the innovation.

So, we discussed several aspects of grocery sector innovation in our draft, including innovation focused on range and service dimensions of quality. We also tried to assess digital innovation, particularly in relation to online shopping. And instore innovation, such as things like self-service checkouts and small format metro stores. We also looked at supply chain innovation, which we saw as being primarily about reducing costs and improving resilience.

Overall, it's fair to say that were not particularly impressed. One of our concerns was linked to profitability and in particular to the observation that firms that have been slower to adopt online shopping, seemed to have similar profit levels to those that were fast to adopt it. I know we're going to talk more about profits in the next session and that the major retailers consider that our numbers are very wrong, but even on the major's views of profits, this general point holds, similar profits but different levels of innovation. So that's an interesting observation, I think.

There is a broader point, though, that I'd like to explore, which is about how we should compare innovation in New Zealand with that in other markets, i.e. what's the benchmark and what are the indicators? Is there any method available other than just listing particular innovations that are seen overseas and then checking to see if they're here and indeed, is that such a comparison (which is more or less the way that we did it in the draft report), is that even valid or fair?

So I think that last question is a good place to start because Foodstuffs North Island, in its submission, urged caution when comparing the pace and scale of innovation in New Zealand with overseas comparators. They said that given the smaller size of our economy and population, it's not appropriate to expect innovation at the same pace as other countries.

So could I start with Foodstuffs North Island, ask you please if you'd like to speak any further about this view and I guess I'm particularly interested in whether the nature of the innovation matters. So some things seem fairly modular, such as one robot, two robots, one store self-checkouts, two stores with self-checkouts. And so there may be some economy of scale issues in some types of innovation, so perhaps you could help us out with your view on that comparison and whether it differs by the type of innovation?

Ms Tardif: Good morning, it's Catherine Tardif, I'm the GM of Strategy and New Ventures at Foodstuffs North Island.

First point, before we talk about the pace of innovation in New Zealand, the Commission's analysis of innovation was premised on the assumption that the major retailers profits were persistently high. So against this backdrop, I think the Commission's draft finding was that the major retailer's innovation was insufficient to explain the excessive returns. So as Jo will explain in the next sessions, Foodstuffs NI's returns are normal and consistent with the return earned by overseas supermarkets. So that needs to be the starting point of any analysis of our innovation.

Second, the Commission sought to benchmark in the draft report by giving examples of innovations overseas and asking whether New Zealand had those innovations. So with the exception of Amazon Go and Grocery Robots, we have or are in the process of implementing all of the other innovations.

Third, we do see difficulties in identifying appropriate benchmark for comparing innovations. New Zealand has a smaller economy and population than the countries the Commission focused on for identifying innovation. Our average household disposable income is less than the OECD average and less than Australia and the United States. These issues will affect the level of innovation that our customers demand.

Therefore, as such, we think the better way to look at the issue is to consider whether Foodstuffs acts on competitive pressure to innovate, and we do. For example, our largest competitor is a large multinational company who is able to leverage off innovations in Australia. Woolworths keeps us on our toes, really, and means that we are constantly looking for ways to innovate.

Smaller innovative retailers also stimulate all sorts of competitive response. We have all sorts of examples of this. And as the Commission has seen in our confidential internal documents, we're always monitoring offshore innovations and considering whether it could assist us to compete in New Zealand and when the time is right for us to include it here.

So, we do think the pace of innovation is adequate for New Zealand. Thank you for the opportunity.

Dr Small: Thank you very much Catherine. Well maybe I should bring Woolworths in at this point. Oh sorry, Tim Donaldson, Foodstuffs SI has his hand up so we'll go to you first, Tim.

Mr Donaldson: Thank you Commissioner Small. I just want to make a couple of general comments that may help. It appears to us that the Commission's analysis of innovation in New Zealand grocery sector was based on its view of major retailer's profits were consistently high. As been shared with the Commission is about to be covered in the next session, the analysis we completed on the whole-of-business basis shows that our returns are consistent with returns earned by overseas supermarkets. So, if the Commission were to accept this analysis of our profitability, we'd actually question whether they would maintain their view on innovation. Foodstuffs South Island considers itself to be an innovative business. And the pace and scale of that innovation is appropriate when viewed in the New Zealand context.

We're a customer-focused business and we see innovation as one of the essential ways that we can differentiate our offer across our brands in order to compete with, not only the major grocery retailers, but the multitude of other retailers that compete for customer's shopping missions.

In an environment that we see have become increasingly competitive with a rapidly growing number of successful, nimble and innovative retailer offers, we would argue that constant innovation has enabled us to remain relevant to the customer. And this need to constantly innovate is supported the Commission's draft findings that other retailers compete with us on quality, range and service and that major retailers also differentiate from each other on aspects of quality, range and service.

We're always looking for new ways to innovate and however, like any business, we have to make strategic decisions about when, where and how we invest. So I'm not going to provide examples in this opening summary of submission, as our submission on the Commission's draft report details our significant investment invocation across the QRS spectrum and our supply chain. However, I look forward to the opportunity to answer any further questions the Commission may have, so thank you for the opportunity.

Dr Small: Thanks Tim. We are going to talk about profits in the next session, but could I just ask you, on that point, so your contention is that your profits are in line with those in other markets, grocery retailers in other markets. Is there a reason why we should, I'm struggling to understand why that would mean that we shouldn't benchmark your innovations against the same companies. Could you help me there?

Mr Donaldson: Yes certainly. So it's not that we shouldn't be benchmarked against those other companies, we believe we are innovative, absolutely. And to Catherine's points, there are reasons why innovation is at a different pace within New Zealand. But our contention or our position is that the Commission's view on innovation seems to have flown from excessive constant profits. And if that is not the case, we would contend then that assumption regarding innovation therefore is also not correct.

Dr Small: Yes, thanks. I mean we did talk about them jointly at one point, perhaps at a couple of points, but we did analyse them separately. But anyway, look I'd love to come to Josh, I'm sure he's got lots to tell us about this. And I mean I note from Woolworths' submission, that you already have comparable innovations to all the ones that we mentioned in the draft report. So, what I'm keen to hear from you is whether you agree with Foodstuffs that there should be a difference in the pace of innovation in New Zealand compared to other countries, in other words, that we're not really comparable because of our cost structure and our low incomes. Perhaps we could start with that one, I've got to follow-up as well but we'll start there.

Mr Gluckman: Thank you Commissioner and I'll talk to that point, I'll probably, as part of some broader perspectives from Woolworths NZ on both the levels of innovation in the marketplace but also how one might try and benchmark something like innovation, which I know is a question of interest.

I mean, certainly and clearly this is an area where we don't agree with the findings or the views put forward in the draft report. And from our advantage point it is very clearly and categorically the case the levels of innovation in grocery retail in New Zealand and within Woolworths NZ, are very, very high, by any reference point. We innovate extensively, and innovation in grocery retail comprises innovations big and innovations small. And that's entirely reflective of high levels of competition that exists because I think all parties in the market are keeping each other on their toes, if I borrow that phrase.

I mean I could be talking about health food aisles, which we've innovated and extensively put into market and actually Woolworths Group in Australia has picked up some of those innovations in their new format stores. Our Macro range, our fresh produce equipment innovation, packaging recyclability, where we're committed to all of our own brand packaging being recyclable or reusable by 2025.

Free fruit for kids, that was an innovation that started in Countdown Botany, and now has (following going viral) has now been adopted by global grocery retailers around the world and is something that our team are incredibly proud of and we're all very proud of.

We've got our Green Star supermarkets where we've opened our first two in Hastings and Richmond. Instore pharmacies, which we now have almost 40 innovative new formats, such as our Wānaka, our pick-up and metro proposition which will be opening within the year.

Or The Foodbank Project, which is New Zealand's largest online food bank, which again is innovation that our team are incredibly proud to support.

We have Scan&Go, which is the ability to shop without even experiencing a checkout and tapping off using your mobile phone.

ESL (electronic shelf labels) we've touched on. E-receipts, app-assisted shopping.

You know, extensive productivity innovation, which I think is a really important point, I'll come back to.

And then of course the innovation that was observed in the NZ market during Covid and I think a really strong example of that was the work of our team to stand-up priority assist as a service to allow the elderly and those vulnerable who actually couldn't get out of their homes to be able to access online groceries and that was turned around in just a few days, it was again, something that our team are incredibly proud of.

We're of course innovating and investing extensively into our value chain as well. And I mentioned the grocery retailers' innovations big and small.

We've got a new $100m Palmerston North DC that's just opened, that will add significant resilience into the Lower North Island supply chain. That includes a number of efficiency initiatives integrated into that site, which are important from a cost management perspective. And of course, again that was opened in the middle of Covid, actually brought forward early to help manage New Zealand's demand at a time of particular need.

We've got our new Hilton Meat Plant partnership that I've referenced already previously, but that's an extensive range of ready meal SKUs being introduced first to market into New Zealand with global processing expertise and support.

