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# Economic effects of proposed merger of FSNI and FSSI – review of statement of issues

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A report for Chapman Tripp

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# 1. Introduction

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1. We have been asked by Chapman Tripp to prepare this report on behalf of the two Foodstuffs cooperatives, Foodstuffs North Island (FSNI) and Foodstuffs South Island (FSSI) (collectively, Foodstuffs or the parties),<sup>1</sup> on the economic effects of the parties' proposed merger (proposed transaction).
2. The purpose of our report is to review the economic principles and matters arising in their application, as described in the Commerce Commission's (the Commission's) statement of issues regarding the proposed transaction (statement of issues).<sup>2</sup> This report should be read together with our earlier report on the economic principles and their application in an assessment of a merger between competing buyers (our first report).<sup>3</sup>
3. By way of context, we explain in our first report that:<sup>4</sup>

Presently, FSNI and FSSI are separate co-operatives that present a uniform national bricks-and-mortar and online retail grocery offering through common brands, ie, New World, PAK'nSAVE and Four Square, as well as commercial wholesale businesses operated by each co-operative, ie, Gilmours (FSNI) and Trens (FSSI). However, store owner-operators also have an ability to compete and make range decisions on a local basis.

The proposed transaction would merge the management and operational functions of the co-operatives' support centres. Individual stores would continue to be owned and operated by individual co-operative members. [footnotes omitted]
4. Our report is structured by reference to three distinct considerations arising in the Commission's statement of issues, ie:
  - a. in section 2, we set out our assessment of matters arising in the applicable markets for the acquisition of grocery products, for which the Commission has raised:
    - i. the implications of any transfer of surplus arising from changed bargaining conditions for competition and consumers;
    - ii. that the effect of the transaction can be characterised as a 'three-to-two' merger of buyers; and
    - iii. the potential implications for private label products;
  - b. in section 3, we examine whether coordination could be enhanced by the proposed transaction; and
  - c. in section 4, [REDACTED].

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<sup>1</sup> We also use 'Foodstuffs' to refer to the proposed merged firm.

<sup>2</sup> Commerce Commission, *Statement of issues, Foodstuffs North Island/Foodstuffs South Island* (Statement of issues), 4 April 2024.

<sup>3</sup> HoustonKemp, *Economic effects of proposed merger of FSNI and FSSI* (HoustonKemp report), 7 March 2024.

<sup>4</sup> HoustonKemp report, paras 3-4.

## 2. Assessment of applicable acquisition markets

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5. In this section we set out our assessment of matters raised by the Commission in relation to the applicable markets for the acquisition of grocery products. Those matters are:
- the implications of any transfer of surplus arising from changed bargaining conditions for competition and consumers;
  - that the effect of the transaction can be characterised as a ‘three-to-two’ merger of buyers; and
  - the potential implications for the merger parties in respect of private label products.

### 2.1 Implications of any transfer of surplus on competition and consumers

6. In its statement of issues, the Commission indicates its agreement with the conclusion drawn in our first report that a bargaining framework is the most relevant for assessing outcomes in relation to markets for acquisition of groceries. However, the Commission also indicates that, in the context of a bargaining framework, it is assessing whether a substantial lessening of competition may be likely if the proposed transaction resulted in, among other things:<sup>5</sup>

‘...a transfer of surplus from grocery suppliers to the merged entity..’ [and/or] ‘a reduction in grocery suppliers’ ability and incentives to invest or innovate.’

7. In the material below, we address:
- whether it is possible for there to be a substantial lessening of competition in the context of not more than a transfer of surplus (with no change in output) between suppliers and buyers;
  - the mechanisms by which investment by suppliers could be affected by the proposed transaction; and
  - the means by which the proposed transaction is expected to affect the parties’ relationships with suppliers including, ultimately, the ranging decisions by which grocery products are selected to be made available to customers.

#### 2.1.1 A mere transfer of surplus is not consistent with a lessening of competition

8. In our earlier report, we explained that in respect of:<sup>6</sup>
- major national suppliers and small national suppliers, the relative bargaining position of the merged entity would be likely to improve slightly, relative to FSNI and FSSI individually;
  - regional suppliers, being those suppliers that presently negotiate with and supply to only one of FSNI and FSSI, the relative bargaining position of the merged entity would not be likely to change, relative to FSNI and FSSI individually, because in practice these suppliers would only change from negotiating with one cooperative to negotiating with the merged entity; and
  - in respect of small local suppliers, the merged entity would not change its relative bargaining position, because procurement in respect of individual stores would be unaffected by the transaction.

