

# THE NZCC MARKET STUDY INTO RETAIL GROCERY



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The New Zealand Commerce Commission is currently undertaking its market study into the retail groceries sector. New Zealand has one of the most concentrated retail grocery sectors in the world with only two major grocery retailers. In this article we share observations on how New Zealand got to this situation and possible outcomes.

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# I. INTRODUCTION

The New Zealand Commerce Commission (“NZCC”) is currently undertaking its market study into the retail groceries sector.<sup>2</sup> This is the NZCC’s second market (competition) study. It was initiated by the Minister of Commerce and Consumer Affairs,<sup>3</sup> citing reasons that “*New Zealand has one of the most concentrated grocery retail sectors in the world*”<sup>4</sup> and “[t]he market is of strategic importance to the New Zealand economy.”<sup>5</sup> The Government’s press release describes the purpose of the market study as to “*ensure New Zealanders are paying a fair price for groceries*” and “*make sure we’re not paying more than we should during the weekly shop.*”<sup>6</sup>

The final report is due to be released on March 8, 2022.<sup>7</sup> A draft report is currently being consulted on which has a preliminary finding that competition is not working well for consumers or suppliers. The draft report identifies a range of possible recommendations from a code of conduct and voluntary changes to structural separation or divestment.

We are acting for New Zealand Food and Grocery Council Incorporated (NZFGC), an industry body which represents New Zealand’s food and grocery suppliers. In this article we comment on:

- Why the NZ retail grocery sector is concentrated and how it got that way
- The types of behavior suppliers say they have experienced due to the imbalance of power
- How market boundaries should be defined and identifying competitors, including how consumer shopping behaviors factor into this
- Theories of harm regarding private labels, which makes supermarket customers and competitors
- The range of possible remedies identified by the NZCC

# II. THE NEW ZEALAND RETAIL GROCERY SECTOR

New Zealand has two major grocery retailers: Woolworths NZ Limited (“Woolworths”) and Foodstuffs Group (“Foodstuffs”). Woolworths is owned by major Australasian company Woolworths Group, while Foodstuffs consists of two co-operative groups, Foodstuffs North Island (“FSNI”) and Foodstuffs South Island (“FSSI”). Between them they operate over 500 stores nationwide under numerous brands such as Countdown, Pak’n’Save, Fresh Choice, Super Value, New World, Four Square and Raeward Fresh. The New Zealand grocery market is estimated to be worth in the order of NZ\$22 billion per annum.<sup>8</sup>

The draft report considered Woolworths and Foodstuffs appear to have a high combined estimated share nationally, finding “*most estimates ranged from 80% to 90% and the lowest estimates of their combined market share were from 70% to 80%.*”<sup>9</sup> Both retailers are also vertically integrated (into wholesale and private label). New Zealand does not have any other independent wholesalers of a full range of groceries.<sup>10</sup>

2 The progress of the study can be followed on the NZCC’s web page: <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector>.

3 “Notice for a Competition Study into the Retail Grocery Sector” (November 17, 2020) *New Zealand Gazette No 2020-go5278* available at <https://gazette.govt.nz/notice/id/2020-go5278>.

4 “Cabinet paper: Initiating a Commerce Commission market study into supermarkets” (November 13, 2020) Office of the Minister of Commerce and Consumer Affairs at [18.1] available at <https://www.mbie.govt.nz/dmsdocument/12272-initiating-a-commerce-commission-market-study-into-supermarkets-proactiverelease-pdf>.

5 “Cabinet paper: Initiating a Commerce Commission market study into supermarkets” (November 13, 2020) Office of the Minister of Commerce and Consumer Affairs at [18.2] available at <https://www.mbie.govt.nz/dmsdocument/12272-initiating-a-commerce-commission-market-study-into-supermarkets-proactiverelease-pdf>.

6 New Zealand Government media release “Supermarkets announced as Government’s second market study” (November 17, 2020) available at <https://www.beehive.govt.nz/release/supermarkets-announced-government%E2%80%99s-second-market-study>.

7 “Notice Amending the Public Release Date for the Final Report for the Competition Study into the Retail Grocery Sector” (September 24, 2021) *New Zealand Gazette No 2021-go4155* available at <https://gazette.govt.nz/notice/id/2021-go4155>.

8 See Draft report at [2.4] (“*In the year to December 2020, more than \$22 billion was spent at supermarkets and grocery stores.*”).

9 New Zealand Commerce Commission “Market study into the retail grocery sector: Draft report” (July 29, 2021) [“*Draft report*”] at [5.92] available at [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0025/260377/Market-study-into-the-retail-grocery-sector-Draft-report-29-July-2021.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0025/260377/Market-study-into-the-retail-grocery-sector-Draft-report-29-July-2021.pdf).