New packaging innovations that will improve product quality and life.

Our distribution innovation including automated and robotic sorting and picking and co-distribution efficiencies with fresh where, again, we have a new fresh DC that will be going live in the North Island in Auckland within the year which will improve cold chain management, meaning fresh foods quality for our customers instore.

And so, you know, I think that those are all very strong examples that we experience and it's not an exhaustive set of examples around that point to the level of innovation that does exist.

And I think if I come to your question around how to be benchmark innovation? Which is an interesting one and I guess, we'd indeed consider that that's question challenging to do and I think, you know, certainly, we would consider that the desktop-based approach, which is contained within the draft report, falls short of the threshold needed to come to any definitive or too strongly determinative views. And so from our vantage point we think in reality there's more likely to be a broad range of indications that need to be observed. Each will come with their own caveats, of course, as you'd expect. You know, we note for example that our customer satisfaction scores have been increasing and have seen sustained increases over recent years which is, in our view, reflective of extensive innovations and improvements that we're constantly making to our proposition for Kiwis.

We note that there are high levels of productivity improvement, for example, in relation to stock loss or operating/processes in stores, reflect not only competition dynamics at work, but again, also innovation.

We note that our levels of capital investment, which is a bit of a crude proxy, but appear broadly consistent with global grocery retailers all around the word. You know we could be talking about online penetration, third-party recognition through awards, (which we've certainly won), the fact that SKU count or products have been growing, not shrinking. And then again, desktop-based approach is still having a role where we do note as has been acknowledged that all of the examples identified have actually already been, are already in train in the case of Woolworths New Zealand in terms of the draft report. So we're really proud.

I think in terms of this question around, pace of innovation in the NZ marketplace, relative to other jurisdictions, you know, I think, for all of the reasons I've outlined, we think we're right up there. But, I mean, I'll share a personal anecdote, I mean, I've been to visit Alibaba's Hema Fresh pilot flagship store in Shanghai, or similarly JD.com or JD's equivalent in Beijing and it's quite an enlightening experience turning up to visit a support office which is being built to fit 20,000 to 50,000 head office employees and then to go and visit their most innovative digital flagship in the most densely populated parts of Shanghai or Beijing. And yet if I think about what I saw when I visited those stores not that long ago, (and without disclosing too much about what's coming down the pipe) I think we can certainly hold our head high. You know, whether that's the role of electric shelf labels, the role of the mobile phone in the shopping experience, app assisted browsing, seamless online delivery integration that is increasingly express. Contactless payments, electronic receipts, digital screens, customer product reviews, and more. And we're based in Māngere, not in Silicon Valley and not in Shanghai.

And so we very proud about the level of innovation that exists. We do think online more broadly is also very, very clearly indicative of very high levels of innovation in the New Zealand grocery market and that's without question, in our view. And as we've noted in our submission on the draft report, even looking at online penetration overall for the grocery sector in New Zealand, it's right up there with the leaders in the world. I mean in an absolute sense, it's already for New Zealand ahead of the US, ahead of Germany, ahead of Italy and ahead of Spain and in line with Australia, but once you adjust the population density, which is actually an important thing to do when you think about online delivery economics, for example, New Zealand is much more clearly right up the top of the leader board, you know, even streaks ahead of Europe, UK and even China and South Korea, when looked at that way.

And, of course, we know for Countdown and I think it's reasonably clearly understood, that with our online penetration, well it was 12% when we disclosed it in the report, it's a number much higher than that now which we'd be happy to share with the Commission offline. You know that's well and truly global leading in every sense of the word, well ahead of Tescos, Kroger, Walmart and Costco. And I note Costco, because they're increasingly offering an online offering, both directly as they have done in parts of Australia and indirectly through their relationship with Instacart, such has been observed in Canada.

So you know, the innovations in the online space has been extreme, I won't rattle all of them off, but we have, you know, two of Takeoffs first automatic online picking fulfilment units are being introduced into the New Zealand market, the second in the Southern Hemisphere, only the ninth in the world. We've got automated clever on pick-up units, we've got driver-up/drive-through e-locker solutions being rolled out at pace. And we invest tens of millions of dollars into our digital business per annum to innovate and that's reflective of the innovation imperative. It's also really reflective of the emergence of online which we touched on, on day one, and the significance of that and you know, the increasingly dynamic competitive context there, whether it's a Supie, an Honest Grocer or a Market.com or Foodstuffs, an Uber Eats, you know, a Costco online or more.

So we're very proud of the levels of innovation that we deliver and that's hence we have quite different views. But I think I've probably covered off all the necessary points, thank you.

Dr Small: Thank you Josh for an extensive rundown on innovation. I'm going to take that as a contribution to the QRS session as well because we're just about out of time and there was a lot of QRS in there. So if you don't mind that's the way I'm going to handle that. I'll come back to Foodstuffs before we close for the break for a comment on QRS if you have one. But now I'd like to go to Tex, he's been sitting there waiting patiently with his hand up for a while on this general point of innovation please.

Mr Edwards: Thank you Commissioner Small. Let me address some of the points my industry colleague, Josh, made. It's Monopoly Watch's position that all marginal investment goes into building barriers to entry. If Woolworths New Zealand was more interested in competition, they wouldn't be building the pocket site outside the window of the Ponsonby centre where the speakers from Countdown are speaking from. Not Māngere, but Ponsonby. They would be building a competitive facility in Thames, next to Countdown and be competing on a whole series of metrics. Point one.

Point two, we answered Dr Small's question by saying that we think that there's two measures of innovation. One is actually coming up with a formula for what we a call a 'consumer productivity dividend' in terms of, what are the metrics that consumers may enjoy over the next two decades from improved productivity and improved utility of shopping. And also the second metric should be export sales of small producers in New Zealand, how much upstream innovation is being created by the supermarkets.

It's our contribution to the conference that we refute the suggestion that competition is occurring in innovation. We highlight to the Commission that Foodstuffs' fundamental organisational structure is not built for innovation, it's setup for short-run profit maximisation of franchisees. And the way they deliver capex programs in their organisation, means there's an argument amongst franchisees of who's paying the capex bill.

We articulate that the Foodstuffs $120m Māngere facility is a monument to this innovation failure. It's got 1960s infrastructure, it's got 2020 architecture. There's no current AI facility in there. There's no internet roboting picking service and there's no scale at the shop level. Many people in New Zealand didn't predict Covid. A lot of people in New Zealand predicted the Internet. And so we highlight the lagged performance in internet shopping from the New World facility, where Countdown have just cut and pasted Aussie.

Dr Small: We're a little short of time, Tex.

Mr Edwards: I'll close off there, Commissioner.

Dr Small: Okay, thank you very much. So we are getting close to the end so I'm going to come to Nick Hogendijk and then Alex and then I'll have to give Foodstuffs something to say on this QRS point, so if we just do things in that order please, and bear in mind we are a little short of time and that you do have opportunities afterwards to send us more material, but Nick, for you first.

Mr Hogendijk: Good morning and thank you. I guess there's a couple of very quick points for me. One is that I'm struggling this morning with the retailers all saying that there's no real ability, and their economists, there's no real ability to benchmark pricing. Yet suddenly we just heard a whole heap of benchmarking against other markets. Nathan Marsh references the GST is a significant factor when you look at other markets and when talking about Ireland briefly before that, when Europe's suggest, VAT rates are significantly higher than NZ's, having lived there in multiple counties in Europe, I can attest to that and even just researching it today, they're all consistently higher.

The other piece around innovation, you know, we talk about cost reductions that are coming through and have been focused on QRS, the challenge that I've got there is, that a lot of those innovations, like health food aisles in Woolworths were because there was a market opportunity cause health foods was a growing trend and therefore how do you get consumers in shoppers out of health food stores into a Countdown store or a New World store or a PAK'nSAVE store? Well, you setup an aisle and you therefore drag those customers in by having a price comparison to those markets. Which are, by their nature, smaller and more expensive markets in health food, having done quite a lot of work in that space across Australia and New Zealand over the last 5 or 6-years.

A lot of the innovation that was brought in there is really good stuff and there's no argument that there's been a lot of innovation that's been brought in, but new store formats, recycling, you know, Green Start supermarkets, etc, are all consumer benefits. However, a lot of these things are also used to get suppliers to actually pay more. So, when we look at distribution centres like Foodstuffs NI's new DC, one of the active efforts that they've been engaging upon is to get suppliers to put their products through that warehouse rather than going direct to store.

Now, there's one supplier that is going to be paying for that rather than one wholesaler. So the costs are actually transferred from the wholesaler over to the supplier in that instance and that happens consistently. So, whilst there's an innovation there, it's also a cost reduction exercise by getting suppliers to pay extra for the shipping costs or the freight and then supply chain costs, and warehousing costs. And it's also the piece around automation and sort of more efficiency that they're looking to put into those facilities which means that their costs internally are going down. So, they're getting funding coming from their supplier base to run those facilities and then they're also automating them, have less people working in them.