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<sup>5</sup> Statement of issues, para 39.

<sup>6</sup> HoustonKemp report, paras 59-60, 56, 70 and 73-74.

9. Put another way, the merged entity may achieve a slight improvement in its relative bargaining position with respect to some suppliers. We also explained that the merged entity would presumably seek to bargain for the better of the terms that each of FSNI and FSSI presently receives.<sup>7</sup> Those same suppliers would also be able to benefit from simpler engagement with one party rather than two separate cooperatives.
10. The first instance implication of a shift of terms towards the better terms received by the parties is a transfer of surplus from suppliers to the merged entity.
11. In its statement of issues, the Commission states:<sup>8</sup>

...we are currently not satisfied that the Proposed Merger would not substantially lessen competition due to unilateral effects in markets for the acquisition of groceries. This is based on our current view that in the factual, the merged entity may be able to unilaterally extract more favourable terms from suppliers than it would in the counterfactual because of an increase in its bargaining power relative to suppliers. This may cause immediate harm to suppliers regardless of whether the merged entity purchases less product from them.

12. The statement of issues does not provide any detail as to the connection the Commission seeks to draw between better terms for the merged entity and a substantial lessening of competition.<sup>9</sup> In contrast, we explain in our earlier report that the essential difference between the monopsony power and bargaining frameworks is the presumption that the amount of joint surplus is not affected by a change in bargaining power, but is affected by a change in monopsony power.<sup>10</sup> Different suppliers also have different levels of bargaining power, including that some suppliers provide ‘must have items’.<sup>11</sup>
13. This is consistent with the OECD’s findings in relation to bargaining power, ie:<sup>12</sup>

Bargaining power, all else equal, shifts surplus between buyers and sellers due to the reduction in purchase prices. This effect is unlikely to concern many advocates for competition policy, unless there are reasons to object to distributive outcomes. [footnotes omitted]
14. Notwithstanding the OECD’s observation, the supposition in the statement of issues that a change in surplus under a bargaining framework may amount to a lessening of competition also implies that there is a ‘correct’ apportionment of the joint surplus that arises when buyers and sellers strike a bargain.
15. In contrast, we explain in our earlier report that the economics literature does not recognise the existence of an ‘imbalance’ of bargaining power (or, indeed, a ‘balance’ of bargaining power).<sup>13</sup> Rather, the act of bargaining is itself part of the competitive process, but does not necessarily lead to a ‘fair’ outcome – indeed, it might be said that the process of competition is inherently ‘unfair’.<sup>14</sup> This is also consistent with the parties seeking to make use of any lower input prices that may be achieved to compete more strongly in retail markets for grocery products.
16. The Commission also indicates that it is considering whether a change in acquisition markets could lead to suppliers raising prices to rival grocery retailers, ie, the ‘waterbed effect’.<sup>15</sup> The means by

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<sup>7</sup> HoustonKemp report, para 60.

<sup>8</sup> Statement of issues, para 81.

<sup>9</sup> See also paragraph 36.

<sup>10</sup> HoustonKemp report, para 18.

<sup>11</sup> Clearance application, para 132.3(b).

<sup>12</sup> OECD, *Purchasing power and buyers’ cartels*, OECD Competition Policy Roundtable Background Note, 2022, p 14.

<sup>13</sup> HoustonKemp report, para 28.

<sup>14</sup> Wainscoat, L, Odgers, Z and Vyas, A, *The threat to competition from regulating bargaining power*, Australian Journal of Competition and Consumer Law, 32(1), 2024, p 39.

<sup>15</sup> Statement of issues, para 142.1

which the waterbed effect ultimately affects consumers is unclear, because consumer prices may still fall if the effect of reducing one buyer's costs outweighs pricing pressure in the downstream market for other firms. In addition, the economic literature recognises the 'anti-waterbed effect', because suppliers have an incentive to reduce a buyer's bargaining power by offering lower prices to that buyer's competitors.<sup>16</sup>

17. The economic literature is unclear on whether the waterbed or anti-waterbed effect is stronger. A study undertaken by a competition regulator in the United Kingdom found no evidence of a waterbed effect in relation to supermarket bargaining power.<sup>17</sup>

### 2.1.2 Effect of a transfer of surplus on investment is ambiguous

18. In its statement of issues, the Commission states:<sup>18</sup>

We are also considering the impact of the Proposed Merger on product innovation. We are concerned that:

102.1 any increase in buyer power may also reduce suppliers' ability and incentives to invest in new and innovative products, due to reduced profitability, and

102.2 the reduction in channels for suppliers may in and of itself adversely affect competition by removing one of the options for new and innovative products or new suppliers to be listed (even if there was not a material increase in the merged entity's buying power).

