26 August 2021

Project Lead (Grocery Market Study)
Commerce Commission
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Dear Sir/Madam

Attached are the comments that New Zealand Food & Grocery Council wishes to present on the *Market study into the retail grocery sector: Draft report.*

Yours sincerely

Katherine Rich
Chief Executive

Market study into the retail grocery sector: Draft report

Comments by New Zealand Food & Grocery Council

26 August 2021

1. INTRODUCTION

1.1. New Zealand Food & Grocery Council Inc (**NZFGC**) thanks the Commerce Commission (**Commission**) for the comprehensive, thorough, and detailed work on the *Market study into the retail grocery sector: Draft report* (**the Draft report)**. NZFGC largely agrees with the Draft report's findings and recommendations.

Draft report findings on the state of competition

1.2. The Commission rightly concluded that there is a duopoly with a fringe of other competitors which have a limited impact (due to their offerings, scale, inability to access competitively priced product etc). It noted that competition tends to be weak in a duopoly unless it is easy for rivals to enter and/or expand to scale to directly compete.

1.3. The Commission identified two key factors: (1) the lack of competitively priced wholesale supply for a full range of grocery outlets; (2) lack of suitable sites for store development, aggravated by restrictive covenants on land and exclusivity covenants and leases.

1.4. It noted there are strategies that avoid direct competition, particularly on price. Giving the example of banners targeting different segments of the consumer population.

1.5. The frequency and prevalence of major grocery retailers' pricing promotional practices, complexity of reward structures in terms of loyalty programs, also confuse consumers making it difficult to compare prices. There are related concerns about the collection and use of that data.

1.6. The Commission also noted that the imbalance in bargaining power has led to shifting of costs and risks onto those not best placed to mitigate them, uncertainty of terms of supply, and restrictions on dealings with other retailers. This has included the threat of "delisting". The Commission noted this can reduce incentives to invest and innovate ultimately leading to lower quality goods produced and reduced choices for consumers.

The findings are consistent with NZFGC's experience, common sense and public feedback

1.7. The findings on the nature and state of retail competition, market outcomes, and effect on consumers and suppliers, are well-evidenced and consistent with supplier experience.

1.8. NZFGC agrees that consumer purchasing is dominated by the weekly shop for a bundle and range of products for which there are no close substitutes for the offerings of the two major grocery retailers. It agrees that competition is not working well for consumers (or suppliers), and that there is no evidence that this will change in any competitively significant way in the foreseeable future.

Options for Recommendations

1.9. The Commission concluded the best options for improving competition are likely those enabling an increase in the number of grocery retailers. NZFGC agrees.

1.10. The Draft report identified a range of possible measures to:

a. **Improve conditions for entry and expansion** including (1) measures to improve wholesale supply of a wide range of groceries at competitive prices; (2) measures to make more sites available for grocery retailing.

b. **Facilitate or create entry by further major grocery retailers directly,** including by government sponsorship or requiring the major grocery retailers to sell some of their stores to create additional major grocery retailers.

c. **Address the power imbalance between major grocery retailers and suppliers,** including by a mandatory code of conduct and changes to allow collective bargaining by suppliers.

d. **Improve information provided to consumers** to enable informed decision-making by consumers which enhances retail competition, including by mandatory unit pricing, simplifying promotional practices and loyalty program terms and making them more transparent.

NZFGC broadly supports the broad thrust of these recommendations

1.11. NZFGC supports the broad thrust of these recommendations.

1.12. The recommended fourth measures (**improve information requirements**) must be uncontroversial and adopted in their entirety. They are low-cost, benefit consumers immensely and quickly, and arguably rectify apparent breaches of the Fair Trading Act and/or Privacy Act.

1.13. Similarly, the recommended third measures (**addressing the power imbalance**) must be uncontroversial and low cost as they clearly lead to greater efficiencies.

a. These recommendations were adopted – and strengthened – in both the UK and Australia. The UK Grocery Code was adopted largely on efficiency grounds despite (at the time) there not being the retail competition concerns.

b. The New Zealand Code of Conduct should be independent and binding on the major retailers, consistent with the Australian regime but reflect local realities by: (1) using an adjudicator role like the UK's Grocery Code Adjudicator regime under the UK *Groceries Code Adjudicator Act 2013*; (2) including clear rules about private label (including structural separation of that business to avoid conflicts and other behaviour inconsistent with consumer's best interests); (3) enabling suppliers to require 'passthrough' of promotional pricing for the immediate benefit to consumers (legally but not practically possible right now); and (4) prohibiting MFNs or similar to assist new entrants offer competitive pricing to consumers.

1.14. The first set of measures (**Improve conditions for entry and expansion**) is understandable and to be applauded. It is a necessary but not sufficient condition.

a. We do not see signs of sufficient entry given the challenging conditions of entry, including the necessary scale and scope of entry, likely incumbent response and other strategic behaviour, potential consumer inertia, proliferation of brands.[1]

b. While separation of wholesaling might be sought to facilitate downstream entry, there are concerns that this could lead to double marginalisation and/or even greater market power at the wholesale level without any benefit to consumers (yet with the potential detriment of even greater market power at the wholesale level).

[1] See our comments in response to Chapter 6.

c. Following that logic, the ideal scenario would of course be a third (or perhaps fourth) integrated wholesaler/retailer, which would benefit from the vertical efficiencies but also introduce contestability.

1.15. So, while we encourage reform around reducing barriers to entry, these would remain formidable, and we submit that the only foreseeable way to deliver the consumer benefits which are clearly available must be through the second set of measures (**Facilitate or create entry by further major grocery retailers directly**). There are a range of options to be considered including preventing the separate Foodstuffs entities from continuing their cartel, demergers following brands, enabling individual store owners.

1.16. NZFGC expects that the supermarkets will raise various practical and other reasons why they argue there cannot or should not be a demerger or similar split or that these and/or other remedies suggested by the Commission could lead to inefficiencies or are not feasible.

1.17. New Zealand has previously had a number of supermarket retailers and it cannot be credibly argued that the minimum efficient scale for New Zealand means there can be only two grocery providers (the complex and multi-layered Foodstuffs structure seems to prevent competition yet while including a number of efficiencies; supermarket franchises are limited). They may also argue that any demerger could somehow impact ‘property rights’. In this context, that may best be interpreted as protection of enduring duopoly rents (including through a number of potential illegalities which the Commission has referred to). There is a reason that ownership of supermarkets is so tightly controlled and effectively ‘auctioned’ in the case of franchisees.

1.18. Further, there are a number of mechanisms by which the Commission and/or government could encourage the major supermarket chains to find pragmatic and effective solutions. The demerger of Chorus from Telecom is but one recent example. It may be that the government, private sector, or Commission raise additional possibilities in this context that assist the major supermarket chains to find solutions that have eluded them to date.

1.19. NZFGC is happy to engage further on these and other areas in this Submission a confidential basis.

1.20. Specific recommendations are in paragraphs 7.8-7.15 below.

Format of this submission

1.21. This submission sets out:

a. comments on Chapter 3 (Market outcomes in the retail grocery sector)

b. comments on Chapters 4 & 5 (The nature of competition in the retail grocery sector and competition at the retail level)

c. comments on Chapter 6 (Conditions of entry and expansion)

d. comments on Chapter 7 (Consumer-facing issues)

e. comments on Chapter 8 (Acquisition of groceries by retailers)

f. comments on Chapter 9 (Recommendations).

2. COMMENTS ON CHAPTER 3 (MARKET OUTCOMES IN THE RETAIL GROCERY SECTOR)

Draft report's Chapter 3 summary:

- *Our preliminary view is that the market outcomes that we have observed are not consistent with what we would expect to see in a workably competitive market.*

Overview

2.1. NZFGC suspected the lack of retail competition in the grocery sector enabled the major retailers to earn super profits and charge consumers higher than necessary. The draft report's findings confirm this is the case and that market outcomes are worse than that which would be expected in a workably competitive market.

a. The major grocery retailers are persistently earning supernormal profit levels.

b. New Zealand ranked sixth highest in the OECD for grocery prices.

c. There are imminent and future product range concerns.

d. There is no incentive to innovate if laggard firms are still making high excess returns.

2.2. NZFGC applauds the Commission for the robust evaluations it undertook that used multiple, reliable datasets and carefully considered the evidence and submissions before it. Large discrepancies in profit and price against benchmarks quantify the real harm lack of retail competition causes and its materiality. It confirms popular sentiment and the need for change.

Draft report's Chapter 3 summary:

- *We have observed consistently high levels of profits being earned by all of the major grocery retailers. These have been above what we consider to be normal levels of profit that would be observed in a market with effective competition, and these returns appear to be persistent.*
- *These levels of profit have been observed using a variety of profitability measures. The Return on Average Capital Employed (ROACE) profit measure appears to be significantly and persistently above our estimate of normal return for these businesses, the Weighted Average Cost of Capital (WACC) for all three of the major grocery retailers in all of the years reviewed.*
- *Expected future profits are also at similar levels to ROACE, with profit expectations for new grocery retailing investments also well in excess of WACC over the time period we have assessed them for those major grocery retailers that provided forecasts.*
- *The three major grocery retailers are also earning greater levels of profit margin than a sample of international grocery retailers.*

Supernormal profit levels

2.3. NZFGC recognises the Commission has extensive experience and expertise with calculating WACC, including for estimating the cost of capital for regulated suppliers and its profitability analysis for the retail fuel study. It has settled practices for calculating WACC that have been thoroughly consulted on.

2.4. The draft report clearly sets out its methodology for calculating WACC, ROACE and their components parts. This methodology seems consistent with the Commission's past practices, and consistent with best international practices.

2.5. The Draft report analyses profitability from a number of angles and all consistently point to the same conclusion: supernormal profits. The comparison with NZX50 returns is particularly striking.

a. The major grocery retailers persistently make a ROACE between 21.6% and 23.8%, well in excess of estimated WACC of 4.6-6.1%, average international grocery retailer ROACE, and average NZX50 returns.

b. The high degree of excess means excess returns are still likely after taking into account margins of error. The draft report notes that adjustments for Woolworths' goodwill or Foodstuffs' rental payments, co-operative charges, and capital figures, are unlikely to change this finding.[2] Sensitivity tests were done and the findings are robust.

c. The major retailers have high expected rates of return for new business projects, 15-25%, and further, do not seem to struggle to meet those targets.

d. EBIT profit margins and NPAT profit margins for the major grocery retailers is consistently above international equivalents. The draft report recognises the limitations on relying on these accounting-based profit margins, however, and NZFGC agrees, they support and are consistent with the range of other analyses conducted.

e. In the absence of entry by new competitors or intervention, these returns are expected to continue into at least the near to medium term future. This market outcome is harmful for the long-term welfare of consumers as it proves retailers could considerably lower retail prices and still have a healthy ROACE. NZFGC submits this market outcome is caused by a lack of retail competition.

2.6. For those participating in the industry, the high levels of profitability do not come as a surprise. It has been difficult to confirm, given the fact that members of the Foodstuffs' cooperatives are not required to publish their financial accounts.

2.7. The findings are consistent with anecdotal evidence of supermarket profitability, including media descriptions that supermarkets are "*worth tens of millions of dollars*"[3] and store owner direct comments to suppliers regarding their profitability expectations. The findings regarding New Zealand individual supermarket levels of profitability are also consistent with evidence NZFGC previously submitted to the Commission that retail analysts proffer that UK supermarkets generally make a 1-3% profit margin as a percentage of revenue, while in New Zealand it is between 3-5%.

2.8. As previously submitted, NZFGC is firmly of the view that profitability comparisons provide insights into the level of competition in the retail grocery sector.[4] The supernormal levels of profit demonstrate there is a materially insufficient level of competition leading to real consumer harm.

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[2] Draft report at [3.44] to [3.50].

[3] Gibson A. "Supermarket 'musical chairs': 4 Pak'nSave, New World stores said to be changing hands". NZ Herald, 21 Jan 2021 https://www.nzherald.co.nz/business/supermarket-musical-chairs-4-paknsave-newworld-stores-said-to-be-changing-hands/RG54YKDZVVTDEF2THUCE5X6MNY/

[4] NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper* at [96]: https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

Draft report's Chapter 3 summary:

- *While it is difficult to compare grocery prices internationally, the data appears to show that New Zealand prices are high by international standards. New Zealand ranks as one of the most expensive Organisation for Economic Co-operation and Development (OECD) grocery markets, and New Zealanders appear to spend a relatively high proportion of their income on groceries. Survey participants have also indicated they consider prices are high and that they are higher than those they have experienced overseas.*

High retail prices

2.9. The Draft report conducts a sophisticated and detailed, data-based analysis. Four datasets are considered. The reliability of datasets is taken into account and their limitations are clearly recognised. NZFGC considers the analysis is accurate and robust. The draft report's methodology is transparent and well explained – anyone with access to the same data sets can verify the Commission's analysis.

2.10. The Draft report analyses retail prices from a number of angles and against a number of datasets. All consistently indicate New Zealand prices are high by international standards.

a. New Zealand grocery prices are around 6th highest in the OECD.

b. New Zealand's grocery per capita spend was at least the 5th highest in the OECD.

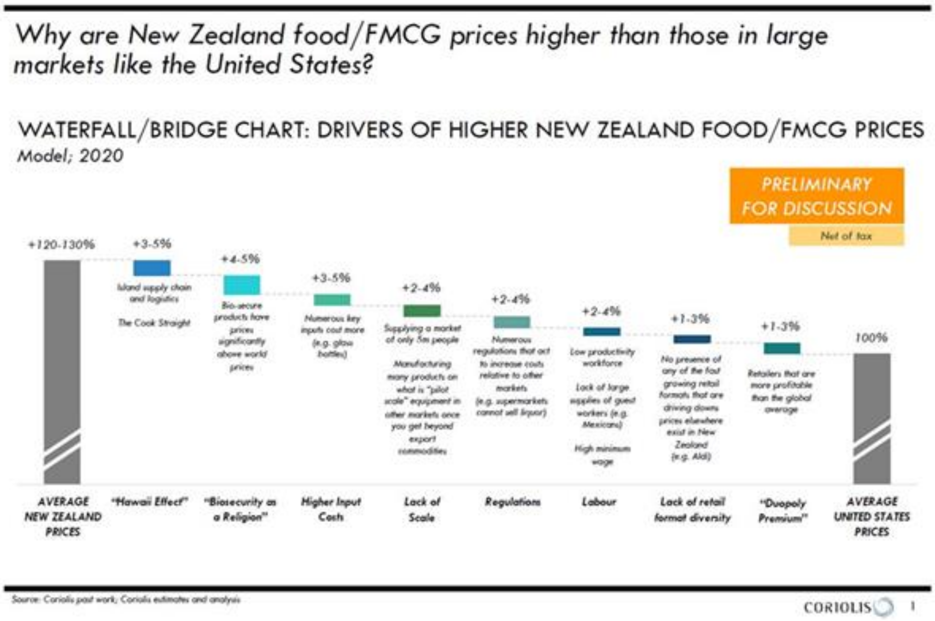
2.11. The findings are consistent with anecdotal evidence, including that consumers consider New Zealand grocery prices are high. They are also consistent with the profitability findings discussed earlier. Media commentary notes everyone "*is paying the price of New Zealand's supermarket duopoly*".[5]

2.12. NZFGC agrees with the draft report that the NERA international price comparison should be discounted because of the methodology inadequacies the draft report identifies. Even more fundamentally, the data used expressly disclaims it should not be relied upon and that this disclaimer must be noted when the data is used. This clearly undermines the credibility and reliability of the data and necessarily any conclusions made using that data.

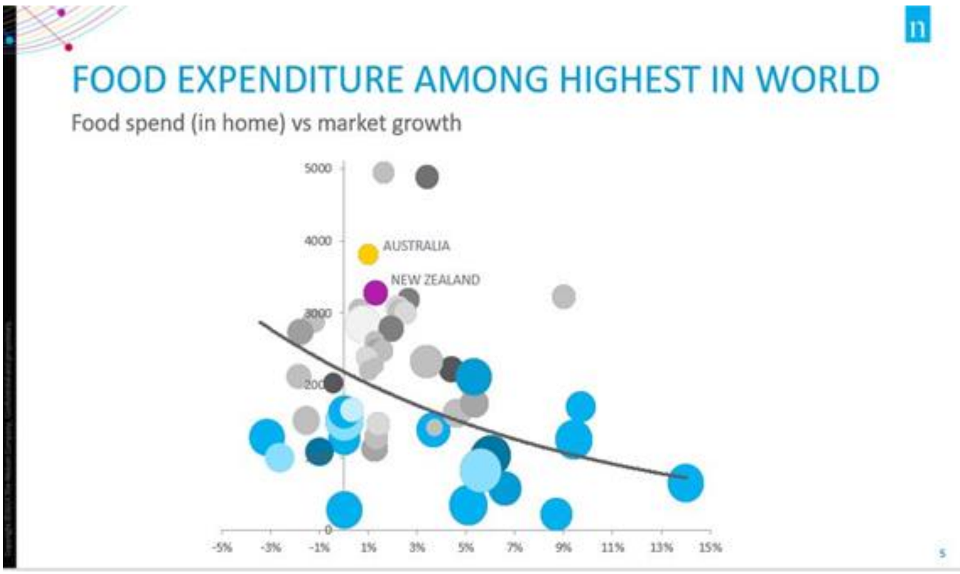
2.13. NZFGC agrees that a lack of retail competition is contributing to high grocery prices for consumers. As previously submitted and consistent with the draft report's findings, Coriolis has also recently attempted to do a visual explanation of why New Zealand's grocery prices are higher than the USA (see below).[6] The 1-3% point gap attributed to the "duopoly premium" seems small, but it translates to multi-millions of dollars in high volume businesses and a significant comparative percentage difference when comparing retailers here with those in the Northern Hemisphere.

[5] Leaman A, Hope S. 'I'm grateful for Homebrand' - shoppers give their two cents on supermarket duopoly. *Stuff*, 30 July 2021. https://www.stuff.co.nz/business/125907629/im-grateful-for-homebrand--shoppers-give-their-two-cents-on-supermarket-duopoly

[6] NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper* at [23]: https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf



2.14. There are numerous anecdotes of prices of New Zealand products being higher in New Zealand than in Australia (eg New Zealand butter costs more in New Zealand than in Australia). As one media commentator notes, the draft report's findings that retail grocery competition is not working well for consumers is "*[n]ot a big surprise for anyone who's paid $14 for a block of New Zealand cheese recently, while our Australian cousins pay less than $9*".[7] According to work done previously by Nielsen in 2014, New Zealanders (and Australians) do spend more on food per annum than other markets. There is no suggestion that New Zealanders buy more or eat more than other markets to explain this higher expenditure.



[7] Mike O'Donnell *Competition in the grocery sector is not working for consumers, so what could be an alternative?* Stuff (7 August 2021): https://www.stuff.co.nz/business/opinion-analysis/300375082/competition-in-the-grocery-sector-is-not-working-for-consumers-so-what-could-be-an-alternative

Draft report's Chapter 3 summary:

- *It is not clear whether the quality, range and service offered to consumers differ materially from what we would expect in a workably competitive market.*

Real concerns for quality, range, and service outcomes

2.15. NZFGC considers there are real concerns regarding range options that may be causing less visible harm now or will cause harm in the future, particularly as current initiatives to consolidate categories continue to reduce range and choice for consumers.

2.16. The market duopsony and gradual shift of margin, value and power from manufacturer to retailer has increased since the major Woolworths NZ and Progressive merger in 2002. This has been exacerbated by the 2005 Woolworths (Australia) acquisition of Progressive, which arguably removed the most likely potential entrant, and the subsequent merger of the prior two Foodstuffs North Island entities.