So, there's a cost reduction and a cost recovery by getting others to pay for those costs. So I'm struggling with that. We'll come to pricing later. But I'm genuinely struggling with the comment that was made earlier which I'm looking forward to exploring after the break which is, the retail price is a negotiation between the suppliers and the retailers. Suppliers don't set retail pricing, retailers do. Thank you.

Dr Small: Thank you Nick. Alex, have you got something to add to this?

Mr Sundakov: Yeah, look I just want to make a very quick methodological point. I think we have to remember the economic literature reminds us that actually we probably expect the highest quality in oligopolistic markets. There's no relationship between high quality and very high levels of competition. So, we need to be very subtle and very careful in how we interpret information about innovation and quality. And I think it is very interesting, I'm somebody who's lived around the world and I'm always blown away by how wonderful New Zealand supermarkets are, given the relatively, how great the shopping experience is, given the relatively low incomes of the population and the generally kind of price sensitive behaviour of New Zealand consumers. But that to me is very consistent with, kind of, being careful in how we interpret the quality information and as you remember in the US, for example, deregulation of airline market led to decline in quality, but a drop in prices as the market responded to what its consumers wanted.

So we just have to be, again, cautious and be reminded of what the literature tells us.

Dr Small: Thanks for that, that's a useful methodological point. I'd just like to see whether Foodstuffs would like to add anything to this discussion on innovation or on QRS and then we'll take the break and come back and talk about profitability.

Ms Tardif: I'll just start by refuting the warehouse comment our new Landing Drive DC is state of the art and includes a lot of innovation and we're really proud of it and is part of our strategy of being customer-driven and we can go into more details in our confidential sessions.

In terms of the QRS competition as benchmark, we don't think it's straightforward to benchmark QRS, competition against other countries, in particular consumers in New Zealand may value different things to consumers overseas, so making comparisons between countries may not be particularly helpful.

We think the better way to look at QRS competition is to consider whether Foodstuffs NI acts on pressure to compete on QRS factors, and it does. We think this is consistent with the Commission's draft findings that other retailers compete on QRS factors, and the major retailers have differentiated their offerings, in part on QRS factors.

Finally, we do note that we constantly monitor customer satisfaction and whether customers consider we are delivering on our brand promises. That monitoring tell us that we are delivering. We have high customer satisfaction (this is stable), so we believe that we are getting our QRS offer right. The world is a small place and our customers are aware of what is being offered abroad and if they felt like we were behind the pace of what was happening abroad for what matters to them, it would show up in our customer satisfaction metrics and this is not the case. So thank you.

Dr Small: Thanks very much Catherine. So I'm going to draw it to a close there. Look I think, from my point of view, this has been a really stimulating conversation, being very helpful contributions from everybody. I appreciate that there will be a number of you out there who may feel nevertheless a little frustrated that there were some things that you wish to add and didn't have an opportunity to do so, there was one hand that I wasn't able to get to. So just please reflect on the session and come back to us with any further feedback that you've got on any of the issues that we've covered here, we are very keen to extent this conversation behind the confines of what we can do in this format. So don't hold back.

And, so, with that, I think we'll call this to a close and come back at 11:15 for discussion of some methodological issues in profitability analysis. Thank you.

Dr Small: Good morning, welcome back, session six, day four of the conference. And this session is about profitability analysis. I think it's been acknowledged previously, certainly in the previous session that it's very difficult to measure some of these indicators of competition accurately and profitability is no exception to that. We presented a number of measures in our draft report and I suppose the one of perhaps most importance was the return on average capital employed. Our estimation of that has been challenged by the major grocery retailers on a number of grounds and some of these we're working through separately because they concern confidential matters. But there's a few issues in these submissions that are relevant to the outcome of profitability analysis that are suitable for discussion in the general session. The matters of principle focused on the valuation of intangible assets, specifically leases, brands, and goodwill.

So, we want, in this session, to focus on the economic principles relevant to valuing such intangible assets in the context of a market study. And we hope that having done this in a general open session, we can further develop and articulate our approach to valuing these assets in the final report and hopefully set us up for future market studies as well.

We're going to start with leases, where the issue is that the recent IFRS 16 requirements have required firms to bring leases onto their balance sheet and they've prompted calls for us to treat future expenses on rent or lease payments, as an asset for the purposes of assessing returns on capital.

So I want to emphasise before we get started on this that we have read and carefully considered and understood, I think, there were submissions on this topic, so it won't be particularly helpful to ask if you repeat arguments that you've made there because we've already grasped those. We certainly understand how IFRS 16 works and we're also cognisant of the precedents there are for capitalising leases which lie underneath those various consistency arguments that have been submitted to us. So I think that's all understood.

Nonetheless, it's certainly clear that IFRS 16 is crucial to the views of submitters that we should recognise the right of use asset as capital in our return on capital calculations. IFRS 16 is also a new development. In fact, it's so new that most of the accounting reports from the major grocery retailers that we analysed in the context of this study, didn't include the IFRS 16 liabilities and assets on their balance sheet.

So we therefore want to examine the economic logic of IFRS 16 and what that logic implies about how we should treat leases in the market study context. So, it would be helpful to start if we could please by considering the purpose of IFRS 16. What was the motivation for the International Accounting Standards bodies to introduce this change to the accounting treatment of leases? Our current view is that the purpose was to highlight off balance sheet financing.

So I'd just like to start by checking to see whether that's the view also of the major grocery retailers, that that was the purpose, was to make it transparently obvious to third-party investors that these obligations are there and so therefore to bring that financing onto the balance sheet. Perhaps I could start with – I don't mind whether the majors would like to address themselves or get economists to do that for them, but perhaps I'll start with Woolworths.

Mr Gluckman: Thank you Commissioner and I might introduce Simon Linstone, who, for Woolworths he's our Deputy CFO, so I'll introduce Simon Linstone, he'll be leading out a lot of the content this afternoon's session.

Dr Small: Thank you.

Mr Linstone: Morena, thank you Josh, Simon Linstone, Deputy General Manager Finance for Woolworths NZ. Thank you, Commissioner. I'm sure we'll all agree this is very important to get these return calculations right cause they are fundamental to the findings of the Commission and we welcome the opportunity today to discuss the important topic, in particular, the treatment of leases and later on, brand assets and other elements of goodwill.

We appreciate the short turnaround that the Commission has been under but in our view the methodology was wrong and you've highlighted Commissioner, that we have disagreed with that. The returns we make are not excessive and leases are linked to this very much so. As pointed out in the Commission's draft report, moving from an accounting base estimate of assets to an economic one, is difficult. And this is a result in the Commission's calculation of returns, understating or omitting the economic value of some of these assets, the big example being leases. Which I'll discuss in more detail in a short moment.

The outcome being a return of 21% whereas if the economic values of these leases and brands have been included, our returns would be less than half and likely be around 8% or 9%.

Conclusions of them being drawn around the competition based on these findings, and in our opinion, they're not correct and Woolworths NZ accounts are audited and filed every year and from that, everyone can see we make 2.4c in every dollar. And so even if we made no return, that's not going to have a material impact on prices, which has been touched on already.

Our margin is not the main driver of prices. By far the largest component is what the customers spend is what we paid for the groceries.

Both the UK and the Australian competition agencies have recognised it is difficult in using returns for competition analysis, and in fact the UK Commission said, "Whatever measure of profitability is used, the calculation of profitability for the purpose of competition is not straightforward". For these reasons, we think it's very important that other measures are also looked at which I know the Commission are doing. Such as the fact that grocery prices have reduced in real terms in the last 10-years and this is despite costs increasing at a higher rate, which has not been passed onto our customers, which to me is surely a sign that competition is working in this market.

As you've said Commissioner, assessing economic returns is difficult and comparisons are equally difficult. If the economic value is not accurately calculated, then returns are unreliable. Our margins are not the main driver of grocery prices.

So turning specifically to the lease topic, which I know you're keen to talk about Commissioner, I'd like a couple of comments and then if it's okay I'd like to pass to James Mellsop at NERA.

Dr Small: Well Simon, that's alright, I did have a fairly specific question and I appreciate that that was a more or less opening submission, and to be honest, I think we've read it before. But so if you could address the lease question, absolutely, that would be helpful.

Mr Linstone: I will do that Commissioner, straight to the lease. So both the UK and Australian Commission have recognised the treatment of leases can distort returns and we're talking about that now. The profitability analysis for assessing competition is an economic one. And in our view, exclusion of lease assets doesn't reflect the economic reality. So there's no economic reason to treat leased assets different from other assets when assessing economic returns. Including leased assets in our asset base provides a better reflection of the economic value of those assets being used to sell groceries to our customers. The decision to lease is a financing decision and international accounting bodies around the world recognise this. And as you've touched on Commissioner, the different accounting treatments of financing operating leases, make comparisons very difficult and hence, the implementation of IFRS 16 Accounting Standard.