In doing so, we are considering:

103.1 the extent to which suppliers currently invest in innovation; and

103.2 the extent to which the Proposed Merger might increase or decrease the level of, or investment in innovation for new suppliers and/or new products.

19. The Commission states that:<sup>19</sup>

- a. 'several parties' do not consider that the proposed transaction would be likely to change or reduce supplier investment;
- b. 'a few parties' consider that the proposed transaction would benefit supplier innovation; and
- c. that there is a 'broad consensus' that suppliers may be less inclined to innovate in response to having one fewer grocery retailer through which to sell its products to consumers.<sup>20</sup>

20. Investment involves the incurring of resource costs and, at an economy-wide level, the sacrifice of present-day consumption. Notwithstanding, firms undertake investment with the objective of increasing their future profits, including by raising the quality of their products, reducing their costs and improving their bargaining position.<sup>21</sup> However, neither investment nor innovation are inherently beneficial; rather, it is the changes arising from successful investment or innovation that bring the prospect of economic benefits, such as lower prices and new or higher-quality products.

21. The effect of bargaining power on investment or innovation has been the subject of a substantial amount of economic research. There is no economic consensus as to whether the presence of

<sup>16</sup> See, for example, van Doorn, F, *The law and economics of buyer power in EU competition policy*, Eleven International Publishing, 2015, p 98.

<sup>17</sup> van Doorn, F, *The law and economics of buyer power in EU competition policy*, Eleven International Publishing, 2015, p 99.

<sup>18</sup> Statement of issues, paras 102-103.

<sup>19</sup> Statement of issues, para 106.

<sup>20</sup> We note that the suppliers cited by the Commission in respect of this 'broad consensus' are [REDACTED].

<sup>21</sup> See, for example: Wainscoat, L, Odgers, Z and Vyas, A, *The threat to competition from regulating bargaining power*, Australian Journal of Competition and Consumer Law, 32(1), 2024, p 37.



bargaining power (or a change in bargaining power) can be expected to increase or decrease investment.

22. For example, although it has been posited in the literature that the exercise of buyer power reduces incentives for supplier investment, present levels of supplier profitability are not themselves determinative of either the level or prospect for efficient investment by suppliers; rather, the relevant consideration is the likely effect of investment on future expected profits.<sup>22</sup> In circumstances where firms that have a viable and profitable investment opportunity that cannot be self-financed from existing profits, they will generally be incentivised to seek external funding.
23. Moreover, suppliers facing a reduction in bargaining power have a *stronger* incentive to invest if that investment would have the effect of reducing buyer bargaining power, including by enabling the firm to gain a competitive advantage over its rivals.<sup>23</sup>
24. In addition, under the bargaining framework whereby buyers and sellers engage and are incentivised to maximise their joint surplus (and therefore to undertake efficient investment), a buyer with increased bargaining power may face increased incentive to co-finance supplier investment, because:
  - a. the buyer can buy more of the product from the supplier and so benefit to a greater extent, enabling it to be a better downstream competitor;<sup>24</sup> and
  - b. the presence of larger buyers may reduce transaction costs and coordination problems between suppliers and buyers, ie, avoiding the hold-up problem.<sup>25</sup>
25. These findings from the literature are consistent with:
  - a. the proposed transaction not precluding suppliers from seeking to invest, innovate and test the provision of products initially within one region, ie, it does not remove an option for suppliers; but rather
  - b. the merged party having an increased ability to provide national-level investment in suppliers, which would enable it to compete more effectively with Woolworths' national-based strategy (which may also include a trans-Tasman component).
26. Further, the ability and incentives for the merged entity to engage in island-based or regional investment would not be reduced (as compared to the proposed transaction not proceeding), say, if consumer preferences or supply constraints suggested region-specific initiatives would be more effective.<sup>26</sup>
27. For example, the merged entity will:<sup>27</sup>
  - a. offer a single new product development (NPD) cycle and process – rather than two, separate and misaligned NPD cycles, which we understand to be perceived by suppliers as a limitation; and

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<sup>22</sup> Wainscoat, L, Odgers, Z and Vyas, A, *The threat to competition from regulating bargaining power*, Australian Journal of Competition and Consumer Law, 32(1), 2024, p 42.