2.17. These structural issues create the problem of consolidated categories. By this it is meant that in order to supply the two major grocery retailers and deliver on those retailers' high margin expectations, it is the global firms with global scale that succeed. Often, this is non-New Zealand based manufacturing that can afford to supply them. With Foodstuffs North Island aiming to reduce the range in New World supermarkets for some categories from 10 choices down to 3 or 4 for consumers, this will only increase category consolidation further with the flow on effect being fewer choices for consumers and fewer opportunities for artisans and start-up New Zealand suppliers.

2.18. Rather than consumer preferences choosing which products prevail as in a workably competitive market, it is retailer margins. Examples of number one brands in categories preferred by consumers recently deleted by Foodstuffs North Island based on extreme margin expectations were highlighted in our previous submissions and evidence. This may distort the range available presently and, in the future, harm consumers in the long term due to the loss of their preferred products. This may also result in lower quality goods being sold. In the UK Grocery report[8], the UK Commerce Commission analysed this in terms of geographical variations but the idea is the same, that is, limited grocery store choice leads to poorer retail offer in the form of higher prices, lower-quality and poorer range of products:

> "*When consumers in a local area have a limited choice of alternative grocery stores, or none at all, grocery stores may provide* ***a poorer retail offer in the form of higher prices, lower-quality product and service, and a poorer range of products."*** [NZFGC bolding]

2.19. As previously submitted, supermarkets can act as "*gatekeepers rather than passive transmitters of consumers' wishes"* and influence the success and failure of brands to further their own interests *"to the detriment of consumers and suppliers alike*".[9] They

[8] UK Commerce Commission. *The supply of groceries in the UK market investigation.* 2008. https://webarchive.nationalarchives.gov.uk/ukgwa/20140402235418/http:/www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/538.pdf

[9] Nicholson C, Young R. The relationship between supermarkets and suppliers: What are the implications?. Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf

> "*play a key role in shaping consumer demand and that, because of the power they wield in the marketplace, they have a strong influence over what consumers buy, and how and where they buy it.*"[10]

Draft report's Chapter 3 summary:

- *We have observed that there has been some innovation in the sector directed at product and service differentiation. However, it is modest when compared to overseas. High profits do not appear to represent returns on investment in innovation since they are also being enjoyed by slow adopters.*
- *It is also unclear how much consumers are benefitting from additional investments in supply chain investment.*
- *None of these observed market outcomes is, on its own, a conclusive indicator that competition is not effective. However, viewed in the round, our preliminary view is that they are not consistent with what we would expect to see in a workably competitive market.*

Weak innovation and investment

2.20. The Draft report's approach of comparing innovations present in New Zealand with those overseas is insightful. NZFGC agrees with the Draft report's findings that the pace and scale of innovation seems slow in New Zealand and consumers are unlikely to be benefitting from cost-saving investments.

2.21. NZFGC also considers it is important to consider incentives to innovate. The Draft report finds despite lagging in digital innovation and penetration, Foodstuffs' stores are earning persistently high excess returns.[11] This is also significant because there is no incentive to innovate if laggard firms are still making high excess returns. The lack of incentive to innovate will create, if there is not already, a systemic problem of lack of innovation. The Commission highlighted the example that despite online grocery shopping and delivery being available elsewhere around the globe for nearly two decades, New Zealand consumers have only had this option relatively recently.

2.22. While the effect of lack of innovation may be less visible at first, it is just as significant a problem as high prices. Indeed, lack of innovation may lead to long term higher prices, as consumers suffer for the lack of investment put in today by retailers who are in a comfortable, stable position and not under competitive pressure to innovate. The importance of innovation as one of the key drivers of productivity is widely recognised.[12]

2.23. NZFGC also comments further on the effect on innovation and incentives to innovate at the supplier level caused by the lack of retail competition in its comments on Chapter 8 below.

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p2; NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper* at [155]: https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

[10] Nicholson C, Young R. The relationship between supermarkets and suppliers: What are the implications?. Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf p2.

[11] Draft Report at [3.156].

[12] See for example Road S, Ahmad A, Horsman W, Kaptein-Russell P. *The Importance of Innovation for Productivity*. Micro-Economic Policy Analysis Branch Industry Canada (March 2001).

3. COMMENTS ON CHAPTERS 4 & 5 (THE NATURE OF COMPETITION IN THE RETAIL GROCERY SECTOR AND COMPETITION AT THE RETAIL LEVEL)

Draft report's Chapter 5 summary:

- *In Chapter 4 we noted our preliminary view that most consumers buy groceries for their main shop at one grocery store and they typically prefer to use one of the major grocery retailers for this main shop. Major grocery retailers are uniquely placed to offer the convenience of a main shop at a single location and appear to be each other's closest competitors for consumers' main shop. Other grocery retailers do not provide a material constraint.*
- *In this chapter we further discuss the level of competition between major grocery retailers, and between major grocery retailers and other grocery retailers.*

Overview

3.1. NZFGC agrees with the Draft report's findings on the duopoly nature of retail grocery competition. There is an insufficient degree of retail grocery competition to provide sustainable, positive market outcomes.

a. There are only two national major grocery retailers and other grocery retailers do not provide a material constraint.

b. The major grocery retailers may strategically differentiate their positions to avoid competing on price.

c. With only two major players, there is considerable scope for accommodating behaviour which can replicate cartel outcomes.

Draft report's Chapter 4 summary

- *Consumers engage in a range of different shopping missions, including: a main shop – typically at a regular interval based on the convenience of using one grocery store to get all necessities in one place; a secondary shop – to shop for specific products, typically at a specialist retailer; and/or a top-up shop – a quick shop for a small number of items, often across a range of other grocery retailers.*
- *Grocery retailers compete across the price, quality, range, and service spectrum to cater to these consumer needs. However, other grocery retailers tend to differentiate their retail grocery offer primarily on non-price dimensions and tend to compete mostly for smaller, secondary or top-up shopping missions.*
- *For most consumers, convenience and price are the key considerations that inform their choice of grocery store. However, store choice and the extent to which consumers consider other grocery retailers as alternatives to the major grocery retailers largely depends on the type of shopping mission a consumer is engaged in.*
- *Most consumers buy groceries for their main shop at one grocery store and they typically prefer to use one of the major grocery retailers for this main shop. Major grocery retailers are uniquely placed to offer the convenience of a main shop at a single location.*
- *Therefore, the major grocery retailers appear to be each other's closest competitors for consumers' main shop. Other grocery retailers do not provide a material constraint. Some estimates of market share suggest the major grocery retailers have a combined estimated share of more than 90% for consumers' main shop, and more than 80% for top-up shops.*
- *There are local markets as well as wider regional and national markets in the retail grocery sector. However, competition for specific shopping missions mostly occurs in local markets because consumers are generally unwilling to travel far to purchase groceries. Consumers in rural locations tend to travel further than those in urban areas.*

- *The local nature of grocery retailing means that the options available to consumers, in terms of product range and the variety of grocery retailers, varies depending on where they live. This is particularly so outside Auckland, including the other major urban areas such as Wellington and Christchurch. Rural consumers often have even fewer choices.*
- *The local nature of competition may also mean that prices are higher in areas where there are few competing retailers. However, decisions on pricing, promotion and acquisition of products by the major grocery retailers mostly take place at a national or regional (or co-operative) level. This may provide some protection from higher prices for consumers in local markets where competition is weak. Despite this, analysis of regional price differences shows that prices in the South Island and the Central and Lower North Island are higher relative to those in Auckland.*

Draft report's Chapter 5 summary:

- *Although the fringe of other grocery retailers provides options for some consumers in local markets for secondary or top-up shopping missions, they generally do not compete with the major grocery retailers for consumers' main shop. Neither do retail offerings like meal kits provide a substitute for supermarket shopping, either alone, or when combined with retail offerings by other grocery retailers.*
- *New small-scale entry is viable. However, new entry by other grocery retailers appears to have limited impact on the major grocery retailers. It is unlikely that any new grocery retailer with a similar retail offer to the major grocery retailers will, under current market circumstances, enter at the scale required for effective competition for consumers' main shop.*
- *Our analysis suggests that other grocery retailers monitor the prices of similar products stocked by the major grocery retailers, but it is rare for the major grocery retailers to monitor and respond to the retail offerings of other grocery retailers.*

The retail grocery market is a duopoly

3.2. NZFGC agrees with the Draft report's analysis of the nature and level of competition in the retail grocery sector and that the retail grocery market is a duopoly. The constraint created by fringe competitors like delivered meals/food bags, dairies and specialist stores is limited because they lack the portfolio of products offered by the major grocery retailers at the same prices. Nor can they provide sufficient volume. The major grocery retailers' own behaviour of closely monitoring one another but paying little regard to other retail grocery providers confirms this.

3.3. NZFGC agrees convenience and price are key considerations for consumers. The Commission's analysis of competition for 'main shop', 'secondary shop' and 'top up shops' is insightful and based on evidence, including a consumer survey designed with advice from an experienced survey designer. Significantly, the major grocery retailers represent a large share of all three for various reasons.

   a. The Commission's consumer survey shows 72% of New Zealanders tend to do at least one or two larger shops each week[13] and 95% use one of the major grocery retailers as their main store[14]. The major grocery retailers have the range needed to serve these customers. The Draft report finds "*on average, smaller grocery retailers stock between 38% to 85% fewer SKUs than New World, Countdown and PAK'nSAVE*".[15] A further point made clear during the current (August 2021) COVID lockdown is that most independent dairies rely on the duopoloy to purchase products at retail price for their stores. When a dairy's wholesale price is a supermarket's retail

[13] Draft report at [4.71].
[14] Draft report at [4.87].
[15] Draft report at [4.64].

price, this explains and entrenches a lack of competition, guaranteeing higher prices to consumers who rely on dairies, particularly the elderly and vulnerable.

b. Market share estimates of different types of shopping missions by retail banner show the major grocery retailers have over 80% share for top-up shops.[16] NZFGC agrees this provides evidence that the major grocery retailers have key advantages over other grocery retailers even when competing for smaller top-up shopping missions. As previously submitted, and recognised in the Draft report,[17] while supermarkets are strong substitutes for fringe competitors, the reverse seems far less likely.[18]

c. The Ipsos study finds that other grocery retailers are generally perceived by consumers to have limited geographic coverage and that they tend to be more expensive than the major grocery retailers.

3.4. Castalia, independent economic advisers commissioned by NZFGC, concluded:[19]

> *"Value-added food and beverage retailers such as takeaway retailers, cafes and restaurants are not close substitutes for supermarket grocery supply. These retailers typically provide a different service with prices that reflect additional inputs to supply prepared ready-to-eat meals.*
>
> *Convenience stores typically sell goods at a significant premium to supermarkets, and stock a limited range of products. As a result, these stores are unlikely to place a significant competitive constraint on supermarkets.*
>
> *Premium food subscription services (meal kits) are also unlikely to be in the same market as supermarkets because consumers are unlikely to shift their consumption towards food subscription services at a scale that makes a SSNIP unprofitable for supermarkets.*
>
> *Purchase of individual grocery types from specialist suppliers is generally unlikely to be a sufficiently close substitute for full-service supermarkets, potentially with some exceptions. Consumers value the convenience of a bundled shop and are therefore unlikely to unbundle their supply of groceries in response to a SSNIP by a hypothetical supermarket monopolist."*

3.5. The Draft report's finding that major retailers represent over 80-90% of the market,[20] confirms New Zealand has one of the most consolidated retail grocery markets in the world. The graph below from work done by Coriolis in 2007 for the Commerce Commission visualises this.

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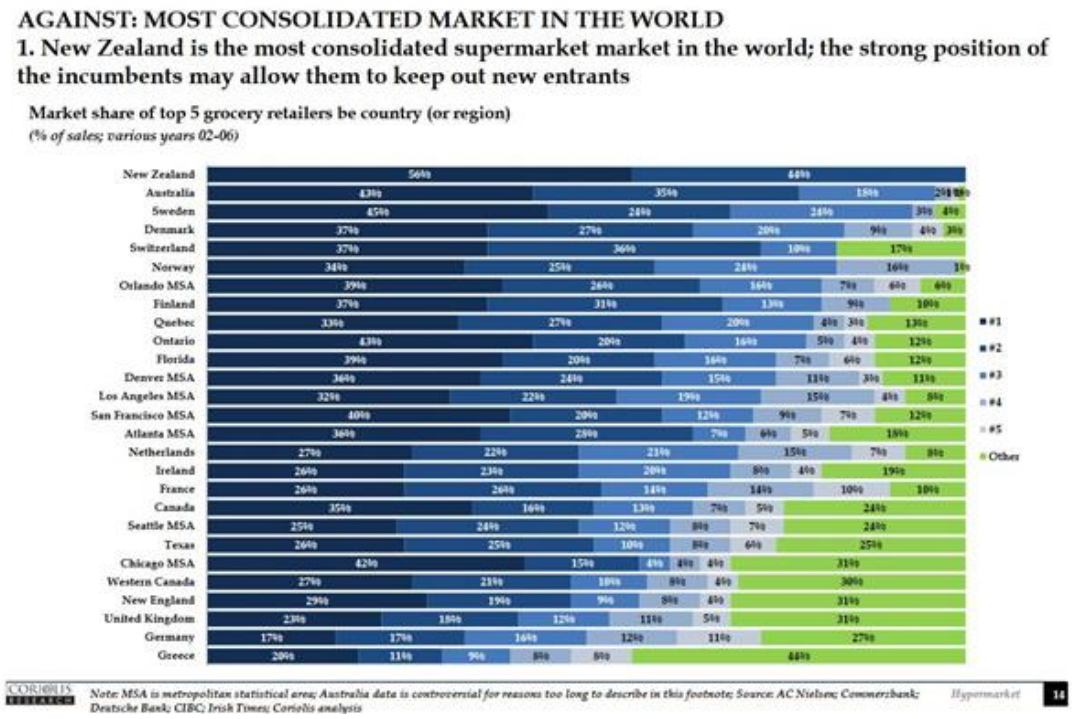
[16] Draft report at [4.97].
[17] Draft report at [5.45]
[18] NZFGC *Comments on submissions received in response to Preliminary issues paper* at [2.8]: https://comcom.govt.nz/__data/assets/pdf_file/0018/253143/NZFGC-Comments-on-submissions-on-preliminary-issues-paper-12-April-2021.pdf
[19] Castalia *Assessing retail grocery competition: Comments on submissions to the Commerce Commission on the Preliminary Issues Paper* https://comcom.govt.nz/__data/assets/pdf_file/0019/253144/NZFGC-Attachment-1-Castalia-Assessing-retail-grocery-competition-12-April-2021.pdf
[20] Draft report at Table 5.1.



3.6. As previously submitted, suggestions that the market is sufficiently competitive because of intra-group competition between brands within Woolworths or Foodstuffs, is inconsistent with the context of grocery bundles and centrally decided pricing.[21]

3.7. The inherent power in supermarkets comes from their aggregated portfolios, and while there is fringe availability of some products in some other channels, supermarkets are the only places where all these products can be purchased together and at one time/visit. Only supermarkets provide the facility where consumers can do a full weekly shop.

3.8. In other retail stores, the offerings might be more targeted (eg butchers, greengrocers etc), have fewer outlets (eg Moore Wilson's, Farro Fresh) and they are likely to have significantly less buying/bargaining power than Foodstuffs and Woolworths due to a lower buying quantity. It is true that some goods can be purchased elsewhere, but other options tend mostly to be small fringe players in limited parts of the market/regions and do little to compete with the two main sources for the main household shop. Shopping around incurs time and search costs. What supermarkets maintain is strong portfolio power. Due to the duopoly being used as a wholesaler by small stores and dairies, refusal to fulfil orders at any time can immediately place immense pressure on these formats as has recently been evidenced by Countdown's declination or slow fulfilment of orders for the NightnDay during the COVID lockdown.

3.9. Further dimensions of competition that could be explored are online sales and promotions.

Competition for online sales

3.10. More shoppers are grocery shopping online and this increased significantly during the COVID-19 lockdown in 2020 (though, as the Draft report finds, this could have been

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[21] NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper* at p5: https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

much higher in a workably competitive market). NZFGC is of the view that online shopping has enhanced the scope/power of the two major grocery retailers by providing an alternative to the physical real estate checkout. This is evidenced by rise of a limited number of ‘dark stores’ which have no retail display but are simply aggregators for order picking.

3.11. Moreover, online shopping has made it more difficult for smaller retailers to compete with large retailers, given the financial investment, sophistication required to trade online and that New Zealand’s wholesale market is inefficient due to the fact that, for most products, the wholesale buy price for small independent stores is higher than purchasing in the duopoly’s retail supermarkets. We note the developments in Australia with Woolworths Everyday Market Place ‘omni-channel’ offering, which could potentially be replicated in New Zealand in the future.

Competition for promotional sales

3.12. Nielsen data confirms that around 60% of grocery items are purchased while on promotion. This is high compared to other markets and may have reduced due to movement towards EDLP (Every Day Low Price) offerings. For some categories the rate of purchases on promotion is higher eg 95% for wine and for butter.

3.13. The high percentage of promotions may be derived from a huge amount of promotional support that the suppliers provide to the supermarkets for their products to be sold through the supermarkets’ shelves – which is indicative of supermarket’s buyer power. Suppliers are under constant pressure to maintain the heavily promoted shelf prices while also meeting the retailers’ margin expectations, which may be at the expense of the suppliers’ margin sustainability. There is an unwritten need to promote products to stave off the constant threat of products being delisted or ranging reduced. As we regularly note, promotional prices given by suppliers are frequently not passed on to consumers by the supermarkets. This is a fundamental part of the PAK’nSAVE model and a significant contributor to super-normal returns. Through the application of ‘Investment Buying’, almost all product is purchased from suppliers at a promotional price, but only ‘passed through’ to consumers for the period of the visible promotion on shelf.

Draft report’s Chapter 5 summary:

- *Our preliminary view is that competition between the major grocery retailers is also not effective. Major grocery retailers differentiate their retail banners in ways that appear to limit competition between them, particularly on price.*
- *Further, analysis shows that local market concentration has little or no effect on price competition between the major grocery retailers and there is also little variation in the market shares of the major grocery retailers’ retail banners over time. This suggests that price competition between the major grocery retailers is less than we would expect to see in a workably competitive market.*

Weak price competition between major grocery retailers

3.14. NZFGC agrees with the Draft report’s findings that competition between the major grocery retailers is not effective and product and service differentiation may provide a way for grocery retailers to avoid price competition. It agrees the stable nature of the market is indicative of a lack of competitive pressure. High barriers to entry protect the market from competitive disruption.

3.15. The Draft report’s findings are consistent with NZFGC’s experience on the supplier side, which is that major grocery retailers are not competing with one another or other retailers to secure supplier products. There is no need when the large shares of the market the major retailers represent mean suppliers feel forced to accept imbalanced terms to maintain supply relationships even if those terms are uncompetitive.

3.16. NZFGC considers a duopoly in a market with high barriers to entry simply doesn't face enough constraints to achieve competitive outcomes. New Zealand has a unique level of market concentration and the Draft report evidences how suppliers, consumers and small retail formats suffer the consequent harm.

Draft report's Chapter 5 summary:

- *Our study did not disclose any evidence that the major grocery retailers are accommodating each other's strategies. However, some features of the retail grocery sector suggest it is vulnerable to tacit coordination, such as common relationships with the same suppliers*

Accommodating behaviour

3.17. NZFGC identified illustrative examples of accommodating behaviours covering products, promotions (not clashing promotions and holding suppliers responsible for this not occurring), pricing and margin compensation, use of data to conduct sophisticated analysis of rivals' behaviour, loyalty programs and promotions, store location selections and slotting fees for shelf space. Retailers undertake price monitoring at least weekly for shelf and promotional pricing of their competitor. They also monitor each other's loyalty programmes and other non-price service offerings. Accommodating behaviour between the retailers may replicate cartel outcomes and are therefore of concern.