This was done more accurately to reflect the economic value of a firm's assets. And I'm slightly reluctant to admit it Commissioner but I think the accountants have learnt from the economists. Woolworths NZ leases the majority of its supermarkets and consequently the leases are a significant impact on the returns, hence the significant difference using the Commission's model by putting leases back in (and I'll talk how we do that shortly) reduces our return from 21% down to 12% and that's before any other factors as brands or goodwill.

And so Commissioner, you talked about the accounting adjustment, but if we're looking at an economic valuation, then really the fact that the accounting profession was a bit slow in coming to this conclusion, is not so relevant as when we're looking at an economic valuation for the time to come up with an economic profit. So James, can you add to that for me please.

Dr Small: Sorry, James before you start, again what we've just heard on leases was more or less what was in submissions. Can I ask you a direct question please James, which is, what was the purpose of the IFRS 16 change? Was it to recognise off-balance sheet financing and the obligations that firms have to pay leases?

Mr Mellsop: Well to me it's what Simon said at the very end there John, it's actually that in economics, a lease is an asset required to generate earnings. And in a sense to me the IFRS 16 thing is almost a red herring in the sense that even it hadn't come along, we should still be counting leases as an asset in the dominator in that ROACE formula. So at least in my view, obviously I'm not an accountant, but the purpose of IFRS 16 is actually to recognise the economic value of a lease to a business. That would be my response.

Dr Small: Not about obligations, it's about assets, okay thanks. Since that was more or less an opening statement, I do feel obliged now, even though it's going to churn into our time to give Foodstuffs NZ an opportunity to say something about this. Ideally, I'd like you to be talking about leases if you could and about the motivation for what you see is the motivation for IFRS 16, whether it was about recognising lease obligations or not? Would that be Nathan Marsh perhaps?

Ms Allan: Thanks Commissioner, I'll kick off if that's okay. I'm Jo Allan for those that weren't in this morning's session, I'm the CFO for Foodstuffs NI. Appreciate John that you'd like to talk about leases, but before I cover off our view on that and handover to Jeff, I would like to note why getting profitability right, matters. And in doing so, do acknowledge upfront the difficulty of calculating profitability for a structure like ours and we have had the opportunity to talk to you post the draft report and we've appreciated that.

But for those on the call, I also acknowledge that for many, it may seem predictable that a company such as ourselves in this situation would defend our position and set out to refute the findings of the draft report, which in particular, notes that excess returns exist and that they're persisted over time and seem likely to continue.

We do believe that getting a more accurate assessment of our profitability matters for reasons much more than our own self-interest. And in particular, over estimating profitability could lead to the unnecessary pressures for interventions which will undoubtedly have the effect of increasing cost to the industry and ultimately consumers. And the bigger perceived problem, the bigger will be the appetite and expectation for intervention and the costs that will go with this.

It's also important to note that interested parties will reasonably take, and indeed, have already taken the headline findings from the Commission's draft report as fact without any appreciation for the nuances of disclaimers to inform the commentary and the view of the industry. We simply do not have the ability to correct these views and reverse the impact on our reputation with our customers, our staff, our shareholders, our suppliers and other external stakeholders, and for this reason, it's important to Foodstuffs that the final report should accurately assess the profitability and returns, not only of our business, but the wider grocery retail industry in NZ and the comparisons made internationally by the Commission.

And in our view, the Commission has materially overstated our returns on capital employed. The draft report stated that our returns are approximately 25% when in fact it's less than half of this, in-between a range of 9% and 12%. And that depends on whether we assess returns over book value or adjusting for market value of our assets.

Naturally you might ask ourselves why such a material difference between our view and the Commission's is there and a couple of reasons for this could be noted.

Firstly, the time pressures put on the Commission to complete the study. The Commission did not engage with Foodstuffs at all through the process of the method it intended to apply to determine the returns on our business. And given the complexities of our cooperative structure, we found that both surprising and disappointing. And in our opinion, the resulting inaccuracies made by the Commission in determining our returns in the draft report were largely due to insufficient time and resulting poor process.

And secondly, the Commission's methodology for calculating our returns was incorrect because you sought to separate the cooperative from the retail stores and this is artificial. We are a fully integrated grocery retailing business and our profitability should be calculated on a whole of business basis, which by definition, means to include both the returns of the stores and the returns of the co-op and all of its associated legal entities as one business. And this actually avoids many of the complexities and inaccuracies with your calculations.

Firstly it removes the need to artificially divide assets and returns between the co-op and the retail stores. It actually removes the issues associated with treating the retail stores as renters and the treatment of IFRS 16. And it removes the need to adjust for the many transactions between the co-op and the retail stores.

And finally, it's comparable to a Woolworths NZ. Any other major grocery retailer and importantly, your own international sample set of grocery retailers.

So in terms of our view on leases, just some remarks here first.

Whether a firm is treated as a renter or owner of the assets it employs, has a material effect on the return on capital. It's measured for the firm and what the firm requires.

Second, the decision of whether to rent an asset or own an asset is a financing decision and both of these outcomes are essentially identical, as they require part of the firm's cashflow first, needs to be devoted to a material fix commitment and that could be rent or interest payments.

And third, the new accounting standard, IFRS 16, seeks to actually correct this issue. It requires recognition of both the interest cost, asset and liability implications of renting, and as such, it brings accounting methods into closer alignment with true economic cost and values.

So I'd like to handover to Jeff Balchin, who has provided a report on our behalf in our submission and he can comment further on IFRS 16.

Dr Small: Thank you very much Jo. Jeff, if you'd like to respond to my question that would be very helpful. I've got some follow-up questions for you on the valuation of the asset, but let's hear from you.

Mr Balchin: Jeff Balchin from Incenta Economic Consulting, here at the request of Foodstuffs. Commissioner, sorry I might disappoint you slightly, your specific question was the motivation for IFRS 16, which is really an accounting question. I'm not precisely sure what the main driver behind the change in standard was. What I can talk to is the economic sense, and I agree, there were two comments made during proceedings that I agree with fully.

One is that this seems to be a case where the accountants might have learnt from economists, because in my view it does have quite a substantial amount of economic sense.

But secondly, I'd also like to agree with the comment that James Mellsop made, that irrespective of IFRS 16, we would still be having this debate because leases are a form of financial leverage, it's a foundational principle of finance that the required return would depend on and go up with the level of financial leverage so there needs to be a proper treatment of leased assets in leases. And you'll know that my view is that the Commission essentially, in its draft, compared a return calculated assuming a very high level of leverage in a sense, essentially, to a return benchmark that assumed no, or very little financial leverage, so an apple and oranges comparison, which was an error.

But in terms of your specific question, sorry I can't shed any light on the accountants' thoughts.

Dr Small: Okay, thank you very much anyway. So just while I have you there, I suppose the thing that would really help us here would be if there was an economic valuation concept that we could identify, that would deliver the value of the lease that's on the balance sheet, the asset value, the right of use asset. And so it's been mentioned a couple of times that if IFRS 16 is really the accountants catching up with the economists, and so if this is the case it will be, presumably, since economists are often interested in asset valuation, it would be relatively straightforward matter to identify an economic valuation methodology that would result in that right of use asset value.

So, that's kind of what I want to ask you about now if you don't mind Jeff. I note that in your report, you say that we should value assets at the current market value for fungible assets and land and buildings certainly are fungible assets, so we try and asses those at their market value. And of course a lease is just the right to use some land and buildings. Many leases are also fungible, cause they can be assigned to third parties.

So, do you think that we should include leases at their market value and if so, what do you think that is?

Mr Balchin: I think the economically correct approach is to include the underlying assets at their market value. Could I just make a point about the significance of this issue. For the measurement of Foodstuffs returns (and this is quite a big difference between Woolworths and Foodstuffs) that Foodstuffs leases very few of its assets. It owns, virtually, all of them. So how you treat leased assets for it at least if you measure it across a whole of business base, it has very little impact on the result.

Whereas Woolworths is under the international experience, it's right at the other end of the extreme, it has a very high level of leasing.

And essentially if you're measuring the economic cost of providing a service, that choice about whether you own or whether you lease, should not affect your result. And I think the correct economic principle is the value of the underlying assets, the physical, tangible, land, building, is what should be included in the denominator.

There is a practical question about how you get to that where you have firms that only report leases, but I think IFRS applying the values that firms are now required to estimate under IFRS 16, it's subject to some imperfections. But it's closer to the mark than either ignoring them or other methods that might have been used in yesteryear.

Dr Small: I'm interested in the concept of selling a lease, cause I don't know if you've ever been involved in subleasing, but there doesn't usually seem to be much of a value attached to them. Normally what happens is somebody takes over the lease and if you're the party getting out of the lease, you're very lucky to get paid anything other than have the debt refunded to you.