10 Draft report at [6.128].

So how did New Zealand get to this high level of concentration?

New Zealand previously had a number of grocery retailers that over time consolidated to three major grocery retailers, which may not be unusual in a small jurisdiction. However Progressive Enterprises Limited (“Progressive”) acquired Woolworths (New Zealand) Limited in 2002. At that time, the test for anticompetitive mergers was being changed from a “dominance” test (a very high level of market power equating to neo-monopoly) to the more orthodox “substantial lessening of competition” (“SLC”) test.

Progressive lodged its clearance application to acquire Woolworths the day before the test was changed in 2001. The NZCC granted clearance under the more permissive “dominance” threshold. Foodstuffs challenged the clearance, arguing that Progressive’s application should have been determined under the new “SLC” test because the Commission decision would occur when the new test came into effect. There were, unfortunately, no transitional provisions Foodstuffs failed in the High Court but succeeded in the Court of Appeal.

Progressive lodged a fresh clearance application. The NZCC declined clearance under the new SLC test. In the meantime, the Court of Appeal’s decision was appealed to the Privy Council and the government passed legislation that clarified the dominance test applied to clearance applications (not determinations) made before the change in test – except Progressive’s. Subsequently, the Privy Council (then NZ’s highest Court of Appeal) held the NZCC was correct to consider the application under the old dominance test.<sup>11</sup>

The ultimate effect was that Progressive was allowed to acquire Woolworths in a 3:2 merger that the antitrust regulator had determined had the actual or likely effect of substantially lessening competition in relevant markets. Progressive was subsequently acquired by Woolworths Australia in 2005 and changed its name to Woolworths in 2018, leading us to the present-day duopoly. (There may be an argument that Woolworths Australia might have been the most likely market entrant, but we are not aware this was ever tested.)

Interestingly subsequently in 2007 a general merchandiser, The Warehouse Group Limited (“TWL”), made tentative steps into grocery. Both supermarket chains took a 10% stake in TWL and sought clearance to acquire more. The NZCC declined these proposed acquisitions, overturned by the High Court, but supported by the Court of Appeal. Ultimately TWL, did not advance beyond a nascent competitor.

### III. BUYER POWER – ALLEGED HARMS

Suppliers have argued that the retail concentration means the two major retailers have duopsony power. NZFGC has submitted that suppliers cannot afford to lose even just one of the major retailers, as there is no meaningful alternative for those lost sales. The lack of alternative channels and imbalance in bargaining power is said to enable the major retailers to engage in harmful procurement practices.

Examples submitted by NZFGC include shifting risks and costs to suppliers (for example by requiring the supplier to cover costs of theft), requiring fees and payments from suppliers (for example display payments), bundling services (for example requiring suppliers to also use that retailer’s own transportation services or requiring suppliers to buy retail data collected by the major retailers), retrospective variations to favor the retailer, threats of product deletion, unreasonably delaying or reducing payments, and demanding perks or free product as condition to stocking the supplier’s product.<sup>12</sup>

FSNI has responded to these claims.<sup>13</sup> It submits “*relationships between FSNI and its suppliers are valuable and generally healthy.*”<sup>14</sup> Woolworths has similarly submitted “*supplier satisfaction levels are high.*”<sup>15</sup>

The draft report’s preliminary conclusion is that:<sup>16</sup>

<sup>11</sup> *Progressive Enterprises Limited v Foodstuffs (Auckland) Limited* [2004] 1 NZLR 145 (PC).

<sup>12</sup> NZFGC “Submission on retail grocery market study preliminary issues paper” (February 4, 2021) at [174] available at [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf).

<sup>13</sup> Foodstuffs North Island “Submission on Market study into grocery sector draft report” (September 10, 2021) [“*FSNI submission*”] at Appendix D available at [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0034/265768/Foodstuffs-North-Island-Submission-on-Market-study-into-grocery-sector-draft-report-10-September-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0034/265768/Foodstuffs-North-Island-Submission-on-Market-study-into-grocery-sector-draft-report-10-September-2021.pdf).

<sup>14</sup> FSNI submission at [9.2(d)].

<sup>15</sup> Woolworths New Zealand “Submission on retail grocery market study preliminary issues paper” (February 4, 2021) at 35 available at [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0030/236946/Woolworths-New-Zealand-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0030/236946/Woolworths-New-Zealand-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf).

<sup>16</sup> Draft report at [9.13].