3.18. Coordination within the retailers seems to cover a range of factors including purchase prices and terms, supplier/customer allocation, territorial allocation and exclusivity, that may or may not be anti-competitive. NZFGC believes there is highly likely to be accommodating behaviour by the two major grocery retailers, based on the market structure, observed behaviour of supermarkets and retail market outcomes:

a. The structure and characteristics of the retail market – high concentration supported by entry and expansion barriers, as well as the ease of repeatedly observing pricing behaviour – is highly conducive to explicit or implicit coordination. Because there is only one other major competitor, the major retailers have demonstrated the ability to calculate the other's market share and margins accurately. This enables them to demand similar margin requirements from suppliers. Documents previously shared with the Commission as evidence show that the supermarkets aim to match each other's pricing and maintain supermarket high margins. A recent tender document issued to New Zealand suppliers by Foodstuffs North Island included the supplier's sales, margins and pricing for Countdown as part of the negotiation.

b. The major grocery retailers behave in ways that would be unusual in a workably competitive market, such as encouraging suppliers to coordinate promotions across retailers. We also observe behaviour that is entirely consistent with accommodating behaviour – watching their rival's prices closely through detailed data analysis is a fundamental characteristic of how the two major grocery retailers compete.

c. Retail grocery market outcomes in New Zealand are consistent with what would be expected in the presence of accommodating behaviour: supermarket pricing hovers around the same levels allowing retail margins that are starkly higher than in other countries with less concentrated grocery markets, and supermarkets focus on non-price competition (such as loyalty promotions which, for suppliers, result in retailers' exclusive access to consumer behaviour information).

3.19. NZFGC considers the draft report's findings on weak price competition strongly suggest there is a sufficient degree of accommodating behaviour at the retail level to create negative market outcomes.

4. COMMENTS ON CHAPTER 6 (CONDITIONS OF ENTRY AND EXPANSION)

<u>Draft report's Chapter 6 summary:</u>

- *There have been a number of smaller scale entrants and/or entrants with differentiated product offerings into the retail grocery sector, and we are aware of the planned entry of Costco. However, we do not consider we can rely, under current competitive conditions, on entry or expansion being sufficient to materially enhance competition for the provision of a main shop in the foreseeable future.*

Overview

4.1. NZFGC agrees with the Draft report's findings that material entry and expansion in retail grocery is unlikely without intervention. NZFGC considers:

a. There is scope for entry.

b. But barriers to entry prevent this from occurring and will continue to do so if no action is taken.

<u>Draft report's Chapter 6 summary:</u>

- *Large-scale entry to the retail grocery sector may be hindered by the size of the NZ economy and its population profile which restricts the number of places a supermarket can be profitably operated.*

Scope for entry

4.2. NZFGC notes the Commission's comments that:

> "The lack of recent and prospective large-scale entry by a supermarket operator despite the high profitability of the major grocery retailers may indicate that conditions of entry and expansion limit the scope for competition to work effectively."[22].

4.3. We agree that the conduct of a 'main shop' requires supermarkets, not specialist retailers in some of the products carried by a supermarket eg fresh produce, health care, meal kits etc. However, as we note below, these need not be the very large supermarkets that are a predominant feature of the New Zealand grocery market where New Zealand "*has a relatively higher number of large supermarkets* [than other countries] *serving larger catchments*."[23].

4.4. While size and geography of New Zealand is a factor in the lack of other supermarket entry, the key urban areas are all forecast to have substantial growth over the next 10-20 years. New Zealand local councils have been conducting 10 year plans over recent years and forecasts for growth have been key influencers. In the Auckland consultation in 2016, the population was forecast to grow by 700,000-1 million by 2041[24]. This accords with the Commission's finding of high rates of urbanisation[25].

4.5. The low density of supermarkets in New Zealand assessed by the Commission[26], at 88 per million people, would suggest that Auckland alone will need between 57 and 88 more

[22] Draft report at [6.26]
[23] Draft report at [6.50]
[24] Auckland Unitary Plan Independent Hearings Panel Report to Auckland City Council Overview of recommendations … 2016 p48
[25] Draft report at [6.41]
[26] Draft report at [6.49]

supermarkets over the next 20-30 years to meet demand. The report and recommendations from the Auckland Independent Hearings Panel included:

> "Modify some of the objectives, policies and rules in residential, commercial and industrial zones to be more enabling of capacity"[27] and
> "Include in the regional policy statement a requirement for the Council to monitor and ensure that there is always suitably zoned land to meet expected demand for residential, commercial and industrial use for at least seven years."[28].

4.6. Wellington's growth is more modest at 15% over the same period[29] but this would still require another 35 or so supermarkets at the current density rate. There therefore seems to be sufficient demand across New Zealand to support more supermarket stores.

4.7. The Commission could recommend that Government provide advice to Councils around factors to consider in zoning aimed at increasing competition and benefiting consumers.

4.8. In the course of the Auckland 2016 planning consultation, there were almost 200 requests for amendments that mentioned 'supermarkets' from groups as diverse as Auckland Regional Public Health, Bunnings Ltd, The Urban Design Forum, Unitec Institute of Technology and the Warehouse[30]. The requests included for smaller-scale supermarkets, with floor areas from 450m^2 to the larger scale over 4,000m^2 facilities.

4.9. The large format supermarkets that generally characterise the New Zealand market may not serve consumers in particular areas. The emergence of 'metropolitan supermarkets' in New Zealand that are smaller format supermarkets, appear to have been very successfully located to service the commuter of the city/urban village scenario. Examples are in city high streets – Queen Street, Victoria Street and Halsey Street (Wynyard Quarter) in Auckland and in Wellington in Willis Street and the 'Golden Mile', Lambton Quay – and transport hubs and railway stations (Wellington Central Railway Station and Albert Street, Auckland). It would seem more feasible for a competitor to enter the grocery market where smaller lease/land arrangements were possible.

4.10. This is not confined to New Zealand. In mid July 2021, Aldi Australia was reported to be "opening a smaller, convenience store offer in North Sydney. The new store layout is designed to support smaller-basket, convenience-driven purchases in contrast to the traditional big-box Aldi supermarket typically frequented by consumers for larger shopping trips"[31] Similar approaches have taken place in Canada[32] and have been a feature of the UK grocery market for many years where, in 2014, Sainsbury's had more convenience stores than supermarkets and Tesco had more than 1,600 branches of Tesco Express. "Once threatened with extinction, the mini-supermarket [was] on the march"[33].

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[27] Auckland Unitary Plan Independent Hearings Panel Report to Auckland City Council Overview of recommendations … 2016 p48
[28] Auckland Unitary Plan Independent Hearings Panel Report to Auckland City Council Overview of recommendations … 2016 p49
[29] https://forecast.idnz.co.nz/wellington/home
[30] Summary of Decisions Requested in Numerical Submission Order 0001 - 3665
[31] Hogan R. Aldi Australia launches corner store in convenience push. *Inside Retail* 13 Jul 2021.
[32] Toneguzzi, M. Small format grocery stores are the future in Canada: rerport/experts. *Retail Insider,* 20 July 2021
[33] Barford V. The rise, fall and rise of the mini supermarket. *BBC News Magazine,* 17 Jan 2014. https://www.bbc.com/news/magazine-25762466

Barriers to entry

4.11. NZFGC considers numerous barriers, both structural and strategic (created by incumbent behaviour), limit entry and expansion. These include: restricted access to products, vertical integration in distribution networks, price competitiveness, concentration of retail grocery outlets, cost-effectiveness of setting up in New Zealand, effects of private labels in limiting available product range, loyalty programmes (discourage switching), informational asymmetries (data collections over time), site availability (covenants, exclusivity, zoning and land banking) and proliferation of brands.

4.12. The return on investment (how long will it take to pay back or break even), access to product supply from manufacturers and producers (attributed to supplier reluctance and/or pressure/threatening behaviour from incumbent retailers to their supplier base) and local knowledge might all limit access to market and prevent any new entrant from having the appropriate categories to attract consumers.

4.13. The Commission noted two particular factors associated with entry even where very substantial and stable supra normal profits exist: site availability and wholesale access. NZFGC also considers strategic barriers to entry play a significant role.

Draft report's Chapter 6 summary:

- *The availability of land for new entrants and existing firms is reduced by difficulties in getting planning permission to develop potential sites and conduct by the major grocery retailers relating to property, including how they use restrictive covenants on land and exclusivity covenants in leases to prevent other supermarkets operating.*

Site availability

4.14. Site availability and development explored by the Commission commented on restrictive covenants and exclusivity covenants, land banking and planning regulations. It noted that over 80 restrictive covenants had been entered into by the major grocery retailers and that at least 50 were not time limited or had terms of 20 years or more.[34] As well, the Commission identified over 120 exclusivity covenants on leases with at least 100 having terms of 20 years or more[35]. These were seen as likely to be a significant factor preventing or slowing entry and expansion.

4.15. By comparison, the UK Competition Commission found, in 2010, that

> "two of the features that adversely affected competition in the market (whether alone or in combination) were the high levels of concentration in local markets for the supply of groceries by mid-sized and larger grocery stores, and the control of land in highly-concentrated local markets by incumbent retailers."[36]

4.16. In the UK, covenants for grocery retailers were prohibited in 2010 under the Groceries Market Investigation (Controlled Land) Order (**Controlled Land Order**).[37] The Controlled Land Order required large grocery retailers to release restrictive covenants in highly-concentrated, local markets as identified by the Competition Commission and were prohibited from imposing new restrictive covenants that may restrict grocery retailing. Large grocery retailers were prohibited from enforcing existing exclusivity

[34] Draft report at [6.68]
[35] Draft report at [6.71]
[36] Competition Commission [UK]. The Groceries Market Investigation (Controlled Land) Order 2010 Notice of Making an Order. 10 August 2010
[37] https://www.gov.uk/government/publications/cma-letter-to-tesco-on-breaches-of-the-groceries-controlled-land-order

arrangements after 5 years post the report date.[38] In 2020, the UK Competition and Markets Authority wrote an open letter to Tesco about 23 instances of non-compliance with the Controlled Land Order.[39]

4.17. In South Africa, last year the South African Competition Tribunal confirmed as an order a consent agreement between the South African Competition Commission and Shoprite Checkers to the extent that:

> "*Shoprite Checkers will no longer enforce the exclusivity clauses contained in various lease agreements against SMEs and specialist line stores with immediate effect. Exclusivity against other supermarkets will cease immediately in non-urban areas and will be phased out over five years in urban areas*."[40]

4.18. In Australia "supermarket owners and landlords risked prosecution if they continued to block business competitors through lease arrangements."[41]

4.19. NZFGC supports similar action being taken in New Zealand and supports a prohibition on covenants of land along the lines of the UK and subsequently seen executed in other markets.

Land banking

4.20. NZFGC is astounded that over 200 sites in New Zealand are held or have been previously held by the major grocery retailers which have either not been used or ceased being used for supermarket development. The Commission notes that such activity might be exacerbated if restrictive or exclusive covenants were no longer options for restricting entry and expansion by competitors[42]. Such an outcome has not featured in other country markets where covenants have been prohibited. It might also be expected to be less likely in the current land price market in New Zealand.

4.21. NZFGC considers removing covenants to be more feasible than dealing with land banking especially in the current housing/land environment.

Planning regulations

4.22. Planning regulations are another important element in facilitating entry and expansion of supermarkets in New Zealand. Where resource consent disputes can delay a supermarket opening for 20 years[43], these are very real issues.

4.23. There are two levels of such regulation: zoning under district and regional plans at the local level and consent processes under the *Resource Management Act 1991* (**RMA**). Time and cost appear as key barriers to their effective operation. As noted above, consultation on district and regional plans provide significant support for facilities such as supermarkets where housing/apartment developments are established or planned. The Commission notes there is inconsistency in treatment across the country[44] and, in

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[38] Competition Commission [UK]. The Groceries Market Investigation (Controlled Land) Order 2010 Notice of Making an Order. 10 August 2010
[39] https://www.gov.uk/government/publications/cma-letter-to-tesco-on-breaches-of-the-groceries-controlled-land-order
[40] Press Release, Competition Commission South Africa 12 October 2020.
[41] ACCC, 11 Aug 2009 NR 189/09
[42] Draft report p172
[43] Draft report p175
[44] Draft report at [6.107.4]

examining the consent process, concluded that competition and consumer choice were "*not being considered in a consistent or systematic manner*."[45]

4.24. NZFGC supports action to require RMA consent decision-makers to consistently take into account the benefits to competition and consumers that arise from increased actual or potential competition.

Draft report's Chapter 6 summary:

- *The absence of wholesale options for a full range of groceries means that independent grocery retailers and new entrants are unlikely to be able to buy sufficient products cheaply enough to compete with the major grocery retailers for the provision of a main shop offering.*

Wholesale access

4.25. Access to independent (of supermarkets) wholesale has not been found in New Zealand when compared to overseas arrangements and this may be an important factor in entry and expansion.

4.26. Some retailers claim that a wholesale level in the market is not necessary because supplier concentration (Foodstuffs NI and SI) is small[46], yet the Commission observed some supermarkets deal with large numbers of suppliers[47][48]. There are no readily available or viable wholesalers in the market. It is suggested that negotiating and making a large number of individual distribution arrangements with a large number of individual suppliers is likely to incur transaction costs and that convenience stores and dairies currently do not have a cost-effective avenue for sourcing a wide range of grocery products. There are also exclusive purchase and other arrangements in place. The prospect of inefficiencies are likely.

4.27. NZFGC is concerned of the danger for one or two wholesalers to replicate the duopoly structure of the retail market and to not deliver benefits as envisaged by the Commission, but we remain open to the proposals. We are concerned that the grocery wholesale function in New Zealand is broken and entrenches the duopoly evidenced by the fact that purchasing through a wholesaler (Trents and Gilmours, part of Foodstuffs) has been shown to be more expensive than purchasing from a supermarket. This is also a fundamental threat to independent dairies when supermarkets can and have declined their orders as a retaliation for entering new areas or during times when the supply chain is under pressure due to issues such as COVID.

4.28. In particular, we think support for the extension of the service sector wholesalers could be worthy of further consideration. We discuss this further under comments on Chapter 9.

Draft report's Chapter 6 summary:

- *We are aware of situations where suppliers may refuse to supply new grocery retailers where they are concerned that the retail prices being offered are too low. In some cases, the refusal to supply may have occurred after concerns were raised by another grocery retailer the supplier trades with.*

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[45] Draft report at [6.113]
[46] Draft report p187
[47] Draft report at p182
[48] Draft report at [8.60]

Strategic barriers to entry

4.29. Strategic barriers to entry contribute to both the lack of site availability and wholesale access. They also contribute to restricted access to a potential retailer entrant's access to a full range of products at prices needed to compete effectively with the major retailers.

4.30. Both the large New Zealand grocery retailers have applied pressure on suppliers to limit the access to products by the online provider, The Honest Grocer. This has taken a range of forms but commonly threats to delist products/product ranges are used. In this area, the large retailers effectively require a 'most favoured nation' (**MFN**) arrangement, which prevents new entry or constrains the new entrant's operations and maintains high retail prices. Online channels of the existing retailers may in fact create additional entry barriers and 'crowd out' other brands. Not surprisingly, suppliers want greater optionality to supply/distribute. Similar pressure has been applied to suppliers in the early days of the Warehouse's entry into grocery and recently with one of the fuel companies attempting to update their grocery offering in stores.

4.31. There is considerable anecdotal evidence to the effect that suppliers will be 'punished' if they are somehow seen as enabling a new entrant to offer competitive prices or ranges (this is an exacerbated version of what seems to be an implicit or explicit MFN obligation in relation to supplying to the "other" major). A useful case study evidencing this point is currently playing out in New Zealand with the launch of The Honest Grocer, which lost numerous suppliers as a result of pressure applied by other retailers. Such conduct prevents fringe competitors and new entrants from gaining access to product ranges to create an offering compelling to consumers or gaining access at competitive rates.

4.32. NZFGC considers the draft report misses an important link that evidence of refusal to supply by suppliers is induced by retailer pressure. The draft report's findings in chapter 8, as further commented on below, show the imbalance of power that exists. NZFGC has provided the Commission with examples of instances where suppliers wanted retailers to supply their product at a lower retail price for the direct benefit to consumers but were refused by the retailers. The lack of supplier bargaining powers means suppliers are not able to enforce maximum resale prices.

4.33. Conversely, retailers are able to pressure suppliers into maintaining wholesale prices to control costs to competing retailers and ultimately final retail prices. Retailers can effectively enforce price floors, particularly when there are competing private label products in the same category or a favoured supplier has product in the category. We comment on the issue of retailers rejecting lower priced offerings for consumers from suppliers because it would undermine the retailer's product further in relation to private label products.

4.34. The major retailers have great visibility of one another's prices, profits and margins because they each are essentially half the market. They have demonstrated the ability to calculate prices and margins a supplier offers to a competing retailer and have demanded the same treatment even though that retailer has a higher cost structure.

4.35. NZFGC disagrees that best price clauses and exclusive supply clauses are unlikely to have significant impact on entry and expansion, especially when viewed in conjunction with the conduct described above. Both formal and informal restrictions arising from the lack of retail competition creates an unhealthy work environment where suppliers operate in fear of retailer retaliation and incentives are skewed, preventing the market from achieving competitive outcomes. A mandatory code of conduct that sets minimum standards for retailer behaviour can help stop the use of these strategic barriers to entry.

4.36. This section focuses on barriers to entry. Similar comments apply in relation to barriers to expansion.

5. COMMENTS ON CHAPTER 7 (CONSUMER-FACING ISSUES)

Draft report's Chapter 7 summary:

- *Promotions and loyalty programmes can provide value to consumers and drive competition between the major grocery retailers. When consumers can make meaningful comparisons between offers, they can make informed choices between them and develop more accurate perceptions of value over time, to help them choose where they would like to shop. This incentivises retailers to improve their offers to attract consumers from one another. Conversely, if it is difficult for consumers to compare offers, they may make less-informed purchasing decisions which can reduce price competition.*
- *During our study, we have received complaints relating to pricing and promotional practices and we have analysed these practices over time. Independent of our study, we are considering what further action may be required in relation to these matters utilising our Fair Trading compliance and enforcement functions and powers.*

Overview

5.1. Unlike grocery market 'fringe competitors', supermarkets provide a 'full service' store where consumers can do a full weekly shop. The supermarket margin is a direct reflection of the price consumers pay to access the food and groceries they wish to buy. The foregoing has indicated that harms applied by the grocery market structure and the duopoly that exists in New Zealand results in consumers paying a duopoly premium.

5.2. Consumers also lose out in product choice and range, quality and shopping options. Supermarkets can influence the success and failure of brands to the detriment of consumers and suppliers alike. They have a strong influence over what consumers buy, and how and where they buy it. Deleting the most popular products in a category because a supplier does not agree to significant margin hikes completely overlooks consumer preferences.

5.3. Another factor that impacts consumers is supermarket loyalty programmes which bring their own range of issues around fairness, privacy and consumer protection issues. The use of consumer data from loyalty programmes is an increasingly important and lucrative revenue stream for grocery retailers, particularly when retailers can place pressure on suppliers to purchase the data (free to the retailer) at a high cost. Similarly, there has been a lack of transparency for consumers in shelf advertised prices or 'loyalty' prices vs true prices.

5.4. Consumer facing issues raise a number of competition, privacy and consumer protection issues. In some countries, a Grocery Code of Conduct has addressed these types of behaviour, ultimately to the benefit of consumers through increased access to products, innovation, lower prices and choice.