So you say that what should happen is not the right of use asset. You're saying that what we should do is ignore the right of use asset under IFRS 16 and instead, impute the market value of the land and buildings, even in a context where a firm doesn't own the land and buildings and might only have, you know, a couple of years to run on your lease. Is that what you say we should do?

Mr Balchin: That's correct. In principle that would be the best thing to do in practice, I said apply the IFRS 16 values is a practical compromise and it's closer, it would provide an answer that's closer to the truth than ignoring leases, ignoring the effect of leases altogether. Because the economic cost of a service is independent of how it is financed. So a principle a Commissioner has respected in a utility regulation, particularly for almost from year dot, is that when setting utility prices you should ignore how firms finance and focus on the physical cost of providing a service. Now, leases are just another manifestation of that, you can buy an asset, or you can lease an asset, it's just a different way of financing an asset, it's just, at least until IFRS 16, they were treated quite differently.

Dr Small: Okay, thanks for that. So not IFRS 16 but IFRS 16 is better than doing the right thing, I think, or better than doing nothing perhaps and the right thing is to impute the land and building value, the capital value even though the firm doesn't own it.

So I would like to pursue this with James Mellsop as well, but since Tex Edward's has go this hand up, I'll go to you Tex.

Mr Edwards: Thank you Commissioner Small. I just urge the Commission to understand that we're dealing with a supermarket here, not a Ferrari dealership. I comment on Jeff's comment that we're not really addressing the leverage available for this industry. I applaud the Commission's analysis using high leverage attached to a supermarket. Monopoly Watch will submit expert witnesses who are CFA Charters, and also members of the Association of Corporate Treasurers in London, who have a specific analysis on IRS 16 to help give a third-party expert witness statement who has a CFA Charter.

The most important thrust point from Monopoly Watch is to read out what, not the accountants, not economists, but the bankers and investors of this assets class are saying. And it's important that we note that Woolworths NZ accounts mirror the same margins and financial structure as Woolworths Australia.

Woolworths remains one of the most expensive supermarket businesses in the world, on a price to earnings ratio. World leading margins, duopoly-like industry structure and high returns on capital, are all reasons cited for the high valuation of Australian supermarkets. European supermarkets trade at 14 times earnings. Australia trades at 28 times earnings.

Let's not believe what their bankers are saying. Let's believe what the Board of Woolworths are saying. They commissioned a share buyback at these outrageous valuations. The numbers behind the share buyback they recently had supports what the financial community is saying.

We believe goodwill should absolutely be removed from the financial analysis of the Commission's work. We urge the Commission to study Beta coefficient more substantially across the whole range of international supermarkets operators and understand how Beta equals high leverage.

And we applaud the Commerce Commission's analysis on property, where some of the monopoly rent attached to supermarket businesses is actually transferred to property owners.

We urge Foodstuffs to have more disclosure of their PAK'nSAVE franchise leverage schemes to enable us to better understand if there's been any mistake made.

Thank you.

Dr Small: Thanks Tex, we'll come to goodwill shortly.

Ms McWha: Just before you go on, I noticed that Andy Matthews had his hand up for a period of time there, I just wanted to check that you didn't want to say something Andy?

Mr Matthews: Thank you, no, sorry I was just trying to encourage an answer to the question which I think we were getting closer to by the end. Thank you.

Ms McWha: Okay.

Dr Small: Thank you. So as I said before, it would be very helpful if we could find an economic valuation concept that lined up with the IFRS 16 right of use asset value. Jeff doesn't seem to agree that that's the market value of a lease. Some parties, even though a lease is a fungible thing, some parties say, "Well market value is fine for some assets but there's more general principle here" which is akin to a replacement cost approach under a modern equivalent asset framework. This is the approach that Oxera took in 2003 in their report for the OFT.

So, I guess my second question and maybe James Mellsop might like to try this one, is should we therefore value leases at the capital cost of finding and negotiating them? That seems to be the modern, you know, it seems like the replacement cost of a lease is what you'd have to expend to get a lease back if you lost it or to get one in the first place and that seems to me to be the search cost, the transaction costs, the negotiations costs, the execution of the deed. Is there any more to it than that?

Mr Mellsop: Well I suppose that to me that is not taking into account the cashflow that you'll generate from that lease, which is usually how we value assets. So I'm not sure, John, that would be the way.

Dr Small: Well one approach is to look at the market value, what you could get for the lease. Another approach is to look at what it cost you to get the lease. Have you got a third one and what is it?

Mr Mellsop: I guess it's just what we did in our report, would be, which is a methodology and Tex mentioned investors, so we mentioned in our report that Moody's, before there was an IFRS 16, was clearly getting frustrated with the fact that leases were note valued and essentially the methodology we use to incorporate leases was the same as Moody's used.

Dr Small: That's not the value of the lease is it, that's the outlays that you require to, that you need to pay, it's the obligations it's not the asset, right? Under IFRS 16, the value of the asset is defined as being the total sum of all the rent that you're going to owe. And what I'm trying to get at is, is there an economic valuation method that gives you that as an outcome for the asset? And I haven't heard one yet.

Mr Mellsop: Well, look maybe I can't give you an answer John, sorry. Basically our approach was to take what IFRS 16 did in 2020 for Woolworths and use that as a proxy if you're going backwards. That's the approach we took.

Dr Small: Okay.

Mr Balchin: Commissioner, could just clarify, there was a view you put to me which is to the effect that I don't agree with IFRS 16, or on this issue could I just clarify?

Dr Small: Please do.

Mr Balchin: So I said that in principle what an economist should be striving for is the cost of replacing the physical asset. So put aside all financing. But what I've said in my report about IFRS 16, is that so IFRS 16 calculates the right of use asset at the present value of lease lands. So provided that, the lease is sufficiently long, that is going to be reasonably close to what it would have cost to buy an asset at that point in time. And I think there's even a limit, there's an upper limit to what IFRS 16 allows you to capitalise at the actual underlying asset cost itself. So there should be, at least at that initial point, there should be some consistency between what it would have cost to buy the physical asset and the present value of the lease payments. But of course, you know, there are compromises that are made in accounting standards and that won't be perfect. Leases in the supermarket sector tend to be very long, so that's probably a reasonable assumption. But there are things that are missed when they value, price escalation clauses are only included if they're mechanical and the like. So there will be some things left out of that calculation.

I also think it's questionable as to, from what I've seen about the discount rates, that corporates tend to use when calculating the right of use asset values, they might be a tad on the low side as well, so that's something that probably goes in the opposite direction.

But my belief, my view, was of the available methods, forgetting the correct, the conceptionally correct value IFRS 16 was reasonably close and certainly better than doing nothing and it's better than some of the alternative techniques that I've heard used in the past where there were rules of thumb capitalisation factors applied to annual lease amounts to ascribe asset values and liabilities and the like. IFRS 16 is at least a deliberate calculation of a cashflow value.

Dr Small: Yeah of an outlay value, that's right. Alex Sundakov's got his hand up.

Mr Sundakov: The comment I wanted to make was the point that Jeff just mentioned and that's the price escalation clauses. I think that's probably the key methodological issue here. A typical structure a commercial lease is that there is a short period of mechanical price escalations, anything between 3 and 5-years, which accounting standards do capture. And then there are periodic market price reviews which the accounting standards don't capture. So I think that's an issue with both the asset valuation, but also, I mean if you were to bring leases onto the balance sheet, you would also need to take revaluations as income. The potential revaluation of the lease as an income. So I think, again I go to the point that there is not perfect solution here. You know there is an argument for bringing leases into the ROACE calculations, but if we do that, we also have to think about the revaluation gains and how those are treated in the income, just as its true, owned property is equally true on lease property.

Dr Small: Yeah, I take your point. So alongside your revaluation point where you suggesting that there was something more important about the early periods of a lease where you've actually got locked in rents prior to review, was that your suggestion?

Mr Sundakov: Well no I'm just saying that I think the accounting standards, because they focus on the mechanical price adjustments which only apply to early periods of the lease, would inevitably product a somewhat biased valuation.

Dr Small: Alright, thank you for that. Vhari, did you want to ask anything else on that topic?

Ms McWha: No, that's fine, thank you.

Dr Small: Right, let's move on. So the second topic here is about brand assets and potentially this applies to both companies, but I've actually just got, if you would indulge me, just a couple of specific questions for Woolworths on this. And I really just wanted to check about the way that your brand assets are valued on your balance sheets. Your most recent account suggests that they're at cost and what I'm keen to know is whether that's cost in the sense of outlays that have been made to construct those brand assets or whether it's from the acquisition of Progressive's, could you help me with that?

Mr Linstone: Simone Linstone from Woolworths NZ, Commissioner, yeah, the relatively smaller value of brands on the balance sheet was the acquisition when Woolworths Australia bought what was Woolworths Progressive Enterprises.

Dr Small: Thank you. And you also mentioned that you continue to build the brand through improvements in the brand customer offer and through marketing expenditure. I presume you're not capitalising that marketing expenditure; I take it that that's a supporting outlay that helps to support your position in the market but doesn't get capitalised into the brand, have I got that right?