The lack of options for suppliers appears to allow the major grocery retailers to negotiate lower prices with, and push more risks and uncertainty onto suppliers than seems efficient. This can reduce suppliers' incentives to invest and innovate and can lead to suppliers exiting the market. In the long run, this can lead to lower quality goods, reduced choice, and a risk that prices will rise.

## IV. NATURE AND SCOPE OF COMPETITION

The major retailers argue the retail sector is highly competitive. They argue that there is intense competition with the increase in “mission” shopping under which consumers shop more often. They argue that they are in competition with, convenience stores, meal kit providers, and takeaways and restaurants as competitors. They disagree that there is limited competition for the “main shop.”

Foodstuffs submitted consumers engage in “mission shopping” and competition is driven by firms seeking to attract shopping missions.<sup>17</sup> An example they identify is the “*breakfast/family breakfast mission to fulfil a breakfast meal only.*”<sup>18</sup> This “mission” could be achieved by the major retailers, specialist or boutique retailers, purchasing directly from suppliers, purchasing through regular subscription boxes, visiting convenience stores, and cafes and restaurants that serve breakfast and brunch. Accordingly, the number of competitors is abundant, barriers to entry are low, and competition is dynamic and nuanced.

The draft report found “grocery retailers compete with each other for specific shopping missions in local markets where consumers live and work.”<sup>19</sup> It distinguished between three categories of shopping missions.

1. The first is the “main shop,” a shop that takes place regularly “based on the convenience of using one grocery store to get all necessities in one place.”<sup>20</sup> This is the traditional (what the major retailers seem to wish were historical) “weekly shop” that one would think of supermarkets for.
2. The second is a “secondary shop,” a supplemental shop at a second grocery store to shop for specific products.<sup>21</sup>
3. The third is a “top-up shop,” a quick shop for a small number of items.<sup>22</sup>

Suppliers, and indeed some of the suggested competitors, disagree that other food/convenience-related purchases are a strong competitive constraint even in the context of “mission” shopping. The draft report found the major grocery retailers had a combined estimated share of more than 90 percent for consumers' main shop.<sup>23</sup> Fringe retailers are not a strong constraint because they cannot offer the convenience of a main shop at a single location. The NZCC has expressed concern that the market shares have remained stable over time.

Meanwhile the major grocery retailers also had a high combined estimate market share of more than 80 percent for top-up shops.<sup>24</sup> Even for other “shopping missions,” the major grocery retailers had the advantage of generally lower prices, greater range, and greater brand recognition.

Another interesting theory of competition was submitted on the draft report by marketing lecturer Robert Hamlin. He pointed out that the strategic unit of supermarket trade is the category:<sup>25</sup>

*The consumer has planned to buy these categories before they arrive at the store – but typically they have not yet determined what products out of each of these categories they will buy. ... Categories are run by supermarkets to maximise the profit (for*

17 Foodstuffs North Island “Submission on retail grocery market study preliminary issues paper” (February 4, 2021) [“FSNI PIP submission”] at [4.1] available at [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0027/236934/Foodstuffs-North-Island-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0027/236934/Foodstuffs-North-Island-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf).

18 FSNI PIP submission at [17].

19 Draft report at [4.27].

20 Draft report at [4.18.1].

21 Draft report at [4.18.2].

22 Draft report at [4.18.3].

23 Draft report at [4.92].

24 Draft report at [4.97].

25 Robert Hamlin “Submission on Market study into grocery sector draft report” (19 August 2021) [“Robert Hamlin submission”] available at [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0027/265752/Robert-Hamlin-Submission-on-market-study-into-grocery-sector-draft-report-26-August-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0027/265752/Robert-Hamlin-Submission-on-market-study-into-grocery-sector-draft-report-26-August-2021.pdf).

*the supermarket) generated by that category. The range of products and brands that are available within that category are simply units that are deployed exclusively by the retailer and at the retailer's pleasure towards that end.*

One category may have several items, but while they “look like they are competing, they are not in any natural manner.”<sup>26</sup> “The net purpose of this is to ensure that per individual purchase, averaged over millions of such purchases, the consumer pays more . . . than they otherwise would do.”<sup>27</sup>

## V. PRIVATE LABELS

Another complication to the retailer-supplier relationship is that supermarkets have increasingly started to supply their own “private labels” or home brands. With private labels, supermarkets become both customer and competitor. However, unlike other suppliers, supermarkets also control vital inputs such as control shelf space, retail data and retail pricing.