Draft report's Chapter 7 summary:

- *The major grocery retailers use an array of different promotional mechanisms. Their complexity and frequent use, particularly when used in combination with one another, may make it harder for consumers to accurately assess the value of competing offers or to develop accurate perceptions of value over time, even when there are genuine savings on offer and the information provided is clear.*
- *This may make consumers less likely to shop around between products and between grocery retailers, affecting the quality of information retailers receive about consumer preferences and impacting competition.*
- *It is unclear whether one-off non-price promotions are affecting competition beyond the shorter term.*

- *Use of unit pricing can assist consumer decision making and competition. However, these benefits are less likely to be achieved when unit pricing is inconsistently or unclearly displayed.*

Promotions & pricing practices

5.5. NZFGC agrees well-informed and confident consumers are a key part of competition and that the major grocery retailers' use of promotional mechanisms and practices may affect consumers' ability to compare offerings and perceptions of value. The University of Waikato report on consumer decision making under complexity offers real evidence confirming these concerns.

5.6. NZGC notes that the analysis of price related promotions across the major retailers that shows products on promotion for more than half the year create consumer and supplier issues. Consumer expectations are that the promotional price is the norm and suppliers are pressured to meet a promotional price for extended periods of time.

5.7. The general public may not be aware that Foodstuffs PAKn'SAVE buys most (and in many cases all) of its stock at a promotional discount from suppliers. The arrangement is that promotional purchasing of a product is undertaken in each of 2 consecutive weeks with a one week buy-in followed by purchasing at normal wholesale price (in theory) for the week. In reality, stores buy everything in the three weeks and buy nothing in the fourth week meaning all stock is purchased at the promotional price offered by the supplier. This is an entrenched practice and is called 'Investment Buying', a practice which is ruled out in Grocery Codes elsewhere in the world.

5.8. To summarise when the retailer over-purchases the product in the three weeks 'on promotion', they completely avoid purchasing at the normal wholesale price in the subsequent 2 weeks 'off promotion' but sell all stock at the normal retail price in the 'off promotion' period and make above normal profits rather than pass the benefit through to consumers. At one stage, Foodstuffs North Island attempted to bring in a 6 week promotional purchasing period with a one week buy in which would have meant that for 7 out of 8 weeks, stores would be purchasing at a promotional price. In reality, this would have meant that all purchases would have been at this rate although the 'pass through' to consumers would most likely have remained for a maximum of 26 weeks of the year. This plan did not progress due to NZFGC opposition.

Prohibiting 'Investment Buying' and ensuring a higher 'pass through' of promotional pricing to consumers, particularly in the PAKn'SAVE format, which could possibly be one of the single biggest contributors to lower the prices for New Zealand shoppers.

5.9. The Commission's analysis of the proportion of products that were sold on promotion[49] provides an indication of the prevalence of the promotional activity. Further analysis of the purchasing patterns from by retailers from suppliers could be helpful.

5.10. NZFGC considers the level of 'pass through' of promotional discounts and other cost efficiencies to consumers is sub-optimal. This is an obvious area where improvement will have a direct and positive impact on prices and New Zealanders' grocery costs.

5.11. Such conduct is prohibited by clause 20 of Australia's food and grocery code which requires retailers to sell products bought at a promotional price to be sold at retail at a promotional resale price, or otherwise refund suppliers for the gains made by failing to

[49] Draft report Figure 7.5 p251

pass on the promotional discount. Similarly, paragraph 14 of the UK GSCOP provides retailers must take all due care not to over-order groceries at promotional prices and to compensate suppliers for groceries sold at a higher non-promotional retail price. It is critical that this is included in a mandatory Code of Conduct for Supermarkets in New Zealand.

5.12. There are also concerns with major retailer unit pricing practices. NZ Consumer's submission and consumer feedback to the Commission's consumer survey and the Ipsos report, identified that major retailers do not use unit pricing consistently, for example not using the same units of measurement and products sometimes did not show unit pricing. The inconsistency creates a barrier to consumer comparisons of offerings.

5.13. NZFGC agrees with the benefits of consistent unit pricing practices submitted by unit pricing expert, Ian Jarratt, including more informed, effective and efficient consumer choice, time savings, and increased competition.[50] These are supported by the University of Waikato's research on consumer decision making under complexity which found display of unit prices may help mitigate the effects of the use of multiple promotional mechanisms, and the Commission's consumer survey, in which over 60% of respondents reported referring to unit pricing when assessing the value of grocery products.[51]

Draft report's Chapter 7 summary:

- *Consumer understanding of loyalty programmes appears low. This is particularly in relation to how accumulated rewards are earned and redeemed, and how consumer data is collected and used by the major grocery retailers. This can make it difficult for consumers to assess the value of these programmes to them and make well-informed decisions about their participation. This can make consumers less responsive to price competition, reduce the major grocery retailers' incentives to engage in price competition and inhibit competition for consumers with certain privacy or data use preferences.*
- *Loyalty programmes may also cause some consumers, particularly those that value accumulated rewards, to focus on earning rewards through a particular loyalty programme and be less inclined to shop around.*
- *Personalised or targeted promotional offers for loyalty programme members can facilitate price discrimination which may raise competitions concerns as it becomes more sophisticated.*

Loyalty programmes

5.14. The Commission's conclusion in relation to the major supermarkets' loyalty programmes is that they are unlikely to impede entry or expansion[52]. NZFGC notes loyalty programmes raise a raft of other issues of concern including unfair contract terms and conditions of loyalty programmes, privacy concerns (disclosing data), adding complexity to purchase decisions, price discriminations and linking payment cards to loyalty cards. This is particularly noteworthy during the current (August 2021) lockdown where New Zealanders have no choice but to shop with the duopoly and must share personal information in order to access lower prices.

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[50] Jarratt I. *Submission on retail grocery market study preliminary issues paper,* 4 February 2021, p2. https://comcom.govt.nz/__data/assets/pdf_file/0025/236941/Ian-Jarratt-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

[51] Draft report at [7.107]-[7.108]

[52] Draft report at [6.195]

5.15. As previously submitted, loyalty programmes appear to involve significant ‘coerced’ use of consumer data.[53] For example, New World’s loyalty programmes offer significant discounts on some products but customers are required to agree to its terms and be on the mailing list to receive a benefit. It may not be clear to consumers how that data is used or where their data is stored (Quantium is based in Australia and Dunnhumby is a global data company headquartered in the UK).

5.16. Similarly, shelf advertised prices will be at the ‘loyalty’ price, with the true price appearing to be in (much) smaller font. These raise a number of competition, privacy and consumer protection issues. The use of consumer data deserves greater scrutiny in terms of privacy, sovereignty and use.

5.17. NZFGC’s key concerns are primarily around disclosing data where product categories might be affected. Retailers sell the data they collect on consumer purchasing behaviour to suppliers. The power imbalance between suppliers and retailers explored in Chapter 8 of the draft report is deepened by the information asymmetry regarding retail sales. Suppliers must pay retailers more money to be on an equal footing to understand how their product is selling, strengthening the power retailers hold. We have received reports about pressure applied to purchase Dunnhumby data and expect this to continue as data (low cost, high margin) becomes a growing revenue stream for supermarkets here as it is in Australia and around the globe.

[53] NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper,* p5. https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

6. COMMENTS ON CHAPTER 8 (ACQUISITION OF GROCERIES BY RETAILERS)

Overview

6.1. NZFGC agrees that for suppliers, the grocery market dominated by two major retailers is the key route for supplier products on the domestic market. This results in the following:

a. the structure of the retail grocery sector limits the ability for most suppliers to transfer significant volumes of products to alternative sales channels – even export as an option is less likely/much harder where the domestic base is eroded or unavailable.

b. there is very limited room for negotiation in supply contract arrangements.

c. evidence of exploitation of suppliers and buyer (supermarket) power has effectively excluded other supermarket competition (eg deleting or threatening to delete a supplier's product in the event of supplying minor newcomers to the market or offering differentiated products to current competitors and preventing other retailers entering).

d. the harms that NZFGC identified and which have generally been confirmed by the Commission are extensive to both suppliers and consumers.

e. there is a greater risk of private labels adversely affecting outcomes and safeguards against this should be put in place.

Commission's chapter 8 summary:

- *Major grocery retailers are a key route to market for many suppliers. Most groceries in New Zealand are sold through the major grocery retailers' retail stores, so a supplier having its products stocked by a major grocery retailer is an important way to drive sales.*
- *For many suppliers there are limited alternative options available to them to sell their products other than to the major grocery retailers. With only two major grocery retailers in each island, which between them have a high estimated market share, in many instances there is only limited competition for the purchase of suppliers' products. We observe that, as a consequence, competition does not appear to be working well for suppliers to the major grocery retailers.*
- *Most suppliers have limited ability to negotiate with the major grocery retailers. Suppliers are typically significantly more dependent on retailers than the retailers are on suppliers. This leads to a bargaining power imbalance in many cases.*

Buyer power

6.2. The Commission has identified that the New Zealand grocery market structure comprising two major retailers that are vertically integrated into wholesale distribution and other areas, delivers buyer power that results in both direct and indirect harms. NZFGC knew that, given the concentrated nature of the industry, the Commerce Commission would face significant challenges obtaining evidence of the exercise of buyer power applied to suppliers and the harms that result due to genuine fear of retribution and commercial punishment. Nonetheless, it received enough to confirm NZFGC's concerns.

6.3. Retail market concentration creates a huge imbalance in bargaining power between large retailers and suppliers. The behaviours of the two major New Zealand grocery retailers are symptomatic of buyer/demand side power and high market concentration.

Despite the two major grocery retailers being present online, many suppliers are constrained by the retailers' restrictive supply terms such as shelf space which includes ranging, delivery, payment terms, consumer purchasing and discounts and rebates. For all these, the supplier is disadvantaged due to retailer bargaining power. Limiting shelf space (withholding demand) could also limit supply of products or categories to consumers.

6.4. Retailers will often make the point that tough negotiations are all focused on ensuring the lowest prices to consumers. This may be the case in some circumstances, but the sorts of behaviour which have led to calls for a Grocery Code of Conduct in New Zealand are not those which are designed to deliver better choices and prices to consumers, in fact quite the opposite. Many of the complaints made by NZFGC and other suppliers are about behaviours that expand margins and increase returns, but do not result in lower prices or other benefits to consumers.

6.5. Retailers place excessive risks on suppliers which affect suppliers' ability and incentive to exist but more ominously, has created an environment within which the small New Zealand manufacturer/supplier struggles to survive, let alone invest, innovate or have the resources to execute an export strategy. This impacts food security for New Zealand consumers and affects the very fabric of New Zealand-based food manufacturing.

6.6. Retailers transfer risks to suppliers through requiring guaranteed margins and/or making suppliers cover costs associated with risks that retailers manage such as theft, wastage and over-ordering. In addition, retailers use their bargaining power to demand payments for shelf space and displays (regardless of whether or not they are needed or delivered in-store). On top of increased risk and cost, suppliers also face unreasonably slow payment terms, requirements to participate in unviable promotions, and face demands for free product and personal perks. Even during the current (August 2021) COVID lockdown, which cements the current duopoly, some suppliers have received demands to pay supermarkets for merchandising services which is a discretionary spend and not a term. This has previously been explained to suppliers as an "investment in the wages account" of the store, to offset the retailers' wages bill.

6.7. When so many food and grocery suppliers are so dependent on the duopsony that the loss of one retailer can threaten their business, suppliers are compelled to agree to terms that would not be required in a more competitive market. Many suppliers agree to these terms under threat that otherwise their products will be deleted or moved to less prominent shelf space. These deletions are not ones that normally occur as a result of the life cycles of brands or genuine competition, but as a result of threats and punishment for failing to comply with the latest demands. With the major retailers representing over 80-90% of the market, failure to supply to a major retailer forecloses a large portion of the market.

6.8. The terms imposed contractually (and non-contractual threats such as delisting etc and the terms not in writing or implied) by retailers are further symptoms of power. These include retailer demanded discounts etc that are not linked to services (eg promotions etc) and costs imposed on suppliers such as stock loss or non-delivery charges. The basis for the application of such costs and the evidence and timeliness of information about them provided to the supplier is also of concern.

6.9. The most recent example is a display fee implemented by Foodstuffs North Island. Previously suppliers would negotiation for and pay for specific displays which would be delivered. Foodstuffs North Island moved to a percentage deduction as a 'display fee' for which a supplier may or may not get any displays. NZFGC has fielded numerous reports from suppliers who have paid significantly more but have received either none or fewer displays in return for this increased expenditure. One supplier complained they had received no compulsory displays at all and while finally given the right to three compulsory displays by Foodstuffs North Island, were allocated zero stores for these compulsory displays.

6.10. Suffice to say, both the major grocery retailers wield immense buying power. This allows them to extract margins which are high globally. Supplying supermarkets is complex and suppliers are faced with a complex array of deductions, discounts, rebates, levies, fees, slow payment terms and other requirements. This complexity and web of many financial contributions is symptomatic of New Zealand's high retail concentration and a minefield for small new entrants who often get caught with costs that weren't apparent even with detailed due diligence. In a competitive market, suppliers would be able to reject, accept or negotiate. While a handful of firms with major brand power can negotiate, the rest of the supply community cannot. This is why most suppliers are price-takers and in some cases find themselves supplying supermarkets at a loss.

6.11. The UK Small Business Commissioner introduced a 'Prompt Payment Code'[54] in 2008 which ensures larger companies pay their suppliers on time. The UK Government recently strengthened this Code to speed up payments (from 60 days to 30 days) for small businesses amongst several other reforms. Chhabara (2009) described this as "Suppliers are practically acting as unofficial financiers for retailers." [55] In effect, supermarkets are getting paid for product before they pay for it. This is another feature of the supermarket low risk/high reward model.

6.12. Supermarkets should be held accountable for bad credit (subject to some form of government-monitored credit score/rating system) just like any other borrower in the economy (including banks). The activity described above would negatively affect the supermarket's credit profile, including its ability to obtain other types of financing. Trade credit shouldn't be offered to a business with a bad credit rating.

6.13. Individual stores abuse the market power their retailer chain holds. NZFGC has provided the Commission with examples of unacceptable individual store conduct, ranging from bullying and harassment of merchandisers to demanding free products. Another example is that suppliers are often required to renegotiate terms already agreed to with individual stores. NZFGC understands suppliers negotiate product supply with each of the head offices of Foodstuffs North Island and Foodstuffs South Island. Suppliers are then often required to renegotiate with individual retail outlets under the same banner as the head offices. This adds transaction costs and extends the buyer power significantly. Head office negotiated and agreed terms should prevail across individual stores.

6.14. Head office also fails to intervene when stores behave in a non-sanctioned way, for example the issuing of invoices for merchandising, ad hoc fines of merchandisers, poor treatment of suppliers' merchandising staff working in store for the benefit of supermarkets or lax health and safety pratices which put merchandisers at risk.

6.15. The table below provides examples of major retailer behaviour seen in grocery procurement. An earlier version of this table was provided to MBIE in our submission to

[54] UK Small Business Commissioner. *Prompt Payment Code.* 2008 amended 2021. What is the PPC – Small Business Commissioner and https://www.smallbusinesscommissioner.gov.uk/ppc/ and https://www.gov.uk/government/news/government-tackles-late-payments-to-small-firms-to-protect-jobs
[55] Chhabara R. Supplier payment ethics – the cost of squeezing suppliers. *Reuters Events Small Business,* 3 Feb 2009. Supplier payment ethics – The cost of squeezing suppliers | Reuters Events | Sustainable Business

the *Discussion Paper: Protecting business and consumers from unfair commercial practices*.

1.	**Requesting retrospective cash payments**
Description of behaviour	Supermarkets have asked suppliers for retrospective cash payments. These are often presented as compensation for "benefits" received by suppliers in the previous trading year that were not included in the agreed terms of supply between the parties. Suppliers have reported feeling shocked and intimidated as a result of these requests, which are often raised verbally in meetings, with little to no prior warning and no scope for discussion or negotiation. These requests for retrospective cash payments also sometimes relate to product "wastage" or "shrinkage" that occurs in-store or are the result of claims that historic invoices remain unpaid. The historical claims are particularly hard for suppliers to refute, due to personnel turnover or lost/destroyed files. Some Foodstuffs stores regularly claim over and above rates of other stores leading some within the industry to believe that this is being used as an additional revenue stream. High rates of claims where suppliers risk being deleted for non-payment are particularly suspicious when the claims are for more than the supplier sold to the supermarket in the first place or may not have sold to them at all.
Harm to businesses & consumers	These requests often leave suppliers fearful of retribution if the money is not paid. Unexpected costs can lead to lower than expected income for suppliers, and increased uncertainty regarding future costs which may be requested in the future inhibit suppliers' ability to plan or invest in product development, innovation and exports.
Examples	A supermarket invited a supplier to a meeting and stated it was disappointed that in the previous trading year it had lost sales volume due to not pricing as competitively as its competitors. It further stated that as a result it required compensation of $1.8 million for "benefits" delivered to the manufacturer in the previous trading year. This sum was said to reflect money "owed" to the supermarket due to the supplier's product being below category average GP%. The supplier requested to view the supermarket's analysis but was denied. This request was never put into writing and, following debate in parliament regarding "retrospective payments", was not pursued any further. Suppliers have also reported being asked to make retrospective payments for losses incurred in-store, such as product wastage and theft. In one case the wastage cost constituted total losses for an entire category, then divided amongst all suppliers (meaning some suppliers may have been charged for wastage that did not relate to product supplied by them). Suppliers have reported being routinely sent claims for promotion contributions (in the thousands of dollars) relating to promotions run up to 4 years in the past. Another example, a fresh product producer was asked to pay for store damage which was absolutely not the producers' fault and this was confirmed by store workers and CCTV. The store said if it wasn't paid the product would be deleted. The supplier refused as a matter of principle as it was outside agreed Minor Damage Allowance rules. The store deleted the product.
2.	**Unilaterally imposing additional costs (often promotional costs) or discounting items without prior agreement**

Description of behaviour	Supermarkets frequently charge suppliers for costs that have not been agreed to in the terms of supply. These costs are often deducted from payments without prior discussion or negotiation with the supplier impacted. Suppliers also report that their products have been discounted heavily by supermarkets without prior agreement. Introducing new costs and deductions which are not linked to actual services eg. Display costs which are not linked to the provision of displays as discussed earlier.
Harm to businesses & consumers	Unexpected costs can lead to cash-flow issues for suppliers and can impact profits. This in turn can inhibit suppliers' ability to invest in growth or new product development. Ultimately the range of choices available to consumers can be impacted. In cases where suppliers' products are continually and/or heavily discounted, consumers' perception of the value of products can be warped and consumer expectations of what a fair price is may change. This can be detrimental to suppliers where consumers' perception of value is disproportionate to the supplier's costs. Where costs are raised for suppliers but prices are not decreased for consumers, supermarkets are merely fattening profit margins at the expense of the suppliers, with little to no benefit for consumers.
Examples	Due to underperformance of a certain product, a supplier agreed to a 50c discount for a supermarket so that the product could be put on promotion for customers. The supermarket decided not to run the promotion but kept the 50c reduction on all sales. The product continued to underperform and was ultimately delisted. One supplier reported that all the products across a category were put on special by a supermarket and each supplier in the category was billed back their share of the discount, despite the suppliers not agreeing to this. No breakdown of sales was provided to suppliers and the cost was deducted from the suppliers' payment without agreement. In one instance a supplier's product was continually put on "deep cut" promotions by a supermarket, which the supplier was forced to fund. The terms of supply between the parties stated that the supermarket did not have the right to unilaterally adjust or amend any part of the deal sheet submitted by the supplier. The supplier reported that the additional payments were crippling its business. The supermarket refused to relent and informed the supplier that it would not accept any new products unless further deep cut discounts were accepted. Another supplier reduced his price because the supermarket wished to offer a lower price to consumers. The supplier agreed and six months later was still reminding the store that the product remained at the original price to consumers. The store finally passed on the reduction, but consumers had lost this benefit for the preceding six months. Suppliers have reported a supermarket requiring that they use an Electronic Data Interchange, and later charging suppliers approximately $1000 per month for their use of it. A supplier refused to pay for damage that had been the fault of the store (i.e. nothing to do with the supplier) and was delisted.
3.	**Refusing to pay agreed costs to suppliers**
Description of behaviour	The terms of supply between suppliers and supermarkets frequently account for costs which the supermarket may owe the supplier. However, suppliers have reported that these agreed costs are often disputed by supermarkets or go unpaid.
Harm to businesses	Non-payment of agreed costs can lead to cashflow issues when a supplier expected to receive payment but did not. There can be associated costs to