<sup>23</sup> van, Doorn F, *The law and economics of buyer power in EU competition policy*, Eleven International Publishing, 2015, p 102.

<sup>24</sup> OECD, *Monopsony and buyer power*, DAF/COMP(2008)38, 17 December 2009, pp 11-12.

<sup>25</sup> Inderst, R and Mazzarotto, N, *Buyer power in distribution*, ABA Antitrust Section Handbook, Issues in Competition Law and Policy, Vol. 3, 2008, p 15.

<sup>26</sup> See, for example, HoustonKemp report, para 68, where we explain that consumer preferences and supply constraints represent the major reasons as to why some supply is best served on a regional basis.

<sup>27</sup> Foodstuffs North Island and Foodstuffs South Island, *Response to statement of issues*, 26 April 2024, para 122.

- b. provide a simpler pathway to national supply, which would enable and encourage suppliers to invest in new products – this process would provide suppliers more certainty regarding, among other things:
  - i. capital investments that require a national sales strategy in order to provide a sufficient return on investment; and
  - ii. allowing for a national sales launch, for which the supplier can also plan a national sales and marketing strategy.

28. We understand from FSNI that key innovations in grocery products tend to occur by means of:

- a. very small suppliers, which we explain in our earlier report would not be likely to be affected by the proposed transaction;
- b. very large, national and multi-national suppliers, giving effect to worldwide trends, in relation to which we would not expect the proposed transaction to affect those investments; and
- c. by suppliers ‘in the middle’, whereby the proposed transaction could in-principle allow an easier growth/testing grounds than dealing with each cooperative separately, for the reasons set out above.

29. Notwithstanding the overarching principle that a transfer of surplus is not consistent with a lessening of competition, the net result of these effects is that incentives for suppliers to invest – in order to, ultimately, provide benefits by means of enhanced output that will benefit consumers – are unlikely to be harmed as a result of the proposed transaction, and may be enhanced.

### 2.1.3 Effect of transaction on ranging decisions is consistent with competition

30. In the clearance application, the parties explain that:<sup>28</sup>

- a. the proposed transaction would not result in a change in the share of supply or quantity supplied of grocery products and that [REDACTED];
- b. the proposed transaction will result in simplification of engagement, ie, including that national suppliers will only have to negotiate with one party instead of two; and
- c. in a small number of cases, separate, island-based supply agreements for the same product with different suppliers may be replaced with a single national supply contract.

31. Put simply, the parties expect that the proposed transaction will give rise to cost savings, manifesting as either efficiencies from the removal of duplication or as buying benefits.<sup>29</sup>

32. In the circumstances applying both with and without the proposed transaction, we understand that the parties seek to ensure that the products they sell (or, post transaction, the products it sells) are those most sought by customers. The effect of this governing principle is that those suppliers that are less efficient or sell products that are less preferred by consumers will, over time, be replaced by suppliers offering a better price-quality combination for customers. [REDACTED].

33. For example, in 2023, FSNI carried out a category review process for [REDACTED] in which it ultimately removed [REDACTED] from its ‘compulsory ranged’ [REDACTED] on the basis that [REDACTED] (in New World stores) and [REDACTED] (a new supplier, in PAK’nSAVE stores) were

<sup>28</sup> Foodstuffs North Island and Foodstuffs South Island, *Notice seeking clearance for the merger of Foodstuffs North Island Limited and Foodstuffs South Island Limited* (clearance application), 14 December 2023, para 132.