Mr Linstone: Commissioner, that is correct, yes, I think probably the important point here is standard accounting practice, businesses don't tend to put their investment in brands onto the balance sheet, they just expense it. So spend obviously millions of dollars every year on marketing, IT and digital, but yeah, that's correct.

Dr Small: Okay, thank you. Could I just throw it open if anybody's got any particular views, as a general matter, about how – I mean we're going to come onto goodwill in a minute, so perhaps if we just stay away from things that arise from an acquisition. If anybody's got any general views about how we should value brand assets in an analysis like this, should it be, I mean for example, if a firm had revalued its brands at fair value, is that something that we should recognise in our calculation, or do you think we should look at the cost of building that brand instead, for example? I don't see any hands up, so maybe there's not a lot of enthusiasm for this question. I won't put anybody on the spot.

Mr Mellsop: Well, maybe if I just say, John, that I do have comments but I can make them in the context of goodwill, which you're coming onto.

Dr Small: Yeah, if they're about revaluations to fair value and that sort of thing, then that would be better, but up to you though.

Mr Mellsop: Well my comment really is the fact that goodwill is paid for acquisitions in competitive markets, implies that there are assets that are intangible and not being captured, and so to me this is one of them. So that was the encompassing comment, John.

Dr Small: That's helpful, so we might as well just move on to goodwill in that case, cause that was exactly the point I was keen to explore.

So this topic is again, obviously goodwill, again is prompted a bit by Woolworths submission, but we will be interested in more wider views. As you probably know in the draft report, we took the view that we should not recognise goodwill arising from acquisitions. But we should do our best to ensure that underlying assets are valued appropriately. So for example, lifting old book value assets up to market value, that sort of thing.

In the Woolworths submission it's argued that we include goodwill, which I take to be the entirety of the goodwill. So I'd just like to explore that. And in particular, I guess to ask about exactly this point that James was alluding to, which is whether you think the goodwill in Woolworths balance sheet is above or below or perhaps equal to its current market value?

Mr Linstone: Simon Linstone again from Woolworths NZ, John are you okay for me to answer?

Dr Small: Absolutely, please.

Mr Linstone: Thank you. So obviously calculating the economic profit using accounting measures is always going to be difficult and we've touched on that already. The nature of the grocery industry around the world is often likely to lead to significant differences between accounting book value and the meaningful economic value. And that difference can manifest itself most clearly when a grocery business is sold and accounting goodwill is generated.

Only last week shareholders approved the sale of Morrison Supermarkets in the UK for 7b pounds, which is 2.8b more than that asset. So this is a real live and very recent example that illustrates that a goodwill of acquisition of a grocery retailer does not necessarily reflect future rents, but more likely to be a difference between the book value and the market value.

Another example was in the US, when Amazon bought Whole Foods. I think they paid $13b of which $9b of that was accounting. I don't think anyone would argue either of these markets are not competitive.

In the retail grocery market, there's likely to be a significant difference between the accounting book value and a meaningful economic value. And so we talked in our preliminary submissions and also in the submissions up to the Commission on the various components that made up that goodwill number. And we've already touched on leases, brands, we've just touched on as well. Specifics, I'd rather save till the confidential session, but at a high-level, we talked about synergies and we talked about heavily depreciated assets, they were the major components.

And probably James, you might have a couple of things to add to that.

Mr Mellsop: And to your question John, I mean I think Simon has given the accounting response. My own suspicion as an economist is that the value of these intangibles that we're talking about probably changes. I actually don't know what the 2.3b that Woolworths Australia paid, you know, 15-years ago is still the value of that or not. These things are probably more dynamic than that, just to answer your question, specifically John, if that helps.

Ms McWha: One of the things that I'm struggling a little with, like I understand you're saying there's some intangible assets here and they have a value. And I don't have a problem with that, you know, I'm sure there are intangible assets and I agree that they probably have a value.

What I'm concerned about is that if in fact, goodwill, and the payment of that when you sell the business, also includes a payment for economic rents in the future. So the seller of the business is in effect, capturing the monopoly rent that the new owner will be able to make in the future.

So, I'm just wondering how do we distinguish those two things, which one, like how do we value the actual assets and make sure that we're not just capturing monopoly rents?

Mr Mellsop: I'm not sure there's an easy answer. I guess a couple of points. In my view, the Commission so far has assumed that the entire goodwill does reflect rents and I don't think that is a fair assumption. I also can't say though that all 2.3b doesn't reflect rents. I mean, you know, but it's pretty clear I think from the empirical examples that Simon has just given, and in fact the Commission's sample of ROACEs, you know, the range is huge and a lot of them are above the Commission's estimated cost of capital. And it's probably for these measurement issues. So I think there's a lot of empirical evidence that there are in there assets that generate returns which are competitive returns.

How you pull them apart? Look, I sympathise, it's not easy. Perhaps if I could offer a couple of conceptual ways you might do this, but they're not easy.

I mean, one is, you could actually take, you could gather a sample of acquisitions of grocers over the last 5-years or whatever, and just look at the ratio of goodwill to book value. Maybe that would help if these are taken from what appear to be competitive markets. I don't know if the data is there.

Otherwise I think, maybe the Commission's left with having to, in my view, accept that there are intangibles which we can't measure. That means that it's not correct to simply compare ROACE to WACC and say if it exceeds it by anything, that's a rent. So there's a sort of margin in there. And maybe you would compare the calculator ROACE to that sample. As the Commission has done of overseas grocers, because they will be subject to the same measurement issues as we're grappling with here.

I'm not sure if that helps Vhari.

Ms McWha: Yeah, that does help James and I'd be interested in any future kind of thoughts that you might have as you have an opportunity to think about this over the coming days.

Mr Mellsop: Okay.

Dr Small: I was slightly distracted there, was that last point you were making, James, about using other people's returns rather than a WACC as a benchmark, was that the point you were making there?

Ms McWha: Yeah.

Dr Small: So that was a point I was going to come up to actually, cause I've certainly heard what you said about that which was lots of these firms have got intangibles and if you look at firms in competitive markets and benchmark local returns to those, you're more like to capture the intangibles, I think that's the thrust of your argument.

I just wondered whether there's a real, just a real circulatory problem here. Which is, if you think about the market value, which is where I started, market value, the set of intangible assets, the goodwill, the brand assets, these synergies, whatever. The market value for those, if you're going to benchmark against other firms, isn't it going to be the amount of goodwill that drives the estimated return to a competitive level, by definition? In other words, imagine the Countdown business was sold, it will be sold to somebody who has got some expectation of a particular return. That sale's in a competitive market. Benchmark it against a competitive market. Excess returns by definition are zero right?

Mr Mellsop: Yep.

Dr Small: So, how do we get round that circulatory, cause that seems like a fairly fundamental problem?

Mr Mellsop: So, I think if I understand the question, the examples of Amazon buying Whole Foods, the Morrisons example in the UK, we're still seeing material levels of goodwill paid. It's pretty hard to imagine that's due to market power rents -

Dr Small: No, no that's right, that's all competitive right –

Mr Mellsop: - yeah.

Dr Small: - that's all entirely, that's just the value of the – the market value of those intangibles because those businesses were sold in a competitive market, that was the market value of their intangibles, so therefore the new owner has no excess returns whatsoever because we've benchmarked those intangibles to the market?

Ms Mellsop: Yes, that's correct, yes.

Dr Small: So that's always going to happen isn't it, if we value, if we look back at these two major grocery retailers in NZ and conduct that same thought experiment, that's where we're going to end up.

Ms McWha: I think James is saying we use the ratio of goodwill, so intangibles in the UK, to apply to NZ, rather than –

Mr Mellsop: Thanks right.

Dr Small: So don't value the intangibles here at their market value?

Ms McWha: No. Cause I was asking him if he had any ideas of how we do that.

Dr Small: So you don't think we should value the intangibles at the market value?

Ms McWha: Well it was just suggested.

Dr Small: Yeah okay.

Mr Mellsop: Well we should value the intangibles.

Ms McWha: Find the market value.

Mr Mellsop: That's right, we should, but I think we're all struggling with what is the market value of the intangibles. My suggestion is, if we're trying to look at that $2.3b of goodwill that Woolworths paid, perhaps we can look at a sample of overseas acquisitions to get some sense for what part of that might reflect intangibles versus rents. So that would try to break that circulatory I think you're referring to John.

Dr Small: Okay, I understand what you're saying, because it is a terrible problem isn't it and it would be a problem here as well if we were to try and value these things at market value.

Mr Balchin: Commissioner, could I just offer a small comment there?

Dr Small: Yeah, please.

