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Submission on Market Study into the Retail Grocery Sector – Preliminary Issues Paper

Background

The Warehouse Group Limited (**TWG**) welcomes this opportunity to comment on the market study into the retail grocery sector (**Study**) and provide feedback on the Preliminary Issues Paper published on December 18. TWG is one of New Zealand's largest retail groups, comprising The Warehouse, Warehouse Stationery, Noel Leeming, Torpedo7, TheMarket and 1-day.

As a general merchandise retailer, The Warehouse provides hundreds of thousands of products to New Zealanders, including a very limited range of grocery food and non-food products. Having attempted to create grocery retail business in 2008, we understand the barriers and complexities, although our views in this document relate more to our more limited present-day knowledge.

TWG's purpose is to help kiwis live better every day, and we are particularly keen to support the Study in its efforts to ensure better outcomes for New Zealanders.

In this respect, two features of the New Zealand grocery market stand out to TWG:

- The first is that TWG understands that New Zealanders pay high grocery prices in New Zealand compared to other international markets. Comparisons in this space will be key to drawing a conclusion.
- The second is that the NZ grocery market is globally unique with, in effect, only two wholesalers and retailers of groceries. The two major grocery retailers (**Grocers**) effectively control supply to consumers, either directly through their retail brands or indirectly through wholesale supply to franchisees or the handful of independent retailers.

While there are, of course, many factors that influence grocery prices, it is hard to escape the conclusion that the existing competition limitations must be a key contributing factor. As the Commission has consistently recognised in the past, there is significant benefit to be had from increasing competition in a duopoly market. The advent of 2degrees in the mobile market is a case in point¹.

¹See, for example, *Vodafone Europe B.V. and Sky Network Television Limited* [2017] NZCC 1 at [95] to [99].

However, the duopolistic structure of the market may have created barriers to, and conditions of, entry that mean that new entry across New Zealand is not likely in the current environment. TWG has a unique perspective to offer in this respect, as it experienced the challenges of entering the grocery market in 2008. It could not make that entry work notwithstanding its size, retail footprint, and brand awareness.

Put simply, TWG does not believe that the current structure of New Zealand's wholesale and retail grocery markets is delivering the best outcome for New Zealand and New Zealanders. TWG believes that the only thing that will make a meaningful difference to the grocery prices consumers pay in New Zealand is encouraging and facilitating new entry into grocery and adjacent markets, while ensuring that competition is not only preserved but flourishes over time.

A new nationwide provider with access to scale and capability would provide a new route to market for suppliers, diluting the existing consolidated scale and in turn benefiting New Zealand consumers with more competitive prices and market competition. This would also provide incentives for the Grocers to competitively price products to absorb seasonal price variances.

TWG respectfully submits that this is what the Commission should focus on in this market study, and it is what TWG has focussed on in this submission.

Key considerations

There are three areas TWG would like to comment on in respect of the Study:

1. The Study scope

In general, we are supportive of the existing scope of the Study. We do, however, believe a stronger outcome could be achieved with consideration of some interdependencies relating to the Grocers, which may impact the ability for others to compete and for consumers to receive the greatest benefit.

Our recommended additional considerations include:

- Expanding the scope to include liquor sales (see 2c below), in-store baked goods and over the counter medicines, to ensure that all major categories offered through grocery retail are covered.
- How to address the price disparity in prominent areas of produce, meat, fish, poultry and dairy, that arises from the scale the Grocers can leverage. Consideration could be given to how best to mitigate this.
- Studying all three elements of grocery wholesale: delivered grocery (delivered wholesale to retailers), cash & carry and foodservice, to ensure that all market volume, supplier and buyer bargaining power, access and control of supply is captured.
- Consider meal kit providers, in the context of any potential acquisition (see 3 below).

2. Barriers to entry

TWG holds the view that there are high barriers to entry for both potential domestic and international operators in terms of:

- a. Scale: defined as immediate access to competitive supply and operational efficiencies given the existing market structure, population size and spread.

- b. Skill: defined as access to infrastructure to support both physical and digital channels and end-to-end supply chain to support temperature-controlled goods.
- c. Policy and regulation: in the context of ensuring a level playing field on property covenants, and operating licences for liquor.