& consumers	a supplier relating to pursuing the unpaid amounts. This can often lead to greater uncertainty for suppliers who do not know when/if they will receive agreed payments.
Examples	One supplier delivers to a supermarket daily. The supermarket would routinely claim that, as it had no physical proof of delivery (a “POD” form) that it did not have to pay for the products. This supplier at one stage had to write off approximately $5 million of payments after the supermarket claimed these products had not been delivered (due to lack of POD), even though they had. The product was of a kind that even one day’s non-delivery would result in swift action from the store. There was no doubt the product had been delivered. Suppliers have reported that supermarkets often pay late but still take the early payment discount agreed in the terms.
4.	**Threatening or exacting “retribution” as a “negotiation” tactic**
Description of behaviour	Suppliers have reported that supermarkets routinely threaten repercussions, including the cancelation of promotions, delistings, or using these measures as retribution for certain behaviour or responses, if the suppliers do not behave a certain way. Often supermarkets follow through on these threats if the supplier attempts to negotiate or refuses to adhere with the supermarket’s wishes.
Harm to businesses & consumers	When threats such as these can be used by supermarkets at will, suppliers’ bargaining power is significantly weakened. Such threats can carry real consequences for suppliers – for example, over 60% of all sales in New Zealand are made while products are on promotion; exclusion from promotions or catalogues can have a major impact on sales. Threats to de-list also create uncertainty and impact on businesses’ ability to plan for the future, including new product development. When the supermarkets follow through on these threats, there can be a flow-on harm to consumers in the form of reduced choice, reduced innovation and new product development, and the missed opportunity of lower prices when products are not promoted. Blocking suppliers from being able to participate in supermarket promotions clearly harms consumers. When this happens some consumers are denied the opportunity to buy their favourite brand at a lower price and can only buy at full retail.
Examples	A supplier of food grocery products was told by a supermarket that, unless prices were lowered in one category, all of its products in another category would be moved to the bottom shelf. This threat was eventually followed through and the supplier lost a significant volume of sales. A supplier was told by supermarket staff that it would face “repercussions” if it continued to pursue a price increase (which was needed in light of increased input costs), including suggestions it could affect ranging or lead to the supplier being dropped from some stores. A supermarket demanded a price decrease from a supplier, citing a competing supermarket supplying the supplier’s products at a lower price. The supplier explained that this was because the competing supermarket was willing to accept a lower margin, and that it could not control the competing supermarket’s prices. When the supplier refused the price decrease, the supermarket responded by reducing shelf facings and decreasing catalogue exposure for all of the supplier’s products, rejecting new product development and excluding the supplier’s products from promotions.
5.	**A general culture of bullying, intimidation and retribution**

Description of behaviour	Many suppliers express a fear of dealing with supermarkets, due to the far-reaching and material potential repercussions of negotiating or raising concerns regarding supermarkets.
Harm to businesses & consumers	Suppliers are extremely fearful of damaging their relationship with supermarkets due to the impact that this could have on their business. This concern is even more material for businesses that deal with supermarkets operating in both New Zealand and Australia. The benefits of raising concerns with or resisting such supermarkets must be weighed with the real risk of having their business affected both in New Zealand and Australian markets.
Examples	One supplier reported that, in the course of a negotiation, it was chastised by supermarket for attempting to elevate issues to senior management level. While often supermarkets will publicly say suppliers are welcome to elevate issues with senior leaders there is often risk and retribution of doing so. In theory senior leaders have an "open door" policy, but in reality only a few large or multinational suppliers have the ability to raise issues. Many suppliers have described their interactions with supermarkets as 'bullying' and 'intimidating'.

6.16. The table below, previously submitted to the Commission, identifies further types of procurement practices.[56]

	Type of behaviour	**Who benefits**
1	**Shifting risk and cost from the supermarket to the supplier**	
1.1	Requiring a supplier to guarantee a retailer's margin regardless of price.	Retailer
1.2	Margin expansion – the practice of extracting higher margins from suppliers and at the same time increasing the on-shelf price.	Retailer
1.3	Tender processes where double and triple the trading margin is expected from suppliers.	Retailer
1.4	Demands for payments from suppliers for costs which are instead genuine retail costs e.g. staff costs for placing products on the retailer's shelf.	Retailer
1.5	Demands to pay for store theft, shrinkage and waste.	Retailer
1.6	Demands to pay for product damage not the fault of the supplier or risk deletion.	Retailer
1.7	Demands for retrospective payments from suppliers for previous financial years for perceived gaps in margin or other vague benefits the supplier is deemed to have received.	Retailer
1.8	Over-ordering and cancelling; overordering due to retailer forecasting errors and then returning the stock.	Retailer
1.9	One-sided contracts e.g. having no exit clause for suppliers; prohibiting suppliers from seeking legal or professional advice on tender documents without approval from the retailer.	Retailer
1.10	Retrospective variations to contracts to favour the retailer.	Retailer
2	**Extracting additional payments/fees from suppliers**	
2.1	Demands to pay a percentage of sales as a "display" payment when the product has not, and most likely will not, be	Retailer

[56] NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper* at [174]: https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

	displayed. Some larger suppliers extract agreements for displays in return, but most signed agreements are without any guaranteed activity from the retailer at all.	
2.2	Demands to pay for shelf space or floor space or risk deletion.	Retailer
2.3	Listing and ranging fees.	Retailer
2.4	"Auctions" and tenders for shelf space.	Retailer
2.5	Unreasonable claims for payment of services or credits dating back more than two years following "forensic audits".	Retailer
2.6	Demands for payment of a % of sales for waste or damage which is over and above actual waste or damage.	Retailer
2.7	Introducing new and unbudgeted costs e.g. a product "neck tag" fee, a product recall fee or some other new cost	Retailer
2.8.	Negotiating a discount from the supplier for a consumer promotion and then not running the consumer promotion. While price is not discussed the negotiation takes place with the supplier intention and expectation that there will be activity in the market of some kind which benefits consumers.	Retailer, Consumer loss
2.9	Demands that a supplier uses the retailer's transport system which is often more expensive, less efficient and less accountable. Threats of punitive action should a supplier wish to leave the retailer's primary freight service.	Retailer
2.9	Demands to purchase retailer data eg. dunnhumby	Retailer
3	**Reducing or delaying payment to suppliers**	
3.1	Deducting a settlement or prompt payment discount despite making late payments.	Retailer
3.2	Slow and extended payment terms for goods; payments made months after the retailer has sold the goods; unreasonable payment delays. irrespective of undertakings as to timeliness in contracts.	Retailer
3.3	Unreasonably long payment terms for high volume goods. For example, a supplier sells product to retailer on 1 December and it sells on 2 December. The retailer pays the supplier 20 January and often later.	Retailer
3.4	A practice by some stores of regularly and significant claiming for short delivery of shipments (signed as received) when the supplier has no doubt the product has been delivered.	Retailer
3.5	Arbitrary deductions of large sums from remittance without consultation. There is little most suppliers can do to get disputed claims back.	Retailer
4	**Product deletion threats and other retribution**	
4.1	Constant threats of deletion as a default and "negotiation" shortcut.	Retailer
4.2	Threatening to move supplier's product to a lower shelf to make it harder for consumers to secure other retailer benefits.	Retailer
4.3	Banning a supplier from promotional activity as a punitive measure for not complying with some other demand or activity.	Retailer, Consumer loss as there are fewer opportunities to buy those brands at a reduced price.
4.4	Rejection of all new product development as a punitive measure for not complying with some other demand reducing consumer access to products and innovation	Retailer, Consumer loss.

5	**Inducing supplier to refuse to deal with competitive retailers**	
5.1	Demands not to supply competitors with exclusive packs or other product variants.	Retailer
5.2	Threatening deletion of a product or applying other pressure if a supplier supplies products to another new entrant in the New Zealand market.	Retailer
6	**Requirements to participate in uneconomic promotions**	
6.1	Requiring suppliers to participate in promotions where the ROI is unclear or unlikely. See 2.9 regarding the purchasing of retailer data.	Retailer, in some cases consumer.
6.2	Demands that suppliers move to a “6 week on, 2 weeks off” promotional rotation which would mean in effect that all stock is purchased from the supplier at the promotional price.	Retailer, Consumers benefit only during the promotion “on weeks” when the lower price is passed on.
7	**Requirements to provide free products or perks**	
7.1	Demands for significant amounts of free product at store before accepting what should be, according to head office decision, a compulsory stocked line and on the shelf.	Retailer
7.2	Requests for petrol vouchers, restaurant meals, free product and other personal gifts either personally or for staff	Retailer, Personal
7.3	Free overseas travel and accommodation	Retailer, Personal
7.4	Demanding suppliers credit all stock after a punitive deletion.	Retailer
8	**Buyer-induced bundling**	
8.1	Requiring suppliers to use retailer-owned or affiliated services eg transport, distribution centres – even when this is a more expensive route to market.	Retailer
8.2	Requiring or pressuring a supplier to purchase retailer data and insights at significant cost.	Retailer
9	**Requiring collusive behaviour in supplier market**	
9.1	Rejecting offers from suppliers for lower priced goods for consumers because the offers would be cheaper than the retailer’s private label product.	Retailer
9.2	Demands to know from a supplier information or details about retail competitor’s promotional programme or pricing	Retailer
10	**Appropriating IP for supermarket’s own brands**	
10.1	Copying or demanding the use of supplier’s intellectual property for private label products and in some cases subsequently deleting the supplier’s product.	Retailer
11	**Inadequate health and safety measures**	
11.1	Bullying of sales representatives, poor treatment of merchandisers leading to mental health concerns.	No one benefits.
11.2	Poor health and safety practices in store	No one benefits

Entrenching of retailer power

6.17. The balance of power is shifting even more to the retailer, driven by their access to and use of internal data/insights. Several retailer ‘internal projects’ are underway using such data, for example Foodstuffs North Island is requesting suppliers to meet certain margin requirements, and PAK’nSAVE is using data behind threatened product deletions on a store by store basis. Suppliers are unable to effectively counter such tactics without paying the very expensive costs to subscribe to receive each retailer's data, so retailers are forcing suppliers into a 'pay to play' model where payment is for data, and accessing the data is the only way suppliers can have any transparency of the demands being placed on them. This has pushed suppliers to use in-store media hubs and a number of suppliers say "*I know it is expensive but it helps us getting listed*".

6.18. Retailers are increasingly using their new and expanding databases of information to extract more from suppliers than they previously have done by charging for access, which creates an increasingly uneven playing field.

6.19. The retailer buyer power is also wielded to prevent supply to other retailers, effectively limiting entry and restricting retail competition. This has the flow-on effect of further entrenching buyer power.

6.20. Retailers also leverage their power by requiring suppliers to use retailer-owned distribution services and transportation services, even where this is more costly.

6.21. While some suppliers may be multinational companies, this does not automatically translate into bargaining power in New Zealand. In many instances they will have a relatively small presence in New Zealand and will be dependent on the supermarkets as a major distribution channel upon which they rely.

Draft report's Chapter 8 summary:

- *With effective retail competition, this can result in cost savings that are passed on to consumers. However, we have heard examples which suggest that in some cases major grocery retailers are using their strong negotiating position to:*
  - *transfer costs and risks to suppliers, despite retailers being better placed to manage them;*
  - *reduce transparency and certainty over terms of supply; and*
  - *limit suppliers' ability or incentive to provide favourable supply terms to other grocery retailers.*
- *Suppliers' incentives to innovate and invest are likely to be adversely affected by this conduct in ways that ultimately harm consumers. For example, this could lead to reduced production or capacity, lower product quality and fewer new product offerings being available for New Zealand consumers. Other grocery retailers may face reduced access to supply of groceries, affecting their ability to enter or expand. There is a risk of prices rising in the future if some suppliers exit the market, reducing competition between the remaining suppliers.*

Supplier harm (and resulting consumer harm)

6.22. Buyer power may explain some of the undesirable market outcomes identified in Chapter 3. As previously submitted,[57] Nicholson and Young identify the effect buyer power abuse can have on consumers in the table below.[58]

Table 3: Effects of buyer power abuse on consumers

EFFECTS OF ABUSE ON SUPPLIERS	EFFECTS ON CONSUMERS
Overall downward pressure on supply prices	• Threat to suppliers' viability may affect supply and over time push prices up and reduce choice • Suppliers forced to cut production costs (possibly ingredient quality, and may squeeze working conditions in intensive stages of production)
Additional costs to supplier	• In the long run, may result in higher consumer prices • In the short run, may result in higher consumer prices in non-supermarket outlets
Risk of stocking new products forced on to supplier	• Fewer new products, with potential knock-on effects on range and quality
De-listing	• Replacement of branded goods with retailers' own brand • Loss of choice and possibly of quality
Cost and risk of shrinkage and/or retailers' forecasting errors passed back to supplier	• Price, range and quality are all put at risk through reduced funds available to suppliers for investment and promotion
Adversely affects suppliers' cash flow	
Risk and cost of product changes borne by supplier, increasing costs and uncertainty	
Domino-effect demands for lower prices from other supermarket customers	• Consumers misled about sustainability of low prices
Competitors' costs are raised	• Affects the availability of products to other retailers • Reduction of store choice
Loss of IP rights, leading to a lower rate of innovation	• Lower rate of innovation and thus of product range

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[57] NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper* at [177]: https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

[58] Nicholson C, Young R. The relationship between supermarkets and suppliers: What are the implications? *Consumers International*, September 2012: Table 3. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf

6.23. Vertical and horizontal issues raised by the likes of retailer transport systems and private labels identify the potential need for appropriate safeguards to address conflict of interest, misuse of information, and exclusionary conduct. Requirements to use the retailer's primary freight model even though services could be sourced more cheaply elsewhere, ultimately lead to higher grocery supply prices faced by consumers. NZFGC's transport members have often voiced concerns that such integration can also lead to weakening New Zealand's transport infrastructure by entrenching inefficiency, creating barriers to entry and encouraging exits from the transport sector.

6.24. While some larger suppliers may be able to push back on these types of demands from supermarkets, smaller suppliers are more likely to decide they have no choice but to use the retailer's vertically integrated freight services even though that means higher costs, rather than face threats of product deletion. Where retailers offer private label products and therefore operate as a competitor to their suppliers, as well as a supplier to themselves, a fundamental conflict of interest is created.

6.25. Behaviours within the grocery sector (principally the behaviour of retailers) and many behaviours related to the vertical and horizontal retailer structure, drive the issues of concern within the sector. Supermarkets can increase profitability by applying requirements to competing branded products and advantage their private label products on price, shelf space, promotions etc.

6.26. In relation to horizontal structure, it may be that the Foodstuffs North Island and Foodstuffs South Island could be re-separated from their transport operation. As well, intervention to require retailer acceptance of lower cost transport than is being offered by the retailer could effectively rebalance the services power. A strong Grocery Code of Conduct could also make clear that the supplier is able to select the most efficient transport option for their business without pressure or fear of retribution of any kind for declining Primary Freight options. We discuss these further under comments on Chapter 9.

6.27. Another buyer power behaviour relates to retailer-supplier negotiations for product into retail. For Foodstufffs, negotiations take place centrally by Foodstuffs. This is intended to bind retail outlets under the Foodstuffs banner to meet the negotiated price. However, many retail outlets then enter their own negotiations meaning suppliers have endless negotiations on a shop-by-shop basis. Foodstuffs central says it cannot compel compliance so while negotiating at head office, getting stores to comply has been a weakness particularly in the rollout of the new Foodstuffs North Island Buying Model. Suppliers have committed significant extra resources, but so far, the result has been disappointing for many. Many suppliers report paying more and getting considerably less. An intervention requiring this would redress the power balance. We discuss this further under comments on Chapter 9.

6.28. There are no large-scale, independent wholesalers of dry groceries (as in packaged groceries) in New Zealand. Supermarkets also own wholesalers which has led to market consolidation and higher pricing for all consumers is the (potential) end result.

6.29. As previously submitted, harms we have identified from actual behaviour of large retailers include:[59]

[59] NZFGC submission to the *Market study into the retail grocery sector: Preliminary issues paper* at [12]: https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf

a. ***Shifting of risk and cost from supermarkets to suppliers,*** including requiring suppliers to guarantee retailer margins and cover costs associated with risks that are managed by retailers (theft, wastage, overordering)

b. ***Extracting fees and payments from suppliers,*** including slotting fees (which can be used to facilitate tacit collusion between retailers), and display payments (even when the product has not and likely will not be displayed)

c. ***Unreasonably delaying or reducing payments***

d. ***Retrospective variations to favour the retailer***

e. ***Demanding perks or free product***

f. ***Constant threats of product deletion or retribution***

g. ***Requirements to participate in uneconomic promotions***

h. ***Buyer-induced bundling –*** such as requiring suppliers to use retailer-owned or affiliated services even where this is more expensive and the potential (as yet unwritten) that suppliers might be being disadvantaged if they don't buy loyalty or Dunhumby data

i. ***Appropriation of IP to develop supermarkets' own private labels***

j. ***Inadequate health and safety measures*** for the protection of suppliers' workers in store eg sales representatives and merchandisers (shelf stackers)

6.30. In sum, these practices squeeze supplier margins and reduce purchase prices below competitive market prices, likely also reducing total economic outputs, with (1) suppliers producing at sub-optimal levels, reducing incentives to invest in improved production (research and development, innovation) and encouraging exit as fixed investments are consumed and not replaced; (2) discouraging entry at the margin. Suppliers accepting supermarket demands which set supplier prices lower than would be expected where there is greater competition is a clear symptom of the current market duopsony/duopoly.

6.31. As a result of the harmful buyer behaviour exhibited by supermarkets in New Zealand, supplier competition could look very different in future and may be characterised by:

a. Unsustainability of local manufacturers, as margins get squeezed by increased costs and risks. Not being able to earn a normal profit in the domestic market also means a supplier is unlikely to garner the resources to invest in an export growth strategy. In any case, being driven out of the domestic market by supermarket behaviour and then relying only on export or alternative channels denies the consumer of access to products they might otherwise prefer;

b. Hollowing out of multinationals' presence in New Zealand, with manufacturing being moved offshore, and local operations being minimised and confined to sales and marketing;

c. Prevalence of private labels, which face little competition, so less variety, lower quality and/or higher prices.

6.32. Powerful purchasers can also engage in various exclusionary strategies to exacerbate their market power. Carstensen categorises these as follows:[60]

a. Exclusive buying

b. Inducing a supplier refusal to deal

c. MFN and MFN plus contracts

d. Predatory buying / over bidding

e. Indirect exclusion.

6.33. The Draft report identifies some of these in its commentary of conditions of entry and expansion. We observe many of these types of behaviour by New Zealand supermarkets, raising strategic barriers to entry and expansion by potential entrants.

6.34. The potential harms have led to a range of measures being adopted across multiple jurisdictions such as grocery codes of conduct (eg UK and Australia), prohibitions on abuse of unequal bargaining power (eg Japan) and unfair trading practices in the business-to-business food supply chain (eg European Union). The ACCC has also taken legal action against both Woolworths and Coles in relation to alleged abuses of buyer power.