Mr Balchin: Just one thing I need to get off my chest. These accountants need to come up with better words for things. Things like goodwill and intangibles are distinctly unhelpful. What we're talking about here, this sort of intangible assets are real live things that firms need to spend money on to compete to enter a market. But they're not just things that get capitalised into balance sheets. And the only time they do show up in balance sheets, is when firms then get traded when the acquiring firm does recognise that this asset the accountants haven't recognised is actually valuable and they pay money for it. And then accountants give that the distinctly unhelpful name of goodwill. I mean we're really talking about organisational capability in all aspects of that, it's quite valuable.

So, when you're talking about these assets, so these assets exist irrespective of whether there's been a transaction and whether it's on the balance sheet. So Woolworths has obviously raised this issue, cause its goodwill asset is large. These assets are present, just not seen for all firms in the sector.

Dr Small: So, you're saying that, I think what you're saying is if I was an entrant and I come into a market fresh and I start building my brand, building my presence in the market, I'm short of capital, I'm expensing everything I can possibly expense so I can save on my taxes, so all my marketing expenses get written-off as expenses. Maybe I've got losses carried forward and so that trading activity over a few years, creates an asset, but is not recognised as an asset, but we should recognise it as an asset?

Mr Balchin: Well it is an asset that the market recognises as an asset and it's an asset the new entrant would have to replicate. So in principle it should be recognised.

Dr Small: Yeah, just talking about that new entrant process that's how they replicate it is by expensing things –

Mr Balchin: That's right.

Dr Small: - yeah, rather than capitalising them, okay.

Mr Balchin: Yeah, and it's across a full range of things. Marketing is part of it, but you're also finding out networks of supply, establishing logistics and finding staff, training.

Dr Small: Yeah.

Mr Balchin: In our report, we sort of referred to, we asserted that there was a large and growing economic literature on this and there is, and it's quite a cutting-edge field in economics and financial economics. I counted eleven quite good articles over the last decade, three of which were in the American Economic Review and one of which in the Journal Financial Economics, which are all about this issue, about the value of intangible assets and their significance to modern firms.

Dr Small: Good thing we're talking about it, thank you very much Jeff. Alex, have you got something to add on this?

Mr Sundakov: Yeah, just again methodological observations. I think the point that John, you made previously, the investment market is competitive and therefore if you use data from market valuation of goodwill, you're always going to have the circulatory because you're always going to turn up with, basically, return them very close to the cost of capital, is a very important observation. I don't think that sort of taking kind of random ratios will break that circulatory.

But to me, the critical question here is, again, there's no perfect measure. But we're trying to see what is the best way to construct a ROACE calculation that allows comparison to the weighted average cost of capital. And since the expense, as you were just saying, the things that go into constructing goodwill are expensed.

For the purpose of understanding what is the return on capital employed, there seems to be a really strong logical reason for excluding those intangibles because they're already accounted for elsewhere. And the only purpose, the only thing we're trying to do here is to figure out what is the right denominator? What is the capital employed in this business? And since you've already accounted for those expenses elsewhere, it's still not perfect but the risk of excluding them from the denominator is pretty low.

Dr Small: Thanks Alex, that's kind of the way I was thinking about it.

Mr Balchin: Could I just respond quickly to that, because I agree with Alex that over the 5 years you analyse, it's either capital or operating and so it's from one bucket to the other but the issue with intangibles is really, you know, the stock of assets that is the outworking of the previous, you know, 20 or 50 years, that you have in place at the start of your analysis period and what value should be ascribed to that, because remember, we're only analysing profitability over a short period, and there is the very important question about what is the starting stock of assets at that period, which I think is what we're really debating here.

Dr Small: Right, Tex has got his hand up, can we hear from you Tex.

Mr Edwards: Thank you. The position here is that we're really debating the $2.3b worth of goodwill on that Woolworths balance sheet. And from a Monopoly Watch, that's the value, the NPV, which I'm going to credit NERA's analysis on page 2, they articulate that goodwill is sometimes monopoly rents, the rent of the business. And, because we're trying to resolve a competition riddle here, are the accounts correct? Is the goodwill correct? What does it take to get a new entrant? I think we should look very carefully at this 2.3 that if there was to be a breakup, the auditors of Woolworths would write down that 2.3b to something like zero. Because essentially, how that number was created on the balance sheet of Woolworths, was the premium over the assets that they paid.

I also note that in the Commission's report, we do discuss Tobin's q and I urge the Commission to revisit Tobin's q in the final report, specifically to the fact that a market value of Woolworths is available in a surrogate form through the Goldman Sachs and UBS sum of the parts valuation. So again here we're talking of the bank doing actual transactions on capital values here and the bankers here or the valuers, the investors, are actually agreeing that they'll pay a capital value according to the monopoly rent. This is different for a challenger because a challenger needs to have access to the infrastructure at a cost base and that's why Tobin's q is important.

Thanks for indulging me on that point.

Dr Small: Thank you. I am close to the end of my questions. Have you got any further?

Ms McWha: No, I'm fine thank you.

Dr Small: I wonder if I might just be time for last orders, has anybody got something they're really keen to get off their chest here that's actually methodological on this matter? Yes, Greg, thank you.

Mr Houston: Yes, thank you Commissioner Small. I just want to take up one point that Alex Sundakov has made that doesn't seem quite right to me. Which is that it's not the case that where the costs of entry, if you like, of developing a brand and developing the know-how. It's not the case that they have been, sort of, we can ignore them because they've been accounted for elsewhere, because those costs may have been incurred many years ago and they're gone, they could be costs in the form of profits or losses, sorry, that were accumulated over a period and they have just completely disappeared from the accounts that you look at today.

And I think the right way to think about, at least one component of goodwill or intangibles, is that that's a representation today of what would be the accumulative cost of a new entrant that would need to incur to come into the sector. And to be sure, if there were monopoly rents, then they would also be reflected in that value, no one quibbles with that concept. But it isn't right to say, well because they could include monopoly rents, we just or should ignore them altogether. You have to take account of the fact that entry in this sector cannot happen overnight and the intangibles reflect that very concept and that's exactly why they need to be counted.

Now, how do you deal with that in practical terms? I think you really should take the guidance from your international comparisons of returns of existing businesses and that is by far, presumably or can be presumed, generally to operate in effectively competitive markets, those returns reflect with all of the accounting idiosyncrasies, what a normal market delivers for these sectors.

So, in some sense, the difficulty you've setup is by trying to compare a benchmark WACC with costs that are not really the costs that you would incur in needing to earn that WACC.

Dr Small: If I just follow that up for a minute Greg. I may have misunderstood, but I think I heard you say that not counting any monopoly rent, the balance of the component of intangibles is like an entry cost for an entrant?

Mr Houston: That's a reasonable way of looking at it, yes.

Dr Small: Is it, cause that's, I mean suppose in Woolworths case that was, let's say it was a $1b, are you suggesting that that would be, surely that – you know, it might cost somebody $1b to enter. But that $1b would be converted into physical assets and plant and equipment and so on, it wouldn't sit on anybody's balance sheet as a $1b worth of intangibles would it?

Mr Houston: No, but entry, my point is simple that entry to get to the scale where you can compete effectively, is a process that takes time and will involve, during that period, some losses or profits that are below the normal level. And there's nowhere on a balance sheet that those cumulative losses exist once you reach a level of profitability and those losses get wound out –

Dr Small: Yeah, they get wound out.

Mr Houston: - the time that it takes for an entrant to build all of the expertise, to build the brand, to build all of the knowhow, is not, as Alex suggested, recorded somewhere in the accounts for an established business, that is cost and losses that are in the past and have disappeared from a balance sheet. Of course you also have assets, but my point is that the goodwill or intangibles can be taken as a market value of a going concern operation that's working effectively.

Dr Small: It sounds to me like you might be making up barriers to entry argument for us a little bit there Greg, but can I just, Tex is familiar with the cost of entry and the losses associated with it so I'll just come to him for a comment on this and then to Nick Hogendijk.

Mr Edwards: Thank you Commissioners. The point James Mellsop is making is about the J curve. And the J curve is the operating losses that you take, year1, year-2, year-3, year-4 and then, to Commissioner Small's point earlier in the day, you take these losses, very painful, and you add them up and your accumulated losses are your go forward tax shelter. And so then you would expire them, you expire the losses, (let's ease of conversation use that $1b capital number) year-1, year-2, year-3, you're going to lose fifty hundred million dollars, and then you're going to have these accumulated tax losses, because the Tax Commissioner will allow you to, essentially, carry that asset on your balance sheet, and then year-5, year-6, year-7 when you're making profits, you can deduct that. Then that relationship with expenditure is expired.

On day 1, you would be investing and making your own choices on how to brand, how to price, what type of intangibles you'd attach to the business. And as a consequence, I can't see how a colleague from NERA, James, is articulating how these losses work, or how this payment exists upfront.

On day 1, we pay up the capital, you buy sites and you build a business plan and you make losses and then those losses are deductible against tax going downstream.

Dr Small: Yeah, I think you might be talking about what happens after you've been in the market for 15-years and you've got a big intangible asset as well, but anyway, that's a possibility. Let me just go to Nick for a comment on this, we're getting close to the end here.