Market attractiveness in the context of skill, scale and regulation

International market entrants: Overcoming the skill and scale deficit is a matter of financial resilience over time. Without immediate skill and scale within New Zealand, it may not be seen as a priority market, unless capability is already established elsewhere in Australasia. Inviting international entrants before enabling potential local operators may not be advantageous due to the risk of additional pressure on local FMCG branded suppliers, who may be expected to supply at globally agreed commercial rates.

Domestic market entrants: The investment burden and risk based on skill and scale is high for domestic entrants, with no guarantee of access to supply, customer uptake or return on investment. The largest wholesalers are owned by the Grocers and although there are other independently owned wholesalers, we do not believe they would have the scale to compete effectively. Investment and support to propagate domestic competition is likely to enable a New Zealand based business to provide better consumer outcomes.

Both international and domestic entrants to the New Zealand market are also likely to be impacted by the limited amount of market data, as compared with other markets, affecting market sizing and potential due diligence.

2a. Scale as a barrier to market entry considerations

Wholesale market

The nature of having only two main players in the market limits competition. We understand most retailers outside of the two main grocery businesses are supplied by wholesale entities owned by the Grocers, so access to supply and price is likely to be controlled and bargaining power between buying and selling entities potentially lost. This too has implications on the foodservice wholesale sector (hotels, caterers etc), where manufacturing scale across sectors and channels is taken by the Grocers. This means the Grocers have significant influence over the supply of food, beyond the grocery retail channel.

Home/owned brand manufacture

Internationally we have noted the recent rapid growth of international discount operators' home brands. For instance, Aldi and Lidl today predominantly sell home/owned brand products (c.95% of offer) suggesting that home/owned brand, in itself, has a large part to play in providing affordable food choices for consumers, who benefit from simplified product ranges and economic operating models. In the New Zealand market, we believe that own brand production by manufacturers of consumer-packaged goods may be used to improve factory efficiencies, however, it may also be used by Grocers as leverage for better range, positioning and commercials for branded goods from the same supplier, which may in itself, not lead to better outcomes for consumers.

2b. Skill

End-to-end capability

Our observation of the grocery sector in New Zealand is that there is a lack of access to large-scale independent supply chain and fulfilment infrastructure (chilled fridges, storage, transportation and labour etc.) for a new entrant or smaller grocer to partner with or acquire. As mentioned above, any international or domestic entrant would require significant financial and resource investment to build the end-to-end omni-channel capability to effectively compete in the existing market. There would also be considerable risk associated with building such infrastructure. Funding options could be considered to lower barriers.

2c. Regulation and policy

Limited property site availability

We understand that there is limited access to supply of suitable sites for new entrants and that certain property leases contain covenants restricting the use of adjacent sites for the retailing of grocery products.

Liquor

Currently those outside of the Grocers must create a standalone business and shopfront to qualify for a license to sell liquor. This negatively disrupts the shopping experience for customers, incurs additional operational costs for the retailer and is a significant disadvantage for new entrants.

3. Consumer impacts and benefits

Preserving competition from adjacent markets

Care needs to be taken to ensure that the limited competition in the grocery market is not exacerbated by allowing what competition exists from adjacent markets to be stifled. For example, meal kits are a relatively new, but welcome addition to the broader New Zealand market. As with many global players in this space, the customer offer predominantly appeals to higher income demographics, therefore not providing a viable value alternative for lower income families in New Zealand. Whilst none of the home-delivery based meal kits currently form a part of the offering of either of the major grocery retailers, partnering or acquisitions in this space by either party would exacerbate the current limited choice for consumers and further consolidate reduced routes to market for suppliers.

Consumer price of food

As part of an assessment of the price of food vs. international markets, consideration could be given to:

- The absolute and percentage of household income spent on grocery food.
- Comparisons of the price of most commonly purchased items across all major categories.
- The cost of fast food compared to buying the ingredients to prepare meals from the lead Grocers.
- The retail price of New Zealand produced product in international markets.

TWG would also support the introduction of a Grocery Supplier Code of Practice to potentially address and govern any inequality of supplier/buyer bargaining power, if this leads to better outcomes for consumers.

Thank you for considering our comments and if you would like to discuss any aspect, please do let us know.

Yours faithfully

The Warehouse Group Limited



Nick Grayston
Chief Executive Officer