6.35. The Federal Trade Commission (**FTC**) is now requesting public comment regarding contract terms that may harm fair competition. The consultation arises out of public concerns about a "*wide range of terms that may create power asymmetries that disadvantage small businesses, workers, and/or consumers … and other one-sided contract terms that may exacerbate or lock in power disparities".*[61]

6.36. One submission to the FTC recognises that monopolistic and oligopolistic firms can use exclusionary contracts to foreclose rivals and control trading powers.[62] It supports this with empirical evidence that dominant firms have used exclusionary contracting and finds the justifications for exclusionary contracts are limited and unpersuasive. The introduction summarises the theory of harm as follows:[63]

> "Monopolists and other dominant firms across the economy use exclusive arrangements to marginalize rivals and preserve their own power over customers, distributors, suppliers, and workers. Firms with dominance can coerce or induce customers, distributors, and suppliers into limiting their dealing with rivals or not dealing with rivals altogether. In concentrated markets, monopolists and oligopolists can use exclusive dealing, exclusionary payments, and related practices to thwart the entry and success of new and small firms and to restrict the freedom of their trading partners. This exclusionary conduct, by stifling or reducing business rivalry on the merits, can inflict substantial injury on consumers and sellers, in the form of higher

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[60] Carstensen PC. *Competition Policy and the Control of Buyer Power – A global Issue (New Horizons in Competition Law and Economics Series).* Edward Elgar Publishing Cheltenham, UK: 2017. ISBN: 978 1 78254 057 p98 https://doi.org/10.4337/9781782540588

[61] Federal Trade Commission *Request for Public Comment Regard Contract Terms That May Harm Fair Competition,* Abstract. https://www.regulations.gov/docket/FTC-2021-0036

[62] Before the Federal Trade Commission Petition for Rulemaking to Prohibit Exclusionary Contracts (July 2021).

[63] Before the Federal Trade Commission Petition for Rulemaking to Prohibit Exclusionary Contracts (July 2021) at p1.

prices, lower quality products for purchasers and lower prices and other less favorable terms of trade for suppliers."

6.37. NZFGC observes such conduct and harms in the grocery sector.

<u>Commission's chapter 8 summary:</u>

- *Consumers may benefit from private label products through lower prices and greater choice. However, retailers of private label products can face conflicting incentives given they are both customers and competitors of branded suppliers.*
- *While private label products could increase consumer choice and lower prices in the short term, there is a risk that growth of private labels could crowd out supplier branded products. This could lead to a loss of consumer choice and higher prices over the longer term.*
- *The risk of private label products adversely affecting outcomes for consumers is greater when retail competition is not effective. For example, competition could be harmed by retailers giving their private label products preferential shelf space or infringing upon suppliers' intellectual property.*

Private labels

6.38. Private labels (and their sibling 'Controlled Brands' which are quasi-private labels) further entrench the strong buyer power of grocery retailers in New Zealand and accentuate the need for appropriate safeguards. The duopoly retailers' control over the channel to market means that private labels will, for many product categories, tilt the balance of power even further towards supermarkets in the buyer-supplier relationship. As a result, suppliers have reduced incentives to invest and innovate. The NZFGC regularly hears anecdotes from suppliers to evidence that demand for suppliers to provide private label versions of branded products embodying significant intellectual property has a detrimental impact in investing in new products, particularly new varieties of produce. In addition, the lack of competitive constraint at the retail level means that retailers are not constrained to ensure private labels benefit consumers. Private label suppliers are chosen mostly based on price without regard to other important factors like value, quality, supply security or local production.

6.39. From a supplier perspective, retailers are both customer and competitor and from the perspective of the consumer, retailers are both seller and manufacturer. Retailer power at the retail level is extended to the supplier level and intensifies the harm done.

6.40. Retailer self-preferencing private label products in terms of shelf space and position, category saturation (eg bagged lettuce leaves and breadcrumbs) and selective branded product deletions effectively drives out suppliers almost entirely and especially small specialist suppliers. This reduces consumer choice and price competition.

6.41. The draft report identifies the following theories of harm with private labels:

a. Retailers promoting their private labels in preference to supplier brands

b. Lower consumer awareness of suppliers' brands which reduces incentives for suppliers to invest and innovate

c. Retailers leveraging information obtained through private label tenders when negotiating with suppliers.

6.42. NZFGC agrees such practices are harmful, and considers the overall effect to be harmful rather than beneficial in the context of retailer market power. It also submits another theory of harm is retailers copying innovations from data obtained through private label tenders of arrangements, or even directly taking those innovations. For example, there have been occurrences where a supermarket has asked suppliers for ingredient data or information about ingredient sourcing the clear concern being that this is for Private Label products. In two recent cases a supermarket asked the supplier to tender for the provision of a Pams product with the exact volumes being the amount the supplier currently supplies with their branded product.

6.43. The major retailers have access to, and NZFGC is aware of instances where they requested, recipe information from suppliers, allowing them to replicate branded products under a private label and freeride on the supplier's research and development. This makes major retailers 'fast-followers' at lower cost (skipping research and development) but entering direct competition with branded products. Private label is not about research, development and innovation. They rely on copying good ideas from brands and copying them cheaply – being '(very) fast followers'. This is the reason that a rise in private label affirms concern about supplier innovation investment. Having one's brand ceded to private label means the investment in branding, packaging, a new product is lost which is a powerful disincentive not to invest in such activities and once again the key focus becomes price.

6.44. NZFGC is also aware of three recent examples in fresh produce where a new innovation was created, such as a new variety of produce or new packaging being developed, and that after those innovations proved to be successful in the market, a major retailer asked for that innovation to become a private label, in this case Pams. This is extremely harmful to supplier innovation and incentives to innovate as the supplier doesn't receive a full return for the resources they put into investment and research and development and has no reason to engage in future investment and research and development.

6.45. Such action completely negates the consumer's desire to know the provenance of their foods. This practice also occurs regularly in other categories such as the meat chiller (eg Pams packaged fresh chicken). In some cases, the supermarkets are actively opposed to suppliers branding their goods, which denies consumers the ability to connect with producers and genuinely rely on brands for a reliable quality, performance and experience. The desire to prohibit exciting brands of higher quality products with a clear provenance story for consumers is completely at odds with consumer trends that consumers want to connect to farmers, growers and food makers and know where their food really comes from. The preferencing of private labels is at odds with these trends because a consumer will never know who exactly is behind the products being offered and in any case, it will change over time depending on who won the tender.

6.46. Such theories of harm have led to calls for reform in the Big Tech space, where, like in grocery, dominant online platforms are gatekeepers and now also supply to their own platform in a way that is harmful to third-party suppliers. The House Judiciary's digital markets report found *"Amazon functions as a gatekeeper for e-commerce. Amazon is the most-visited website in the world for e-commerce and shopping*"[64] and *"[i]nterviews with sellers, as well as documents that Subcommittee staff reviewed, make clear that*

[64] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 256: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

Amazon has monopoly power over most third-party sellers and many of its suppliers. ... Sellers feel forced to be on Amazon because that is where the buyers are"[65]*.*

6.47. The digital markets report describes the poor treatment third-party sellers received due to the asymmetric power dynamic that closely echoes the poor treatment grocery suppliers have received and recognises:

> "*[b]y virtue of its role as an intermediary in the marketplace, Amazon can give itself favorable treatment relative to competing sellers*"[66]. "*Amazon has control over critical inputs for competing sellers and other types of competitors - including consumer data... that give it the ability to advantage itself over rivals*".[67] It also identified "*[a]nother way that Amazon leverages its market power is to force certain brand manufacturers that would prefer to be third-party sellers into being wholesalers".*[68] *"Armed with* [third-party seller data]*, it appears that Amazon would: (1) copy the product to create a competing private-label product; or (2) identify and source the product directly from the manufacturer to free ride off the seller's efforts, and then cut that seller out of the equation*".[69]

6.48. Similar findings were made regarding Apple and whether it was abusing its ownership of iOS and the App Store to preference its own apps or harm rivals, and Google and Facebook in regards to adjacent or nascent competitive threats. "*When operating in adjacent markets, these platforms compete directly with companies that depend on them to access users, giving rise to a conflict of interest".*[70] These findings led the House Judiciary to recommend reducing conflicts of interest through structural separations and

[65] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 257: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[66] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 282: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[67] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 283: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[68] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 259: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[69] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 275: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[70] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 378: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

line of business restrictions.[71] The House of Representatives Judiciary Committee subsequently approved the American Innovation and Choice Online Bill which looks to prohibit discriminatory conduct by dominant platforms, including prohibiting online platforms from favouring their own products and services.

6.49. The claim that private label product pricing provides a benchmark price to prevent suppliers pricing too high is weakened when retailer buyer power over competitor products means retailers can effectively dictate price to ensure the private label price retains a competitive edge irrespective of efficiency or quality. The opposite, private labels may be setting price floors because may not want competing, strongly branded goods, to be priced below their private labels. There have been regular comments to NZFGC that suppliers have offered better products at potentially lower prices to consumers but have had them rejected because the offering would be to the detriment of the supermarket's Private Label. When this occurs consumers clearly are worse off.

6.50. The Commission identified a low (by global comparisons) penetration of both edible and non-edible private label products in New Zealand. However, the identifiable private label products in New Zealand (noting other supermarket-owned labels would not have been included) are shared by just two major retailers. This compares, for example, with the 8-10 major supermarkets in the UK sharing the UK private label penetration which might translate to an average of around 2-3% each supermarket.

6.51. The Draft report may also understate the extent of private label penetration in New Zealand. Supermarkets also give preference to product labels not readily identified with the recognised private labels called 'controlled brands'. This confounds the choice further and concentrates categories even more. This has been described as follows[72]:

> *"…in the absence of a strong competitive reason, the retailer might be reluctant to pass on any supply price cut and instead pocket the extra margin; meaning that the brand producer loses margin with no guarantee of gaining any compensating additional sales. In other words,* ***no matter how the brand producer adjusts its supply price, the retailer may still want to use the combination of a brand and private label alternative to work in tandem for the purpose of segmenting consumers.*** *In which case, the brand producer might have* ***to accept its sales being limited to quality-conscious consumers and so instead focus on its margin and push up its wholesale price.****"* [emphasis added]

6.52. For example, in the nappies category, Zuru's product Rascal + Friends is a 'controlled brand' for Foodstuffs. Retailer data does not classify controlled brands as private labels, however controlled brands contract directly with Foodstuffs' home brands who essentially outsource manufacturing to, in this example, Zuru. Controlled brands receive preferential treatment by their retailer given the greater margin they create for retailers as they are effectively a private label to the retailer. NZFGC believes growth of Rascal + Friends nappies (produced in China) had a direct impact on the exit of Treasures, one

[71] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary *Investigation of competition in digital markets: Majority staff report and recommendations* (October 2020) at 378: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[72] Dobson PW, Chakraborty R. Assessing brand and private label competition. *European Law Reform.* 2015, 2:36, 76-81.

of the few New Zealand nappy manufacturers with a local factory, to close down. The manufacturer had been in New Zealand 45 years and provided 26 jobs[73].

6.53. The number of products in supermarkets is significant because it appears that a strategy to reduce the number of product (and consumer) choices within categories is being actively pursued with suppliers. While it is possible for the online consumer to find alternative online suppliers for selected products, this requires time and analysis, factors that have a cost to the consumer over potential benefit in a time poor environment. Retailers will typically have greater buyer power for products with fewer alternative channels to market.

6.54. As margins have been continually squeezed by increased costs, supermarket pressure and transfer of risks, the unsustainability of local manufacturers emerges. Not being able to earn a normal profit in the domestic market also means a supplier is unlikely to garner the resources to invest in an export growth strategy. In any case, being driven out of the domestic market by supermarket behaviour and then relying only on export or alternative channels denies the consumer of access to products they might otherwise prefer. It also threatens food security. One of the findings in the UK grocery report[74] includes:

> *"…**transfer of excessive risk and unexpected costs** by grocery retailers to their suppliers through various supply chain practices if unchecked **will have an adverse effect on investment and innovation in the supply chain, and ultimately on consumers**…"* [emphasis added].

6.55. As previously submitted, the New Zealand market structure lends itself to greater manipulation than might otherwise be the case in another market with genuine competition.[75] There are a number of conflicts of interest here:

a. *Retailers get significant inside information from suppliers:* Parties do not normally supply competitors with volume, cost/price and promotional information. As far as we know there are no measures to protect that information from being misused for anti-competitive purposes. There are no genuine or accessible protections of a suppliers' intellectual property.

b. *Price relativities at retail.* Retailers may not want competing, strongly branded goods, to be priced below their private labels and in some cases will reject deals for higher quality product because the branded product would be cheaper for consumers than the retailer's private label. Private labels might then set a price floor and reduce price competition. In reality, supermarkets control pricing for both branded and private label goods, so there is no real price competition in-store[76].

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[73] Tresures nappies shutting down – can't compete with imports. *Stuff*, 27 June 2020. https://www.stuff.co.nz/life-style/parenting/121963349/treasures-nappies-shutting-down-cant-compete-with-imports

[74] UK Commerce Commission. *The supply of groceries in the UK market investigation.* 2008, paragraph 3. https://webarchive.nationalarchives.gov.uk/ukgwa/20140402235418/http:/www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/538.pdf

[75] NZFGC *Comments on submissions on preliminary issues paper* at [4.10] https://comcom.govt.nz/__data/assets/pdf_file/0018/253143/NZFGC-Comments-on-submissions-on-preliminary-issues-paper-12-April-2021.pdf

[76] Institute of European and Cooperative Law, University of Oxford. *Trends in retail competition: private labels, brands and competition policy. Report on the twelfth annual symposium on competition amongst retailers and suppliers.* Oxford University, 10 June 2016. symposium_report_2016.pdf (ox.ac.uk)

Conversely if the private label goods were regarded as better quality, then the then-applicable level of comfort in relation to lower price point private labels the ACCC was able to reach in its 2008 grocery market study would not seem relevant.

c. *Quantitative issues – Retailers become competitors for vital shelf space.* Not only could this impact the viability of suppliers, consumers may miss out on the variety and innovation, particularly as quantities of private label increase. Not only do retailers become competitors, however. They are, at the same time, 'gatekeepers' of that finite shelf space.

d. *There are also concerns about us of know-how and/or intellectual property belonging to the supplier.* Suppliers may unknowingly or unwillingly be forced to effectively gift this information and intellectual property to the major retailers. Suppliers have reported this to NZFGC over the years.

6.56. Further commentary on private labels comes from a McKinsey Report on the growth of private labels through supermarkets imitating national brands, giving themselves premium shelf space, and ensuring that they set the private label retail price at a gap below national label product[77]:

> "*Setting and regularly enforcing price-gapping measures is particularly important for private labels, many of which attract consumers precisely because of perceived value. Ideally, retailers would systematically compare the price of each private-label SKU against internal and competitor benchmarks. Here, too, compliance with established guardrails becomes lax over time, national-brand promotions weaken the private-label value story, and—perhaps most egregiously—brands play at very different price tiers across categories, without clear messaging to support these disparities."*

> *"Although private labels have traditionally relied on price and shelf placement to drive purchase, leading retailers have recently been using cost-effective channels to communicate the story behind their store brands—for instance, how they source ingredients or where the products are made."*

> *"In the past, private-label packaging tended to resemble the look and feel of national-brand equivalents. Leading retailers are now developing brand language on their packaging that not only draws shoppers' attention but also conveys the functional benefits of the brand. A leading private-label player in the value segment has added a prominent callout on its packaging announcing its clean ingredients, differentiating it from other value national brands."*

6.57. Retailers have an interest in continuing to supply other products to provide consumers with a range of goods – but only to a degree. Market distortions can occur because it is the major retailers who have the power to decide how many competitors and which competitors it will allow to compete to maximise the retailers' overall profits, rather than consumer choice deciding which products should prevail and rewarding such products accordingly. Earlier in this submission NZFGC mentioned examples of recent decisions by Foodstuffs North Island to delete brand leaders, that is, the most popular products with consumers based on their purchase decisions. In the context of retailer market

[77] https://www.mckinsey.com/industries/retail/our-insights/turning-private-labels-into-powerhouse-brands

power, the benefits of private label are unlikely to be fully realised and the risk of adverse effects is likely to be greater.

7. COMMENTS ON CHAPTER 9 (RECOMMENDATIONS)

Commission's chapter 9 summary:

- *We have identified a spectrum of options for recommendations that could address the factors that we have identified as adversely affecting competition for the acquisition and supply of retail groceries. This chapter outlines and invites comment on the options we have set out to help us to determine what, if any, recommendations to make as part of our final report.*

Overview

7.1. The Draft report identified a range of possible measures to:

a. **Improve conditions for entry and expansion** including (1) measures to improve wholesale supply of a wide range of groceries at competitive prices; (2) measures to make more sites available for grocery retailing.

b. **Facilitate or create entry by further major grocery retailers directly,** including by government sponsorship or requiring the major grocery retailers to sell some of their stores to create additional major grocery retailers.

c. **Address the power imbalance between major grocery retailers and suppliers** including by a mandatory code of conduct and changes to allow collective bargaining by suppliers.

d. **Improve information provided to consumers** to enable informed decision-making by consumers which enhances retail competition, including by mandatory unit pricing, simplifying promotional practices, loyalty terms and making them more transparent.

7.2. NZFGC supports the broad thrust of these recommendations.

7.3. The recommended fourth measures (**improve information requirements**) must be uncontroversial and adopted in their entirety. They are low-cost, benefit consumers immensely and quickly, and arguably rectify apparent breaches of the Fair Trading Act and/or Privacy Act.

7.4. Similarly, the recommended third measures (**addressing the power imbalance**) must be uncontroversial and low cost as they clearly lead to greater efficiencies.

a. These recommendations were adopted – and strengthened – in both the UK and Australia. The UK code was adopted largely on efficiency grounds despite (at the time) there not being the retail competition concerns.

b. The Code should be independent and binding on the major retailers, consistent with the Australian regime but reflect local realities by: (1) using an adjudicator role like the UK's Grocery Code Adjudicator regime under the UK *Groceries Code Adjudicator Act 2013*; (2) including clear rules about private label, including structural separation of that business to avoid conflicts and other behaviour inconsistent with consumer's best interests); (3) enabling suppliers to require "passthrough" of promotional pricing (legally but not practically possible rights now); and(4) prohibiting MFNs or similar to assist new entrants.

7.5. The first set of measures (**Improve conditions for entry and expansion**) is understandable and to be applauded. It is a necessary but not sufficient condition.

a. We do not see signs of sufficient entry given the challenging conditions of entry, including the necessary scale and scope of entry, likely incumbent response and other strategic behaviour, potential consumer inertia, proliferation of brands.[78]

b. While separation of wholesaling might be sought to facilitate downstream entry, there are concerns that this could lead to double marginalisation and/or even greater market power at the wholesale level without any benefit to consumers (yet with the potential detriment of even greater market power at the wholesale level). One thing is clear, a wholesale market where independents and food service have to regularly purchase at prices higher than buying at the supermarket, is a broken one.

c. Following that logic, the ideal scenario would of course be a third (and perhaps fourth) integrated wholesaler/retailer, which would benefit from the vertical efficiencies but also introduce contestability.

7.6. So, while we encourage reform around reducing barriers to entry, these would remain formidable, and we submit that the only foreseeable way to deliver the consumer benefits which are clearly available must be through the second set of measures (**Facilitate or create entry by further major grocery retailers directly**). There are a range of options to be considered including preventing the separate Foodstuffs entities from continuing their cartel, demergers following brands, enabling individual store owners.

Specific recommendations

7.7. This section briefly summarises our specific recommendations (ie measures that can or should be adopted immediately) and areas for further consideration for recommendation.

Measures directed at improving information provided to consumers

7.8. NZFGC endorses all the measures directed at improving information provided to consumers to enable informed decisions enhanced retail competition, including implementing a mandatory unit pricing regime like that in Australia.