<sup>29</sup> Statement of issues, para 47.

able to provide a product of the same quality at a lower price. The result of this change in ranging was a reduction in consumer prices and [REDACTED].<sup>30</sup>

34. This process is entirely consistent with the ever present, dynamic forces of competition, ie, the process of rivalry, rather than – as characterised in the statement of issues – the merged firm simply ‘cherry pick[ing]’ the more favourable supply terms of the two parties.<sup>31</sup> In the case study provided by FSNI, one competitor was ‘injured’ at the expense of another, an outcome that is precisely consistent with the outworking of firms (both buyers and sellers) competing vigorously.<sup>32</sup>
35. As a matter of economic principle, suppliers should be expected to compete with each other to offer compelling products to grocery retailers and/or other buyers of grocery products, while grocery retailers – including the parties – should be expected to compete with each other to provide grocery products that best match the needs of consumers. The proposed transaction will enhance the ability of the parties to undertake this process and ultimately compete harder by providing benefits to consumers.
36. By contrast, in some instances the implied focus of the statement of issues appears more consistent with the effect of the merger on particular competitors, rather than on competition. For example, the statement of issues:
  - a. refers to an example in which [REDACTED];<sup>33</sup> and
  - b. then states that the Commission’s current view is that the ability of the merged entity to bargain for more favourable terms:<sup>34</sup>

...may cause immediate harm to suppliers.
37. Although it might be acknowledged that this particular example involved harm to a particular individual supplier, in terms of the effect of this typical instance on competition, it would have been more appropriate for the statement of issues to have acknowledged that the consequence of this example is that [REDACTED]. It follows that this example is more likely than not to be consistent with an increased intensity of competition in the relevant grocery acquisition market, as well as benefits to retail grocery customers.
38. We note also that the Grocery Supply Code (the code) took effect on 28 September 2023 and the six-month transition period ended on 28 March 2024. The Commission explains that the code is intended (among other things) to promote fair conduct and transparency in agreements between regulated grocery retailers and suppliers. This includes a requirement for regulated grocery retailers to provide reasonable notice and genuine commercial reasons for delisting products, and expressly prohibits delisting of a product in response to a supplier complaint or dispute.<sup>35</sup> The code also requires regulated grocery retailers to provide to suppliers their product ranging and shelf-space allocation principles.<sup>36</sup>
39. The code applies in both the factual and counterfactual, ie, suppliers will have the benefit of the code protections when negotiating with either FSNI/FSSI separately or with the merged entity. The presence of the code reinforces the limited effect of the proposed transaction on suppliers.

<sup>30</sup> Foodstuffs North Island and Foodstuffs South Island, *Response to statement of issues*, 24 April 2024, case study 3, pp 24-25.

<sup>31</sup> Statement of issues, para 89.

<sup>32</sup> *Queensland Wire Industrial v Broken Hill Pty Ltd* (1989) 167 CLR 177, p 191.

<sup>33</sup> Statement of issues, footnote 85.

<sup>34</sup> Statement of issues, para 81.

<sup>35</sup> Commerce Commission, *Factsheet: the grocery supply code*, 28 September 2023, pp 1-2.

<sup>36</sup> Commerce Commission, *Grocery supply code checklist for suppliers*, 29 February 2024, p 40.

## 2.2 Mischaracterisation as three-to-two merger of buyers

40. In our earlier report, we explain that the assessment of the effects of the merger needs to be undertaken in the context of the market in which each supplier operates, ie, by reference to the degree of power (monopoly power or bargaining power) held by that supplier and its outside options for selling grocery products, ie, to other grocery retailers *and* to other buyers. We explained that in respect of:<sup>37</sup>
- a. major national suppliers and small national suppliers, the bargaining position of the merged entity would be likely to improve slightly, relative to FSNI and FSSI individually;
  - b. regional suppliers, the bargaining position of the merged entity would not be likely to change, relative to FSNI and FSSI individually; and
  - c. small local suppliers, the merged entity would not change its relative bargaining position, because procurement in respect of individual stores would be unaffected by the transaction.
41. In other words, the merged entity may achieve a slight improvement in its relative bargaining position with respect to some suppliers. We also explained that the merged entity would presumably seek to bargain for the better of the terms that each of FSNI and FSSI presently receives,<sup>38</sup> and that some suppliers are likely to have significant (countervailing) supplier power over buyers.<sup>39</sup>
42. In contrast, the statement of issues characterises the effect of the proposed transaction as being, in respect of the markets in which supermarkets compete to purchase wholesale grocery products from suppliers, as a ‘three-to-two’ merger of buyers. In our view, this is a substantial mischaracterisation of the circumstances faced by essentially all suppliers.
43. For those wholesale grocery product markets involving major national suppliers, some of which will supply ‘must-have’ products for the merged entity, these suppliers are likely to have significant countervailing power. At the other end of the spectrum, very small suppliers are likely to continue to negotiate with one or a small number of stores directly. For both these categories of suppliers, it is difficult to envisage how the merger will give rise to any material change in either the degree of rivalry between buyers, or the intensity of competitive outcomes.
44. Suppliers falling outside of these two groups include smaller/medium national suppliers, and possibly some regional suppliers. In order to understand the other options for these suppliers, we identified 500 suppliers at FSNI as representing these ‘middle’ suppliers, based on sales at FSNI during a 13 week period.<sup>40,41</sup> We asked FSNI to classify those suppliers based on the extent of outside options available for these suppliers to sell their products, including whether those products are:
- a. exported from New Zealand (either by that supplier or its competitors), in which case we assume that exporting would be another option (and indeed, may set the price for those products);
  - b. imported into New Zealand, in which case we assume that those suppliers already face significant competition from imports and should not be expected to be materially affected by the