NZFGC submitted concerns on potential conflicts of interest.<sup>28</sup> Firstly, retailers receive sensitive commercial information from suppliers which suppliers would not normally supply to competitors. Secondly, retailers may not want competing, branded goods, to be priced below their private labels. Thirdly, retailers become competitors for vital shelf space and may have an interest in favoring the placement of their own private label products.

Fourthly, there may also be concerns about use of know-how and intellectual property belonging to the supplier. Retailers may have an interest in using this information to improve their own competing private label. They could require the supplier to manufacture the retailer's private label as a condition of supply, thereby increasing loyalty to the retailer's brand rather than the supplier's.

In a competitive market, competition might prevent these conflicting interests from creating adverse outcomes. Indeed, the draft report recognized “[c]onsumers may benefit from private label products through lower prices and greater choice.”<sup>29</sup> However private label concerns arguably require greater scrutiny in the context of a duopoly. Similar concerns have arisen in the context of large online platforms such as Amazon and the Apple app store.<sup>30</sup>

## VI. RANGE OF REMEDIES

The draft report's preliminary findings are competition is not working well for consumers and the retail grocery sector can be best described as a duopoly with a fringe of other competitors.<sup>31</sup> In line with the NZCC's prior fuels enquiry, at this stage the draft report only identifies options for recommendation, while the final report will likely have final recommendations.

The NZCC identified four groups of possible remedies to address the NZCC's preliminary views on the problems in the sector.

The first group of remedies is aimed at reducing barriers to entry, in particular relating to land and wholesale access. The NZCC identified wholesale barriers could be addressed either by improving supply through existing wholesale grocery channels, for example through voluntary commercial arrangements, enforceable access undertakings, a regulatory access regime, or operational separation, or by facilitating the entry of an independent wholesaler, for example by structurally separating the retailers' wholesale and retail business, or seeking Government investment. Land barriers could be addressed by changes to planning law and removal of restrictive and exclusivity covenants preventing use of potential retail sites. Again, this could be achieved voluntarily, or through regulatory intervention. Land banking could also be monitored.

The second group of remedies look at facilitating retail entry directly. For example, Government investment in a new entrant, or divestment of existing retail stores.

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<sup>26</sup> Robert Hamlin submission at 2-5.

<sup>27</sup> Robert Hamlin submission at 5.

<sup>28</sup> NZFGC “Comments on submissions on preliminary issues paper” (12 April 2021) at available at 21-22 [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0018/253143/NZFGC-Comments-on-submissions-on-preliminary-issues-paper-12-April-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0018/253143/NZFGC-Comments-on-submissions-on-preliminary-issues-paper-12-April-2021.pdf).

<sup>29</sup> Draft report at [8.147].

<sup>30</sup> See for example 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](https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519).

<sup>31</sup> Draft report at [9.8] and [9.10].

The third group of remedies seek to address the imbalance of power that exists between retailers and suppliers. Something that has been important to our client is advocating for the implementation of a mandatory and independent code of conduct, as has been implemented in the UK and Australia. The code would set minimum standards for retailer conduct in relation to suppliers. The draft report also considered the possibility of a generic regulatory regime in the Commerce Act allowing for the adoption and enforcement of industry codes, collective bargaining and use of the Fair Trading Act's new prohibitions against unconscionable conduct and unfair small trade standard contracts.

The fourth group of remedies addresses consumer information problems. The major retailers indicated they were already voluntarily undergoing the process of simplifying their pricing and promotional mechanisms. However other submitters considered a consumer information standard is needed to ensure a consistent minimum standard was kept to. Other possible reforms include mandatory unit pricing, price comparison websites and improving the clarity and transparency of loyalty programs terms and conditions and data collection. The Privacy Commissioner noted that data portability of loyalty program data would be desirable as to prevent data from becoming a barrier to entry in the future.

## **VII. THE CONFERENCE & NEXT STEPS**

From October 20 to November 2, 2021, the NZCC held an online conference to consult with parties further. The major grocery retailers have argued strongly that the draft report's findings on excessive profitability and lack of innovation are incorrect, that the major grocery retailers face a number of constraints, and that in any event the NZCC should take a forward-looking approach (where Costco may enter, and internet shopping may be material). The major grocery retailers have expressed some support for a code of conduct between suppliers and the supermarkets, which may be modelled on the UK or Australian approach. They have also suggested that they may take action to remove some restrictive covenants on land and leases.

The conference has evaluated possible remedies such as wholesaling operational separation, structural separation, and divestment of some retail stores to facilitate entry. These are complex issues and have been the subject of heated debate. Already the study has generated an incredibly detailed draft report supplemented by independent expert reports and many lawyers and economists have been involved in the process. Post conference submissions are due by November 23, 2021.