Measures to address the power imbalance and deliver consumer benefits

7.9. On measures to address the power imbalance between major supermarkets, and to deliver the consequent benefits to consumers, the NZFGC **recommends the following**.

a. Implementing a mandatory Grocery Code of Conduct, independently established & administered with strong and accessible dispute resolution processes.

b. Designating the major grocery retailers to be subject to the Code of Conduct under enabling legislation.

c. Harmonising with Australia where appropriate given domestic conditions, although absolutely not on the matter of it being a voluntary Code of Conduct.

d. More efficient, effective, and direct dispute resolution should be adopted. Accordingly New Zealand should adopt an adjudicator role equivalent to that under the UK *Groceries Code Adjudicator Act 2013*.

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[78] See our comments in response to Chapter 6.

e. The Code of Conduct pre-emptively addresses the risks in the New Zealand environment around private labels (and sponsored labels). This should require structural separation of that business to avoid conflicts and other behaviour inconsistent with consumer's best interests. (NZFGC recognises that this may not sit in a Code of Conduct and may be provided for in another statutory instrument.)

f. The Code of Conduct enables suppliers to require "passthrough" of promotional pricing, including setting of maximum resale prices (legally but not practically possible rights now due to the major retailer' duopsony market power). This would provide immediate direct benefits to consumers. Prohibition of the practice of 'investment buying' (purchasing from suppliers at a promotional price struck for the intended benefit of consumers) with no intention of passing on those reductions consumers for at least half of the time (sometimes more) thereby reaping even higher margins.

g. The Code of Conduct prohibits any requirement around MFNs so that new entrants can achieve pricing equal to or better than incumbents, to facilitate new entry.

h. Creating a class authorisation or exemption for supplier collective bargaining.

i. Prohibiting head office negotiated terms of supply being renegotiated at individual retail outlets operating under the same banner, through the major retailers providing enforceable undertakings.

j. Prohibiting the practice of retrospective forensic audits used as a way of extracting further historic payments.

k. Removing the right to take prompt of payments when payments are late.

l. Removing of the right to make ad hoc deductions from payments without the suppliers' approval.

m. Prohibiting deductions not linked to the exchange of genuine services or genuine costs e.g. displays, claims

Measures to improve conditions for entry and expansion
Sites

7.10. NZFGC supports the Draft report's recommendations on resource management and zoning reforms.

7.11. NZFGC also recommends deeming entering into or giving effect to restrictive covenants and lease restraints in respect of which a major grocery retailer is party to (or the beneficiary of) to breach section 28 of the Commerce Act and prima facie in breach of the common law doctrine of restraints of trade (recognising s 7 of the Act) unless authorised by the Commission (perhaps with an expanded scope to permit authorisation on alternate grounds of demonstrated competition benefits at the local and national level).

Measures to improve conditions for entry and expansion
Wholesale access

7.12. NZFGC is mindful of the risks of enhancing market power at the wholesale level without retail competition and potential inefficiencies. The optimal market structure would be three or four full-service, vertically integrated, supermarket chains. Further consideration could be given to facilitating expansion of independent Service sector wholesalers. Following an issue which has arisen during the COVID lockdowns, small independents must be assured certain wholesle supply so that they can serve their customers. Withholding orders or only fulfilling their orders at the discretion of the retail majors places these rural and suburban stores (and the customers they serve) under pressure. The duopoly has a privileged position which comes with responsibilities to maintain supply to other very small independents that currently rely on the retail majors for a wholesale role due to their being cheaper than official wholesalers. Independent dairies are relied on by many consumers who are elderly or not able to access supermarkets easily so limiting supply to these stores during the lockdown is problematic.

Measures to facilitate or create entry by further major grocery retailers directly

7.13. Consider and outline more specific mechanisms and options for creating additional retail competition. For example:

a. A demerger of banners for one or both the two major supermarket chains. Some further ideas on this proposal are in Attachment A.

b. For example, demerging Four Square outlets from FSNI and FSSI to provide a national player with a strong brand as a platform for expansion.

c. Enable New World and PAK'nSAVE franchises to purchase their land and freely negotiate alternate options for branding, collaborating and wholesale supply as they see fit to compete.

d. Demerging Supervalue and Freshchoice franchisees from Countdown (perhaps enabling them to rebrand and guaranteeing wholesale for a short period).

e. Prohibiting Foodstuffs North Island and Foodstuffs South Island from continuing the apparent cartel under which they have agreed not to compete in each other's island and the Commission might consider the role of the collaboration mechanism, Foodstuffs New Zealand, owned by both Foodstuffs North Island and Foodstuffs South Island which regularly meets to align the businesses on various business and lobbying issues.

f. Bringing in lines of business limitations for major grocery retailers (perhaps resulting in divestment / repurposing of Gilmours / Trents, liquor businesses).

g. Limit catchment area and permitted outlets within geographic areas (say 5km) leaving it to the major retaiilers to determine divestments (following the Commission's divestment undertaking guidelines).

Other measures to enhance consumer welfare

7.14. NZFGC also recommends:

a. The Commission should use its enforcement powers to investigate potential breaches of the Fair Trading Act and Commerce Act, and refer any possible Privacy Act breaches to the Office of the Privacy Commissioner.

b. Alternatively, it should be more specific about the risk areas so that they could be efficiently addressed through direct or secondary legislation.

c. Adopting creeping acquisition provisions to ensure that any business acquisitions by by the major retailers are scrutinised and only permitted if they have demonstrable public benefits. Any acquisitions should be void unless authorised.

d. Considering specific predation rules to reduce the risk of strategic barriers to entry (incumbent response). For example, a prohibition on pocket pricing.

e. Lines of business limitations to reduce risk of adverse vertical and conglomerate effects (and crowding out of potential entrants and nascent competition).

7.15. Below we expand on some of our reasoning and identified options.

Draft report's Chapter 9 summary:

- *Finally, we have identified some measures directed at enhancing existing competition at the retail level of the market by improving the ability of consumers to make informed purchasing decisions. These include simplifying promotional pricing, mandatory unit pricing and disclosure of terms and conditions relating to loyalty programmes.*

Recommendations to improve consumer information

7.16. NZFGC agrees consumer are not as well informed as they could be and supports the Draft report's recommendations to improve consumer information. Most of the options for recommendations suggested are non-intrusive, but have clear benefits improving consumer's ability to compare prices and so choosing the best deal, and otherwise improving consumer welfare by introducing a greater degree of transparency.

7.17. NZFGC supports the Commission asking retailers to simplify pricing and promotional mechanisms, improve disclosure of loyalty program terms and conditions and improve practices on explaining to consumers how their personal data is collected, used in loyalty programmes and where around the globe their information might be stored or used. The use and disclosure of issues around data should also be considered further by the Privacy Commissioner who should make binding recommendations.

7.18. Clear product labelling and disclosure to consumers is relatively straightforward to implement and clearly would benefit consumers. The frequency and nature of "sales" arguably already breaches the Fair Trading Act. The most efficient way to address this would be clearer rules from the Commission or a grocery adjudicator.

7.19. NZFGC also supports the introduction of a consumer information standard under the Fair Trading Act that sets requirements relating to grocery retailer pricing displays, and mandate the use of a consistent system for unit pricing. As the Draft report notes, there are benefits in aligning Australian and New Zealand regulatory regimes. Australia has the Australian Unit Pricing Code, which has been found to be *"operating efficiently and effectively in line with its primary objective of empowering consumers to make informed decisions about grocery purchases through greater price transparency".*[79] A similar system could be adopted in New Zealand.

7.20. The introduction of a price comparison website also seems beneficial for consumers. NZFGC supports exploring this option further.

7.21. As a further suggestion, not raised by the Commission, state funding of Consumer NZ's regular supermarket basket research might be considered so that it continues to be able to regularly undertake the collection of this important information for consumers.

[79] https://treasury.gov.au/review/grocery-unit-pricing-code-review

Draft report's Chapter 9 summary:

- *We consider that the imbalance of power between the major grocery retailers and their suppliers could be addressed by a number of measures, including a code of conduct and changes to restrictions against collective bargaining by suppliers.*

Mandatory, independent grocery code of conduct needed

7.22. NZFGC strongly agrees the grocery sector would greatly benefit from a mandatory and independently developed and enforced Code of Conduct**.** The Code of Conduct would be an unintrusive, effective way to address the imbalance of power that exists and give suppliers a set of rules to refer to in day to day interactions with supermarkets. A Code of Conduct will provide greater clarity about what retailers can and cannot demand from suppliers and be a practical tool for day-to-day discussions and immediately rule out some of the more egregious behaviours and tactics that occur from time to time. Importantly it will give clearer processes to deal with supplier concerns and complaints which currently have no genuine process to be dealt with and heard. A mandatory Code of Conduct could provide valuable support at all levels of a supplier's business down to improving the treatment of merchandisers and sales reps at the store level.

Code of Conduct is needed to ensure minimum standards of fair commercial dealing

7.23. New Zealand needs a Code of Conduct to ensure more certain and transparent dealings between grocery retailers and suppliers, so consumers can have faith that the grocery supply chain is efficient and sustainable. The Code of Conduct would set minimum standards of fair commercial dealing between the major supermarkets and suppliers to protect against abuses of power.

7.24. The benefits of a Code of Conduct have been recognised by our peers is much less concentrated markets, including Australia and the United Kingdom, with a proposed code in Canada. Similarly, Japan and Switzerland prohibit misuse of unequal bargaining power.

7.25. The need for a Code of Conduct has long been recognised.

a. **In 2011, Sue Kedgley proposed a Grocery Code of Conduct** citing abuses of horticulture producers and the need for a Code was supported by Horticulture New Zealand[80].

b. **In 2014 Minister of Commerce, Craig Foss proposed the idea of a voluntary code.** This was not supported by NZFGC or the Labour and Green parties as a mandatory code was preferred.[81] Both supermarkets rejected the idea of any code, voluntary or mandatory.

c. **In 2015, Mojo Mathers proposed legislation to set up an independent supermarkets adjudicator and a compulsory code of conduct**. **[82]** She explained:[83]

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[80] https://www.stuff.co.nz/national/5442052/Calls-for-supermarket-code-of-conduct
[81] https://www.rnz.co.nz/news/political/239455/supermarket-code-idea-a-joke-jones
[82] See the bill here: https://www.parliament.nz/en/pb/bills-and-laws/bills-proposed-laws/document/00DBHOH_BILL67672_1/commerce-supermarket-adjudicator-and-code-of-conduct
[83] https://www.parliament.nz/en/pb/hansard-debates/rhr/document/51HansD_20151202_00000040/commerce-supermarket-adjudicator-and-code-of-conduct

> "At present just two big supermarket chains control over 90 percent of the grocery market in New Zealand. This means that small local food suppliers, the people in New Zealand who grow and produce the food that we eat, can struggle to access that market. … there is a very unequal power relationship between the big supermarkets and the local foodstuff producers, who employ people in our regions and make great food. If they want their food to be on the supermarket shelf, it can be very hard to achieve that."

d. The Labour Party shared those concerns and issued a press release on 20 November 2014 announcing they had draft legislation to establish a mandatory Code.[84] They considered a Code should include a penalties regime with an arbitrator that has the power to investigate, publicise and enforce penalties.

e. **In 2020, NZFGC started a petition calling for a mandatory code of conduct.[85]** The petition received 500 signatures.

f. **Retailers already have their own supplier charters**, showing acknowledgement of minimum standards needed regarding retailer-supplier relationships. Unfortunately, the charters are self-enforced with no independent dispute resolution mechanism and so are largely symbolic and seldom used. The supplier community does not view the charters as living documents (particularly within owner-operator supermarkets) providing robust frameworks to deal with business relationships. This can only come from an independent mandatory code across all supermarkets. NZFGC has used the Foodstuffs Partnership Guidelines to raise a series of significant issues, but the results have been lacklustre and not enduring.

7.26. The UK and Australia already have legislated codes of conduct. In Canada, a draft code of conduct has also been submitted for industry and government consultation. Measures to address supermarket buyer power have also been taken in the EU, Ireland, Switzerland and Japan.

7.27. The UK Groceries Supply Code of Practice (**GSCOP**) was introduced in 2008 to limit potential abuses of buying power. It replaced the prior Supermarket Code of Practice which was criticised for being too weak. Key improvements include:

a. The UK GSCOP is a **mandatory** code that binds retailers with a turnover greater than £1B or those specifically named.

b. An **independent adjudicator**, the Groceries Code Adjudicator, was set up to enforce the UK GSCOP. It is wholly funded by a levy on retailers. The Groceries Code Adjudicator has the power to impose fines of up to 1% of annual turnover on the regulated retailers to create an effective deterrent to retailers breaching the code.[86] Earlier this year it launched "Tell the GCA", a confidential reporting platform, to encourage suppliers to share their concerns. The Groceries Code Adjudicator is subject to a statutory review every 3 years to measure the Groceries Code Adjudicator's performance and effectiveness.

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[84] https://www.scoop.co.nz/stories/PA1411/S00249/mandatory-code-of-conduct-needed-for-supermarkets.htm

[85] https://www.parliament.nz/en/pb/petitions/document/PET_102583/petition-of-katherine-rich-grocery-code-of-conduct-for

[86] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901016/gca-report.pdf

7.28. The Australian Food and Grocery Code (**Australian Code**) was introduced in 2015 to improve standards of business conduct in the retail grocery sector "*in response to community concerns that the major retailers were mistreating their suppliers*".[87] The Australian Code is voluntary but all major retailers have now agreed to sign up to the code. It is enforced by the Australian Competition and Consumer Commission (**ACCC**) which can seek court-imposed injunctions or accept administrative undertakings to remedy wrongdoing. The latest review of the Australian Code led to amendments in 2020 to provide:

a. **greater clarity** on retailers' obligation of good faith.

b. **stricter prohibitions** against retrospective and unilateral variations and new rules around price rise processes.

c. **improved dispute resolution processes**, including appointing an independent reviewer to ensure these processes are conduct independently and without bias.

7.29. Reports from our sister organisation, the Australian Food and Grocery Council (**AFGC**) and members who have worked in the Australian and British markets under the Australian Code report that it made a significant difference in terms of stopping more egregious behaviour.

7.30. The draft Canadian code is inspired by the UK GSCOP. It "aims to stabilize relations between retailers and suppliers by calling for fair and efficient handling of all negotiations and commercial agreements".[88]

Code to prohibit unacceptable commercial conduct – must be mandatory, independent and enforceable

7.31. It must be **mandatory** for major retailers to be bound by the Code of Conduct. Unlike the Australian Code which was introduced on a voluntary basis and negotiated between the AFGC, Coles and Woolworths, the NZFGC does not have the resources or ability to conduct this with any hope of a strong and binding Code of Conduct. The Commission or MBIE must hold the pen and engage with stakeholders. Leaving it to the supermarkets will result in a weak Code of Conduct and the status quo.

7.32. NZFGC supports a Code of Conduct that creates obligations on the major retailers similar to those in the UK GSCOP and Australian Code, tailored to the New Zealand market as appropriate. Key obligations needed include:

a. **An overarching obligation to act in good faith.** The concept of good faith and how it is breached must be set out clearly in the Code of Conduct. The Australian Code has recently been strengthened to ensure that the spirit of the code remains paramount so retailers do not use pedantic interpretations to find loopholes.

b. Requirements **regarding the form and content of grocery supply agreements,** including that they must be in writing and must cover basic terms clearly, for example the quantity and quality of products supplied.

c. **Duties in relation to delisting,** including that genuine commercial reasons and reasonable notice must be given to de-list a supplier.

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[87] Independent Review of the Food and Grocery Code of Conduct (September 2018) at page 16.
[88] https://www.fhcp.ca/Industry-Resources/News/View/ArticleId/545

d. **Prohibitions against unilateral or retrospective variations of agreements**.

e. **Prohibitions against unconsented off-sets** against a supplier's invoice.

f. **Prohibitions against requiring suppliers to pay for** shrinkage, wastage, better positioning or other costs that are rightfully part of the retailer's business.

g. **Prohibitions against demands for** significant quantities of free product, percentage payments that are not linked to specific services (eg percentage display payments but no displays), prompt payment discounts taken when payments are late, outdated settlement deductions for the privilege of being paid by retailers.

h. **Prohibitions against forcing suppliers to purchase or use retailers' services.** For example purchasing data reports, retailer transport or retailer warehousing.

i. **Prohibitions against overordering at promotional prices** and then failing to pass on that promotional discount to consumers.

7.33. To be effective, the highest priority in a must be independent dispute resolution. An independent adjudicator is vital. This was the most significant amendment in the recent amendments of the Australian Code and, similarly, was the area strengthened in the UK GSCOP. A New Zealand Code of Conduct must have the following elements:

a. **An independent adjudicator** to enforce the Code of Conduct, for example the Commerce Commission or a sufficiently funded grocery adjudicator body. The Commerce Commission already has a Telco Commissioner. We support a Supermarket Commissioner with the powers to receive complaints, undertake investigations and proactively review the state of competition and pricing in the New Zealand grocery market.

b. **Easily accessible dispute resolution processes** for suppliers who may have less resources to defend themselves than retailers.

c. **Meaningful consequences for breach**, such as significant pecuniary penalties proportionate to the entity's turnover, any commercial gain and the severity of the conduct.

d. **Inability to be contracted out of** given that one of the concerns is whether contracts are negotiated fairly in the first place. For example, a recent standard term retailer supply contract had exit provisions for the retailer, but no exit provisions for the supplier.

e. **Compliance obligations** which require retailers to implement compliance programs and educate and inform staff about Code obligations, particularly at store level.

f. **Review processes** which monitor whether the Code of Conduct is effective and which facilitates any improvements needed.

7.34. NZFGC would like to work with the Commission and stakeholders in the industry to help create a fair and effective Code of Conduct that is fit for purpose for the New Zealand grocery sector. It is imperative that the Commission holds the pen. Leaving the development of a Code of Conduct in the hands of a voluntary industry group will see the views of NZFGC, suppliers, ConsumerNZ and small independent retailers overwhelmed and diluted by the well-resourced duopoly and their legal teams.

Code of Conduct will benefit suppliers, consumers and the economy

7.35. The Code will foster a healthier grocery sector that has greater transparency and clarity, cutting out inefficiencies arising from uncertainty and distorted incentives from suboptimal risk allocation. It will achieve outcomes that are normally expected in other industries that do not have such an imbalance of power.

7.36. Retailers will know the standard of conduct expected of them and supermarket owners with good practices would not be disadvantaged by the ones with poor practices because everyone would be working to the same rules. Suppliers will be protected from unacceptable conduct enabling them to make long term plans on how to improve their products and processes and collaborate constructively with retailers. We are confident that a Code will improve behaviour at the top and specifically for store merchandisers, lower paid frontline workers who complain about bullying and abuse.

7.37. Reviews of the Australian Code and UK Grocery Code Adjudicator show that a Code of Conduct is beneficial in practice.