<sup>37</sup> HoustonKemp report, paras 59-60, 56, 70 and 73-74.

<sup>38</sup> HoustonKemp report, para 60.

<sup>39</sup> HoustonKemp report, para 58.

<sup>40</sup> We note that this method of analysing suppliers is imperfect. However, we sought to achieve a balance of the granular analysis required to satisfy the Commission of the options available to suppliers without undertaking this process for all of FSNI’s suppliers. Of the 500 suppliers, 17 were not able to be classified by FSNI, and two were Foodstuffs internal supply codes. These 19 suppliers have been excluded from the analysis.

<sup>41</sup> Specifically, out of the [REDACTED] suppliers for which FSNI sold products during the 13 week period, FSNI analysed suppliers beginning at [REDACTED] and ending at [REDACTED]. These suppliers represented [REDACTED] of sales during this period. Larger suppliers than these suppliers represented [REDACTED] of sales during this period and smaller suppliers represented less than [REDACTED] of sales during this period. Sales of fresh produce were excluded from this analysis.

merger, or, indeed, the supplier could be the sole importer of a product and would have countervailing power;

- c. sold to food service, food manufacture, or meal kit providers; and/or
  - d. sold to other key retailers, as relevant for the products, eg, vitamin/nutrition products that are not only sold at Foodstuffs' retail grocery stores but also supplied to, among others, Chemist Warehouse, other pharmacies, independent retailers and the Warehouse.
45. Figure 2.1 below shows that of the [REDACTED] suppliers analysed, only [REDACTED] have been identified as not having one or more material options outside of the major grocery retailers, ie, Foodstuffs and Woolworths. These suppliers represent [REDACTED], or less than 1 per cent of FSNI's sales. Of these [REDACTED] suppliers, [REDACTED] mostly or exclusively supply private label products to FSNI. The single remaining supplier, [REDACTED], represents less than [REDACTED] FSNI's sales, and is [REDACTED].<sup>42</sup>
46. We do not have access to similar information from FSSI regarding its suppliers, but we assume that the conclusion that the vast majority of FSNI's 'middle' suppliers have realistic options in addition to major grocery retailers equally applies to FSSI.
47. This analysis shows that a characterisation of the effect of the proposed transaction as being, in respect of the markets in which supermarkets compete to purchase wholesale grocery products from suppliers, a 'three-to-two' merger of buyers, is not consistent with the fact that suppliers typically appear to have realistic options beyond simply supplying to major grocery retailers.

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Figure 2.1: Suppliers' other options (by number and sales)

[REDACTED]

Source: Data provided by FSNI.

Note: Of the [REDACTED] suppliers in the right-most column, [REDACTED] mostly or exclusively supply private label products to FSNI.

## 2.3 Private label products

48. In section 2.1.3 we explain that the parties seek to ensure that the products they sell (or, post transaction, the products it sells) are those most sought after by customers, which has the effect that those suppliers that are less efficient or sell products that are less preferred by consumers will, over time, be replaced by suppliers offering a better price-quality combination for customers.
49. This principle applies no less equally to private label products, which we understand are generally introduced by the parties as an additional or alternative products in a category – generally at a lower retail cost than the branded equivalent and, in turn, sold to customers at a relatively low price. Private label products are already developed by the parties jointly (via Foodstuffs Own Brands Limited), although they are ranged by each cooperative separately.
50. Notwithstanding that it is already in the best interests of the parties to provide the best range of products (including at various price-quality offerings) and this extends to the inclusion (or not) of

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<sup>42</sup> [REDACTED]

private label products in the range, key provisions in the code also require that regulated grocery retailers do not discriminate in favour of private label products.<sup>43</sup>

51. We explain above that the code applies in both the factual and counterfactual, ie, suppliers will have the benefit of the code ‘protections’ either when negotiating with FSNI/FSSI separately or with the merged entity.
52. Taken together, there can be no harm arising from the transaction in respect of private label products, because:
  - a. the parties already supply private label products jointly;
  - b. the incentives of the parties to offer products within a category at various price-quality offerings remain unchanged; and
  - c. the protections in the code – which apply with and without the proposed transaction – mean that the parties could not discriminate against suppliers in favour of private label products.