Mr Hogendijk: Yeah, thanks I'll keep it brief Commissioners. Thank you for the time. I want to pivot a little bit form the conversation around profit and trust. Just to go back to retail earnings and discuss some of the questions and challenges that I've got. When I hear talk about our profits are in line with global standards, we're not excessive in terms of what we earn. So, according to Deloitte's 2021 report on retailing that FMCG globally has a nett margin of 2%.

Costco has been referenced in these conversations over the last day, it sits at 2.4. Tesco at 1.5. Morrison at 2. So we're talking about retailers that have been referenced and so when you compare that to the retailers that we're talking to, they're in the room today, there is a discrepancy and it's about 100%. In some instances, more.

So I'm curious as to what's fair and I understand as well that will in turn put pressure on suppliers which what should happen in a healthy and competitive marketplace. So just to be clear, this is not about it's all the retailers fault and they need to be competitive and therefore the poor suppliers are victims. If they're not doing their due diligence, then tough luck for them. So it has to go both ways and a healthy competitive market will see margins come down for retailers, but it will also see suppliers have to tighten their belts on the way. But it will give them more options to be competitive themselves as a brand owner and as a supplier.

So, if you're a Pernod Ricard or you're a Unilever who have been, you know, Unilever was reference I think it was yesterday, as having strong market position in categories, well you know, they might have to tighten their belts along the way and so be it. That's, I guess that's the interesting juxtaposition of the duopoly dealing with a duopolistic supplier, so to speak.

But there is a challenge there for me in terms of the profit margins that are being referenced in this – additionally, I keep coming back to this 68c in the $1 and we only make 4% that Foodstuff references. So, I've gone and done some homework on that and I have a really, really weighty question for me that sits in my mind anyway, around the annual report for 2021 that states that they made, their turnover was $3.7b. And it doesn't add up.

So I've done some homework, I've spoken to different people across the industry, I've looked at information that I've had, interviews and discussions I've had with store owners previously and when I look at, you know, 43 – 44 PAK'nSAVEs or look at 101 New World stores, give or take, 150 to 200 Four Square stores, we're talking about a business based on revenues of somewhere around the $2.3m mark as an average for a PAK'nSAVE, $1 to $1.4m for a New World and let's call it $20,000 a week for a Four Square store.

When you annuitize that out over a year, that turns into a $12b business. Stripping out GST, that's 10.4. Stripping out 68c in the $1, that's a $7.1b business.

So, that tells me that in the financial reports that we're seeing at 3.7, we're not looking at direct costs and other costs that go through that value chain. And therefore that then challenges back to me how is this working?

So I even spoke to the CEO of a business and this person has been CEO of retailers, wholesalers and cooperatives, all of them multibillion-dollar business, and I asked them the question and their comment back to me was, (in an SMS chat only 48-hours ago), it's a very interesting chart, (referring to the Foodstuffs chart which shows the 4c). Are they saying that they're only making 4% wholesale EBIT plus the retail making 25% - 45% gross margin? Or are they saying it's 4% across the board? So I said it's 4% across the board based on Chris Quinn's comment the other day.

So, the comment back to that (and I'll quote it so I'm not misrepresenting) is, *"Wow, that's lean, must be a lot of restrictive practice costs in there. Perhaps they shouldn't have tens of millions tied up in the land banking and supermarket building, warehouse building assets, been very creatively depreciated and they may also be feeding profit into JV outcomes, so where does their data mining set, who does their PR, their advertising, their AI work, etc, etc. It could be conceived that this is a pyramid scheme if you look at it from the outside in*", was the comment that was made to me.

I'm not suggesting it is, but I think it's important to understand where the money is sitting and what the value chain looks like.

Dr Small: Thank you Nick for that. It would be good if you could send that through, it's very hard to just pass it as you're working through that calculation -

Mr Hogendjik: I will.

Dr Small: - that will be helpful. And if anybody wants to see the transcript to respond to that, there will be a transcript available as well of course. Jeff Balchin has his hand up, please Jeff.

Mr Balchin: Yeah, thank you, I just want to get back to the topic about intangibles and round out my view, so you've got it for the record.

So what I advocated and what is actually consistent with what Greg Houston argued a moment ago, I don't have a magic, I think the idea that they're intangible assets and it's an ongoing process whereby firms devote resources to developing intangibles, organisational capability that doesn't get capitalised. I think that's quite well established, I don't have a magic bullet as to how to value it, so I think what I argued in my report and I haven't changed my position, is that the prudent thing to do is for the Commission to benchmark the returns of the NZ supermarkets against the returns of the international grocery retailers. Because to the extent that these intangibles, these organisations, the value of organisational capability is, is something that is systemic across the supermarket sector and I think it is. That will be reflected in higher accounting rates of return everywhere and so that will implicitly be picked up.

So that was a large part of my argument as to why that was the appropriate point of comparison.

Dr Small: Thanks Jeff, I think we've definitely heard that point. Alex?

Mr Sundakov: I think I just wanted to respond to Greg. And I think Greg was setting up a little bit of a strawman and then knocking it over. I mean obviously by not having any provisions for goodwill, you are, you have to accept there's an element of bias. Equally I think it has been well ventilated, taking accounting, goodwill will also introduce bias.

So the question is, what is the best way to use available information and how can be interpret the results?

I think that's, first of all, I think that while comparisons with other supermarkets around the world are interesting and they're relatively easy because you can obviously more easily decide whether to use data on a consistent basis, whether you take goodwill in or goodwill out, will give you consistent comparisons. The problem is that there is probably no global supermarkets that are truly competitive. I mean the investigation that the Commission is conducting in NZ has been repeated in just about every comparison country.

So that to me is a fundamental problem with just doing international comparisons. So then you do have to compare to a measure of the cost of capital. And given the likely error of either including or excluding goodwill, it seems to me that that's one lesson we can think about is, how do we look at, for example, regulated business.

So a comparison of the regulated business is the Commerce Commission sets WACC and they earn WACC on that tangible assets and we know that regulated business always sell for some multiple of their weight. So there is that implicit goodwill that's built there and what the Commission does and what other regulators do, is they look at those multiples and they say, "Are they reasonable multiples. Do they give us some comfort that we got things right or are the multiples looking really, really too high and therefore we've probably got things wrong".

I think exactly the same logic applies here, you know, the sensible comparison is to exclude the goodwill, use that for the calculation of ROACE, compare that with the weighted average cost of capital, and then look at the kind of margin of difference. You know, if ROACE calculated that way is just slightly above WACC, you'd probably say, well, you know, there's enough error there that nothing to worry about. If it's significantly above WACC then you start asking questions.

Dr Small: That's an interesting approach, thank you. Jo Allan, can I come to you now please.

Ms Allan: Thanks Commissioner. Look, I'd just like to make a few remarks on some of the comments that have been made.

The first one is essentially related to the fact that we need to understand all of the profits in our value chain. And in our submission, as you know, we have recommended that you look at our business on a whole of business basis. And on that basis, our returns are between 9% and 12% and that compares to around 25%, which you estimated our returns to be. And the main issue here is that you didn't allocate the assets to the retail part of our business as we've discussed with you in previous sessions.

The second one is that we do believe that ROACE is the best benchmark of the global competitors, not NPAT margin. And the reason for this is that NPAT will differ depending on whether a retailer is a renter or an owner, as the cost of the rent might be higher than the cost of the interest and depreciation.

So I think those two points are really important to understand.

And probably just another point to note is if the Commission's view on the returns of the major grocery retailers in NZ was correct at 25%, which I do note that's nearly 20 points higher than what you estimate an appropriate return to be of WACC at around 5%, surely commercial reality would have prevailed by now and international competitors would have actively been entering our market. They haven't, our returns are between 9% and 12%. They're consistent with international retailers and again, I think that's an important point to understand.

Thank you.

Dr Small: Thanks very much Jo. I think, I really don't want to have a round of closing submissions. I think that's been a really helpful, that was a useful comment, thank you cause it was methodological. But I think this might be a good time to wrap things up. From our point of view it's been very, again, another really, really helpful conversation to delve into some of these important issues and as I said at, the start, you know, they're fundamental to where we come out and they're also potentially of relevance in the future.

So thank you very much. I'll hand over to Anna Rawlings, our Chair, in a minute for closing comment but I just wanted to remind you too that anything that you think you'd still like to share with us you can do that through our email address and also for cross-submissions. So Anna, would you like to close us out.

Ms Rawlings: Thanks John. Nothing really further from me today. Thanks for this morning and we'll reconvene tomorrow morning at 9.30 again. Just a reminder that there is no session on Friday of this week, but we'll come back on Monday and then we'll provide an update as we go through perhaps tomorrow or Monday as to the content of any session that we might have on Tuesday as well. So thanks very much again for a really interesting morning and contribution and we'll see you tomorrow.