PRACTICAL BENEFITS	LATEST AUS CODE REVIEW	LATEST UK GROCERY CODE ADJUDICATOR REVIEW
Effective	*The broad feedback from stakeholders is that the Australian Code has contributed to a significant improvement in retailer-supplier relations over the last three years.*[89]	*The Grocery Code Adjudicator had made a difference within its current legislative framework in ensuring fairness between large retailers and their suppliers.*[90]
Healthy commercial relationships	*Suppliers have reported significantly less issues with retailer practices that previously troubled the industry*[91]	*The existence of the Grocery Code Adjudicator had sent a message to large retailers that their supplier relationships needed to be conducted fairly and in accordance with the UK GSCOP*[92]
Healthy and collaborative culture	*It has helped drive cultural change within these organisations*[93]	*Most respondents to the Review reported evidence of a strong culture of collaboration between large retailers and their suppliers and that the Grocery Code Adjudicator has made large retailers more accountable and more open in their dealings with their suppliers.*[94]
Deter unfair conduct	*The signatories have taken their compliance with the Australian Code seriously and this is due largely to the ACCC's role as the regulator.*[95]	*All respondents to the Review considered the current permitted maximum fine to be an effective deterrent to retailers breaching the UK GSCOP.*[96]

[89] Independent Review of the Food and Grocery Code of Conduct (September 2018) at page 16.
[90] Statutory Review of the Groceries Code Adjudicator 2016-2019 at paragraph 11.
[91] Independent Review of the Food and Grocery Code of Conduct (September 2018) at page 16.
[92] Statutory Review of the Groceries Code Adjudicator 2016-2019 at paragraph 55.
[93] Independent Review of the Food and Grocery Code of Conduct (September 2018) at page 1.
[94] Statutory Review of the Groceries Code Adjudicator 2016-2019 at paragraph 7.
[95] Independent Review of the Food and Grocery Code of Conduct (September 2018) at page 47.
[96] Statutory Review of the Groceries Code Adjudicator 2016-2019 at page 8.

PRACTICAL BENEFITS	LATEST AUS CODE REVIEW	LATEST UK GROCERY CODE ADJUDICATOR REVIEW
Support new entry	*ALDI has grown rapidly over the past three years and is a major source of competitive pressure. … Of the other retailers, Costco and Amazon continue to grow, with intentions to increase presence in Australia*[97]	
No negative impact on consumer prices	*There has been a considerable effort from both Coles and Woolworths to substantially reduce prices and promote everyday low prices, such as Coles' 'Down Down' or Woolworths' 'Prices Dropped'*[98]	*Large retailers, most suppliers and other parties in the grocery supply chain reported that the Grocery Code Adjudicator has created a more level playing field and it had not limited the ability of the UK's groceries retailers to compete and provide a good consumer offer.*[99]

7.38. The Code of Conduct is an unobjectionable, unobtrusive way of just ensuring normal commercial dealings. It has little downside and potentially significant upsides.

7.39. NZFGC also supports the Commission having a generic power to adopt and enforce industry codes, like Part IVB of Australia's *Competition and Consumer Law Act 2010*. This is a discrete issue. The case for a grocery Code of Conduct is clear. NZFGC can also see broader benefits of a generic code regime, (that could apply to other duopolies or highly concentrated markets where there is similar distortion and poor treatment). One thing to be careful about, however, is the level of penalties that would be available under a generic scheme, as without strong penalty deterrents generic codes may not be effective.

Collective bargaining

7.40. There are currently significant legal risks in suppliers jointly negotiating with retailers given this may be a sensitive area for cartel law. NZFGC supports introducing a class authorisation or statutory exception for collective bargaining by grocery suppliers to grocery retailers.

7.41. Australia has a class authorisation for small businesses to collectively negotiate supply contract with their suppliers without seeking ACCC approval. It was implemented through an ACCC power to make class exemptions for conduct that it is satisfied is unlikely to substantially lessen competition or is likely to result in a net public benefit. The collective bargaining authorisation could similarly be implemented by a Commission power to designate class exemptions.

7.42. The ACCC considered "When they bargain collectively, businesses can share the time and cost of negotiating contracts, and have more say when negotiating." While collective bargaining by small businesses does not generally harm competition, when competitors

[97] Independent Review of the Food and Grocery Code of Conduct (September 2018) at page 11.
[98] Independent Review of the Food and Grocery Code of Conduct (September 2018) at page 10.
[99] Statutory Review of the Groceries Code Adjudicator 2016-2019 at paragraph 8.

act together they require some form of exemption to avoid the risk of breaching competition laws."[100]

Requiring head office negotiated terms to prevail across outlets

7.43. NZFGC is aware that suppliers negotiate product supply with each of the head offices of Foodstuffs North Island and Foodstuffs South Island. Suppliers are then often required to renegotiate with individual retail outlets under the same banner as the head offices. This adds transaction costs and extends the buyer power significantly. Head office negotiated and agreed terms should prevail across individual stores that are part of the cooperative. Negotiating at head office and then again at store level simply to get the store to comply with head office is inefficient and predatory. This behaviour has nothing to do with lower prices for consumers, as whatever additional payments or free product gamed at the store level contributes to the stores margin only.

7.44. An intervention to prevent head office negotiated terms of supply being renegotiated by every retail outlet operating under the same banner would contribute to addressing at least in part, the buyer power exercised by Foodstuffs. The Commission should recommend the retailers give an enforceable undertaking to the Commission that individual stores will not renegotiate terms already agreed to by their head office.

7.45. This obligation can also be added to the Code of Conduct, however this would be in addition to the enforceable undertaking. NZFGC considers a binding commitment from the major retailers to the Commission is needed to remove any doubt and to place enforcement power directly in the hands of the Commission rather than through an adjudicator.

Using enforcement powers against potential breaches of the Commerce Act, Fair Trading Act and Privacy Act

7.46. The Draft report identifies several areas which risk breach of the Commerce Act, Fair Trading Act and Privacy Act. NZFGC encourages the Commission to investigate these potential breaches and to take enforcement action as appropriate. In particular:

a. whether restrictive covenants and exclusivity covenants in leases restricting the use of land by competing retailers are in breach of section 28 of the Commerce Act.

b. whether supermarket pricing practices are misleading in breach of the Fair Trading Act.

c. whether supermarket loyalty programme and data collection practices are false or misleading in breach of the Fair Trading Act, or in breach of the Privacy Act (or referring the latter to the Office of the Privacy Commissioner to investigate).

d. whether best price clauses and exclusivity clauses in supply contracts breach section 27 of the Commerce Act.

7.47. NZFGC also recommends the Commission investigates whether agreements between Foodstuffs North Island and Foodstuffs South Island are illegal cartel arrangements.

[100] ACCC media release *Collective bargaining by small business facilitated by class exemption* (3 June 2021): https://www.accc.gov.au/media-release/collective-bargaining-by-small-business-facilitated-by-class-exemption

Recommendations to address private label concerns

7.48. As set out in our comments to Chapter 8, NZFGC considers there are significant concerns over private labels that the final report should recommend solutions for or implement safeguards to protect against.

7.49. Consistent with paragraph 9.126 of the Draft report, the clear conflicts of interest and potential harms from private-label should be addressed in the Code (or elsewhere).

7.50. The rules around private labels should recognise (1) the clear conflicts of interest between a supermarket acting as a market place and then competing with other participants (2) that this incentivises retailers to price branded goods higher as private label products will generally be seen as lower value (3) that there is limited shelf space available.

7.51. Accordingly there must be clear rules that prevent retailers from discriminating against other marketplace participants and misusing them as suppliers (forcing them to supply white label / house brand products) or their intellectual property. In the event that a supermarket has taken on the wholesaling role for other independent small dairies and convenience stores, it should not be arbitrarily be able to cut off that supply or only fulfil orders at the supermarket's discretion. As mentioned earlier, many dairies are in rural and suburban and are relied upon by many New Zealanders e.g. the elderly, those without transport etc, who may not be able to get to a supermarket for every purchase. Reducing supply during the latest (August 2021) COVID lockdown has had a detrimental effect of putting some dairies and the customers they serve under significant pressure.

7.52. There must also be rules preventing confidential information from suppliers which would not ordinarily be provided to competitors, (as this also raises cartel concerns). Given the evidential and other difficulties with this, NZFGC submits that there must be structural separation of the private label brands and that the onus must be on the major retailers to demonstrate they are treating private label products and competing products on the same basis. Exceptions may be provided where the major retailer is able to produce evidence justifying supplying private label products because it is more efficient or there is clear consumer demand. Private label managers or others in the supermarkets should not be able to ask suppliers to share intellectual property information, product recipes, ingredient sourcing information, details for packaging suppliers etc.

7.53. To avoid the issues of private-label products (which are often perceived to be "budget" alternatives) setting price floors, suppliers must be enabled to specify and enforce maximum resale prices. This has not been able to occur due to the lack of countervailing bargaining power and the retailers' incentives to promote their own products in competition. ***This would provide an overwhelming and direct consumer benefit by ensuring pass through of price reductions.*** Likewise retailers should have to consider products which potentially are cheaper and better or equivalent quality for consumers even though the offering is cheaper than the retailer's private label. Declining cheaper products to protect the retailer's more expensive private label harms consumers.

Draft Report's Chapter 9 summary:

- *We consider that the best options for improving competition are likely to be those that enable an increase in the number of firms competing in the retail grocery market. In the long term, threatened and actual entry or expansion is likely to be the greatest driver of competition in grocery markets.*
- *The first way this could occur is through measures to improve the conditions for entry by new grocery retailers and expansion by existing retailers. These include measures to*

improve access to a wide range of wholesale groceries at competitive prices, and measures to make sites for grocery retailing more readily available through possible changes to planning laws and restrictions on the use of restrictive covenants.

- *The second way this could occur is through measures to facilitate or create entry by further major grocery retailers. These could include direct facilitation of entry by the Government or divestment by the major grocery wholesalers of existing assets to create additional market participant(s).*

Recommendations to facilitate retail entry

7.54. NZFGC agrees greater contestability is needed at the retail level and that this is unlikely to occur without intervention. It also agrees great caution is needed not to create a wholesaler with even greater market power, or to inadvertently enhance the market power of the major retailers by further aggregating demand to their wholesale channels. However, it is important to emphasise that any wholesaler must be competitive. The New Zealand wholesale market will remain broken as long as it is considerably more expensive to source goods from a wholesaler than it is to source products at a supermarket. Given that Trents and Gilmores are part of Foodstuffs, at a minimum there is an opportunity to restructure the wholesaling part of the cooperatives to ensure that they are genuine wholesalers offering competitive pricing. When a dairy's buy price from a wholesaler is much higher than the retail price in a supermarket, the weakness of this part of the New Zealand market is clear.

7.55. Given these concerns, NZFGC considers the best outcome would be if there were a third (and maybe fourth) full-scale independent, vertically integrated retailer to stimulate competition. Removal of barriers to entry such as restrictive supply terms, and lack of land availability, seems to be an appropriate response to facilitate such entry. If these measures were not effective, more direct measures would need to be considered.

Measures to improve conditions for entry and expansion – site availability

7.56. The lack of site availability contributes to barriers to entry through several mechanisms: restricted access, covenants and exclusivity, zoning and resource consenting.

Planning regulations and zoning

7.57. NZFGC understands that the supermarkets will disagree with the Commission comments on land reform and state that they have collaborated around these reforms. While this is beyond the scope of our expertise, that collaboration of course has been in the context of a duopoly where there may have been mutual benefit. This also seems inconsistent with the land banking and other measures outlined by the Commission.

7.58. In relation to zoning, advice from Government to Councils around factors to consider in zoning aimed at increasing competition and benefiting consumers would increase consistency of decision making and potentially increase site availability.

Restrictive and exclusivity covenants and land banking

7.59. NZFGC is of the view that, as has been done in other jurisdictions, restrictions and covenants for supermarkets should be prohibited. We note that in addition to the issues raised under section 28 of the Commerce Act the common law doctrine of the restraint of trade also applies under which such restraints are prima facie unenforceable.

7.60. However there are enforcement costs and risks. Further it may be hard to demonstrate anti-competitive harms in relation to one individual site, conversely because each supermarket or site may fall within different geographic markets, it may be hard to demonstrate their individual anti-competitive effect even though the cumulative effect as a barrier to entry is clear.

7.61. NZFGC considers that there are several relatively easy and low-cost measures to improve land availability.

a. Most obviously these provisions (whether restrictive covenants or restraints and leases) could be deemed anti-competitive under the Commerce Act unless cleared or authorised by the Commission. This would ensure visibility but enable legitimate matters to proceed. This should not necessitate significant process. Variants could include notification or similar regimes but given the clear overall harm it should be up to the party seeking to apply such provisions to demonstrate their benefits.

b. With regard to the existing land banking type arrangements, there could be a window (say 12-18 months) for parties to seek clearance or authorisation for continued "giving effect" to those provisions. There could be a presumption that if this was not forthcoming then the relevant covenant or restraint would be deemed ineffective. As the Commission has implied, this is an area which could be remedied easily by the supermarkets now.

Measures to improve conditions for entry and expansion – wholesale access

7.62. We applaud the Commission for raising the issues around wholesale access. We see how this may facilitate downstream retail entry. We recognise that this and the other measures may still not be sufficient to encourage entry or expansion at the levels necessary to represent a true competitive constraint.

a. We would not favour any measures that further exacerbated the market power imbalances and consequent harms. For this reason, we could have concerns about the ability to piggyback or open access regimes in relation to the existing wholesalers. Any such regime would need to be short-term in duration and could not be used as a mechanism to further depress supply prices.

b. While one or more independent wholesalers may have some attraction, our concern is that this could further depress prices on the upstream "by side" exacerbating existing distortions, ie the harm of even greater buyer-power, without any benefit to consumers.

c. While an independent third wholesaler might be seen as facilitating entry for a downstream retailer, there is a risk it would simply lead to greater pressure to have the same supply terms (with possible inefficiencies) without consequent benefits. Particularly given the "chicken and egg" problem that there may be no downstream demand.

Facilitating the expansion of Service sector wholesalers

7.63. In addition to the wholesaler options presented by the Commission, we note that the feasibility of assisting the foodservices wholesalers was not explored. A brief description of the reasons these wholesalers were not in the wholesale to retail market were provided[101], but there was no discussion of what might incentivise them to supply to that market. Incentives might include direct government assistance or other interventions by way of inducement.

[101] Draft report at [6.133]

Measures to facilitate or create entry by further major grocery retailers directly, including by government sponsorship or requiring the major grocery retailers to sell some of their stores to create additional major grocery retailers.

7.64. NZFGC considers that the optimal market structure would be three or four full-service, vertically integrated, supermarket chains.

7.65. Government sponsorship is an interesting concept. There are a variety of ways this can occur. For example near entrants such as The Warehouse Ltd or others with a nationwide footprint (eg service station chains). But we have concerns that near entrants or even new entrants will be unable to overcome the considerable barriers to entry/expansion, despite the potential profitability. As noted the scale required and incumbent response would be significant. Further, they may simply focus on the more profitable segments without being a full service provider.

7.66. For that reason, a demerger and/or creating independence of locally owned stores could be an option. As noted, we recommend that the Commission consider and outline more specific mechanisms and options for creating additional retail competition. For example:

a. Demerging Four Square outlets from Foodstuffs North Island and Foodstuffs South Island to provide a national player with a strong brand as a platform for expansion.

b. Enabling New World and PAK'nSAVE franchises to purchase their land and freely negotiate alternate options for branding and wholesale supply.

c. Demerging Supervalue and Freshchoice franchisees from Countdown (perhaps enabling them to rebrand and guaranteeing wholesale for a short period).

d. Prohibiting Foodstuffs North Island and Foodstuffs South Island from continuing the apparent cartel under which they have agreed not to compete in each other's island. The Commission might also review the level of coordination through Foodstuffs New Zealand in key business areas

e. Bringing in lines of business limitations for major grocery retailers (perhaps resulting in divestment/repurposing of Gilmours/Trents, liquor businesses).

f. Limit catchment area and permitted outlets within geographic areas (say 5km) leaving it to the majors to determine divestments (following the Commission's divestment undertaking guidelines

7.67. An effective separation of Foodstuffs North Island and Foodstuffs South Island (and also dissolution of Foodstuffs New Zealand) would be one where each entity maintained its own central office with no cross data sharing at all and operating independently under the shared banners. This would introduce a genuine third retailer but would not constrain their activities to any particular geographic region after a settling in period.

7.68. Separation of Four Square outlets from Foodstuffs North Island and Foodstuffs South Island as a standalone network could also be effective. In both cases, though the retail shop formats are smaller than New Worlds or PAK'nSAVE's, there are a substantial number of outlets under both Foodstuffs North Island and Foodstuffs South Island (167 in Foodstuffs North Island compared to 145 New Worlds or PAK'nSAVE's and 62 in Foodstuffs South Island compared to 158 other outlets under the Foodstuffs South Island control).[102] Similar consideration could be given to separating other banners into separate networks. This would require consideration of wholesale arrangements and distribution but would introduce a third (or fourth) retailer.

Conclusion

7.69. NZFGC appreciates the Commission's breadth and depth of work in the grocery study draft report. As noted at the outset, NZFGC largely agrees with the conclusions and recommendations in the draft report. We have commented on a number of these in our comments on chapter 9, notably: creating a class authorisation or exemption for supplier collective bargaining, prohibiting head office negotiated terms of supply being renegotiated by every retail outlet operating under the same banner, private label remedies, facilitating greater contestability at the retail level through horizontal retailer separation and facilitating the expansion of service sector wholesalers and improving consumer information. Each and every store must be covered by a mandatory Grocery Code which would make clear requirements for transparent business relationships and in particular, appropriate business conduct and treatment of suppliers.

7.70. There are other areas we have suggested that might be examined further including horizontal separation, a prohibition on restrictive and exclusivity covenants, horizontal separation and independent wholesale supply to the benefit of suppliers and consumers.

7.71. Most significantly, however, we come back to the fundamental necessity of having a mandatory, robust and detailed mandatory New Zealand Grocery Code of Conduct that sets out parameters of negotiation and the processes that must be adhered to, in the course of negotiations. We recognise that New Zealand has the opportunity to draw on the best elements from similar codes in other jurisdictions that are already working well so that our starting point is effective and delivers immediately on redressing the power balance in the retailer supplier relationship. We also note that should some categories of products be so different (such as short shelf life) there may need to be special arrangements in place for these within the Code.

7.72. In going forward, and recognising that a 'post-Covid' environment may be some years away, the recommendations need to be considered against a future environment. This may be one where food security for New Zealand's consumers together with supplier resilience and survival must be paramount for economic, social and environmental wellbeing. Lockdowns in their present form continue to cement the duopoly and the dependence of consumers, suppliers and small independent retailers on them and allow the supermarkets to continue to generate super-normal returns.

7.73. We strongly advocate for no delays in proceeding either by the Commission or the Government. Just as Foodstuffs North Island has doggedly pursued its new business model to significantly increase margins and supplier costs while consolidating categories while reduce consumer choice throughout the whole Covid experience, adding enormously to supplier pressures at a time of considerable stress, the future of the grocery sector to address competition must be pursued vigorously and with speed. Our submission lays out changes that can be made in the short, medium and long term for the benefit of consumers, suppliers, independent retailers and also the supermarkets themselves.

[102] Draft report at [2.19]

Attachment A

How government might 'encourage' a divestment/demerger

0. Stephen Joyce undertook this with the USB where Telecom had to put the demerger in place to be able to take part so that was more of an incentive: http://media.nzherald.co.nz/webcontent/document/pdf/201131/struc%20sep%20details.pdf

1. There are a couple of pressure points that could encourage the supermarkets to split:

   a. Government statement that they are considering assisting entry or entering in some form (akin to the ladder of investment in telco; perhaps any assistance or offering a government entity with a network).

   b. Perhaps a "windfall" tax on supermarkets. The UK implemented this on banks a number of years back. This could be backward looking so that it could not be passed on to consumers as a penalty.

   c. Implementing a 'licensing' regime to operate grocery and putting in place a number of obligations.

2. Other options:

   a. Similar to what we have suggested in some of the remedies: preventing existing supermarkets from owning more or removing existing restraints and allowing some of the current supermarket operators to own more than one to build their own mini empires.

   b. This could be similar to the way that the franchisees in fuel (who are stuck with their supplier) are protected. The challenge here is that it is profitable at the moment but this profit might be threatened

   c. Limiting retail supermarkets to lines of business which could be part of a supermarket licensing regime eg prevent cross ownership of liquor businesses (Foodstuffs appears to own over 100) see https://www.kwm.com/en/au/knowledge/insights/whats-the-deal-with-merger-reform-20210823.