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<sup>43</sup> Commerce Commission, *Grocery supply code checklist for suppliers*, 29 February 2024, p 40.

## 3. Coordination will not be enhanced

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53. The statement of issues indicates that the Commission is investigating ‘...whether the Proposed Merger could increase the likelihood, completeness and sustainability of coordination between the merged entity and Woolworths’ in markets for retail supply of groceries or for markets for the acquisition of groceries.<sup>44</sup>
54. In our opinion, coordination will not be enhanced by the proposed transaction. Suppliers and grocery retailers have ‘made it clear’ that they do not facilitate coordination, and the ‘evidence of indirect ways’ through which the Commission says that coordination could be facilitated are in fact consistent with both buyers and suppliers competing with each other, rather than being evidence of potential for coordination.

### 3.1 No evidence relating to coordination in acquisition markets

55. In respect of markets for the acquisition of groceries, the Commission notes that there is no direct evidence relating to coordinated effects, with both suppliers and retailers stating that to the contrary they do not discuss terms of supply with other suppliers or retailers.<sup>45</sup>
56. The Commission identifies ‘several factors’ that could increase the ability and incentive for the merged entity and Woolworths to coordinate in the acquisition of grocery products include that the merged entity would be a ‘similar national operation to Woolworths’.<sup>46</sup>
57. Notwithstanding direct evidence to the contrary, the Commission states that it has identified some indirect ways in which a supplier *may* make observations about a retailer’s terms of supply with other suppliers, such as via product positioning on store shelves or by monitoring retail prices.<sup>47</sup>
58. It is not clear to us that the act of grocery suppliers monitoring the retail prices of products sold by their competitors is consistent with facilitating coordination. Rather, such conduct is indicative of competition between suppliers. For example, a supplier that observes better shelf-positioning for one of its competitors could in turn engage with the retailer and offer a better product, lower prices or other terms, which ultimately will flow to benefits for consumers.
59. The Commission is correct to observe that ‘symmetry’ between firms has been regarded as a factor that may facilitate coordination.<sup>48</sup> However, the Commission’s contention that the merged entity ‘...would have a similar national footprint to Woolworths operating across the North and South Island with a central head office’ ignores at least one major distinction between Woolworths and the merged entity, being the merged entity’s owner-operator cooperative model. Although the two firms may have a similar ‘footprint’, their *modus operandi* involves some important differences, which also extend to the different retail brands and associated pricing strategies operated by the parties (such as the distinction between the retail propositions of New World, PaK’nSAVE and Four Square).

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<sup>44</sup> Statement of issues, paras 56, 122 and 165.

<sup>45</sup> Statement of issues, para 127.

<sup>46</sup> Statement of issues, para 126.

<sup>47</sup> Statement of issues, para 128.

<sup>48</sup> Motta, M, *Competition policy: theory and practice*, Cambridge University Press, New York, 2009, p 147.

### 3.2 No evidence relating to coordination in retail markets

60. Similarly, in respect of retail grocery markets, the Commission identified that '[REDACTED]',<sup>49</sup> which is consistent with it ensuring it can compete effectively with Woolworths. Moreover, [REDACTED].<sup>50</sup> This behaviour is inconsistent with coordination. The Commission also suggested that:<sup>51</sup>
- a. potential entry by FSNI or FSSI could disrupt coordinated behaviour;
  - b. the potential for national-based pricing decisions may make it easier for Woolworths to monitor the merged entities' prices and detect changes in those prices;
  - c. a national Foodstuffs may be 'similar in size and structure' to Woolworths as compared to the present two cooperative model, which may facilitate coordination; and
  - d. if the proposed merger increased barriers to entry, this could reduce the likelihood of coordination being disrupted by new entry or expansion.
61. We assess [REDACTED].
62. In our view, the potential for national-based pricing to make it easier for Woolworths to monitor the merged entities' prices and detect changes:
- a. would not amount to a meaningful increase in Woolworths' ability to monitor prices at Foodstuffs' retail stores, because Woolworth already has the ability to do so at existing FSNI and FSSI retail stores/online;
  - b. firms continually monitoring prices of rivals and responding to changes in those prices is a feature of highly competitive markets; and
  - c. the individual owner-operator cooperative model means that individual stores may set different prices<sup>52</sup> and this will continue with the proposed transaction.
63. We addressed the 'similar in size and structure' issue above.

Barriers to entry or expansion will not materially change

64. Finally, the Commission has indicated that it is considering whether barriers to entry or expansion in retail grocery markets could be increased by the proposed transaction, and whether this could reduce the likelihood of coordination being disrupted by such entry or expansion.
65. The Commission has suggested that a barrier to entry or expansion is the ability for the merged entity to offer lower prices to consumers. This would appear to be a benefit of the merger, because the merged entity could compete harder against new entrants and existing competitors, including (but not limited to) Woolworths. The Commission's contention is that lower prices for consumers could increase the minimum scale for rival firms to enter and compete effectively, ie, assuming that there are significant sunk costs and economies of scale associated with entry.
66. Among others, an important shortcoming with this contention is the implied suggestion that any competitive action that resulted in a firm offering lower prices would raise barriers to entry. For example, if Woolworths undertook some form of private investment that lowered its costs (but not its

<sup>49</sup> Statement of issues, [REDACTED].

<sup>50</sup> Foodstuffs North Island Limited and Foodstuffs South Island Limited, *Response to submissions on Commerce Commission statement of preliminary issues*, 7 March 2024, para 52.2.

<sup>51</sup> Statement of issues, para 175.

<sup>52</sup> Clearance application, para 114.



rivals' costs) and subsequently lowered prices for consumers, the Commission's contention would suggest that investment was anticompetitive.

67. The Commission also indicates that it is assessing whether the merged entity will have access to a:<sup>53</sup>
- ...larger combined set of data on retail sales and customer insights...' [than] '...smaller scale retailers....
68. Firms of all sizes use data to improve outcomes for customers. For example, firms may analyse their sales to identify products that customers buy frequently and extend the range of those products and reduce the range of products that consumers buy less frequently. Firms can also acquire data from third parties, such as Nielsen IQ, eg, to assess opportunities to fill potential gaps in product ranges. We expect that the parties already individually make use of their data in order to maximise their retail sales, ie, by providing the right range of products to consumers at prices that encourage consumers to purchase from the parties, rather than their rivals.
69. It appears unlikely to us that the combined set of data on retail sales in the North and South Islands will provide the merged entity with any material advantage over 'smaller scale retailers' than the parties may already have. The parties each have access to island-wide data, and in the counterfactual will presumably continue to collaborate on certain national promotions and marketing. These factors imply that the combination of data at a national level is unlikely to provide any material additional advantage.
70. To the extent that any such additional advantage arising from a national dataset did exist, it follows that the parties would be most likely to use it to compete more effectively against Woolworths (because Woolworths already has a national retail presence) – which we note the Commission describes (although we disagree) as 'the merged entity's only meaningful competitor in the acquisition of groceries'<sup>54</sup> and as the only other 'retail grocery retailer'.<sup>55</sup>
71. Finally, the Commission has suggested that the proposed transaction could deter entry through '...strategically targeted price cuts or other behaviour'.<sup>56</sup> Notwithstanding that we are not aware of any evidence of the parties' previously engaging in such conduct, it presents as over-reach to imply that the proposed transaction would materially alter the ability of the parties to engage in such conduct.

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<sup>53</sup> Statement of issues, para 55.2.

<sup>54</sup> Statement of issues, para 96.

<sup>55</sup> The Commission explains that it is considering whether the proposed transaction would 'increase barriers to entry and/or expansion for a **third retail grocery retailer** [emphasis added]', ie, that the existing retail grocery retailers with the proposed transaction would include the merged entity and Woolworths. Statement of issues, para 175.4.

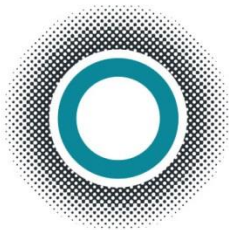
<sup>56</sup> Statement of issues, para 55.3.

# 4. [REDACTED]

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[REDACTED]





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