



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Initiating a Commerce Commission market study into supermarkets	Date to be published	16/11/2020

List of documents that have been proactively released

Date	Title	Author
13/ 11/ 2020	Cabinet paper: Initiating a Commerce Commission market study into supermarkets	Office of the Minister of Commerce and Consumer Affairs

Information redacted

YES / NO

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet

Initiating a Commerce Commission market study into supermarkets

Proposal

- 1 This paper outlines my intention to require the Commerce Commission to undertake a market study into supermarkets, specifically, any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand.

Executive Summary

- 2 The Commerce Commission is empowered under the Commerce Act 1986 (the Act), on its own initiative or at my direction, to carry out studies into any factors that may affect competition for the supply or acquisition of goods or services.
- 3 The Labour Party 2020 Election Manifesto committed to initiating a market study into supermarkets before the end of 2020. I intend to deliver on this commitment by commencing a market study into any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand. A proposed notice for the study is attached in Annex 1.
- 4 I am satisfied that a market study into supermarkets (defined as the New Zealand retail grocery sector) is in the public interest. This is particularly the case given the high level of concentration in the sector, some potential competition concerns, the significant importance of groceries to New Zealand households, and the fact that there has not been an in-depth market study carried out into the grocery sector in recent times.
- 5 I am confident that a study can be carried out by the Commerce Commission in 12 months. This approach has some risks, but the Commission can mitigate these by focusing attention on key product and supply lines that will have the most value. I intend to require the Commerce Commission to publish its final report by 23 November 2021.

Background

Market studies power

- 6 The Act gives the Commerce Commission the ability to undertake competition (market) studies into the supply or acquisition of goods or services. The purpose of a market study is to determine whether there are any factors that may be impeding competition in a market. If so, the Commerce Commission may make recommendations as to how competition could be improved.

I N C O N F I D E N C E

- 7** Under the Act, the Commerce Commission may conduct a study on its own initiative or at my request if it is in the public interest to do so.
- 8** What is in the public interest is not defined, but it should be interpreted consistent with the purpose of the Act, which is to promote competition in markets for the long-term benefit of consumers within New Zealand.
- 9** I consider that it is likely to be in the public interest to carry out a market study if it promotes the purpose of the Act and some or all of the following (non-exhaustive) criteria are met:
- 9.1 there are existing indications of competition problems in the market (such as high prices or low levels of innovation);
 - 9.2 the market is of strategic importance to the New Zealand economy or businesses or of significant importance to consumers;
 - 9.3 it is likely that there are viable solutions to any issues that are found; and
 - 9.4 a formal Commerce Commission market study would add value above work that could be done by other government agencies.
- 10** In conducting a study, the Commerce Commission may use its mandatory information gathering powers if it is necessary or desirable for the purposes of the study. The Commerce Commission must prepare a draft report and release it to the public to allow a reasonable time for comments. The final report must include the Commerce Commission's findings and may include recommendations. These recommendations are non-binding, but the Government must respond in a reasonable time.
- 11** In December 2019, the Commerce Commission completed its first market study into the retail fuel market and I consider its final report was well received. The Fuel Industry Act 2020 was passed in the previous term of Government to address the Commission's recommendations.

Process for selection of candidate for study

- 12** The Labour Party 2020 Election Manifesto outlined that the Minister of Commerce and Consumer Affairs would require the Commission to conduct a market study into supermarkets before the end of 2020.
- 13** This follows on from a request by Cabinet in the previous term of Government on 17 February 2020 [CAB-20-MIN-040 refers], where my predecessor was invited to report back to Cabinet on a notice (terms of reference and timeframe) for a market study into supermarkets, following consultation with the Commerce Commission.
- 14** Before my predecessor could report back to Cabinet, the Government's response to the COVID-19 pandemic took priority and significantly impacted on the grocery sector, making it prudent to delay the commencement of this study.

I N C O N F I D E N C E

- 15 I consider that the grocery sector has now moved on from a COVID-19 response to the recovery phase, and it is timely to recommence this process so that New Zealand consumers can be assured that they are paying reasonable prices for groceries.

Market study into retail groceries

- 16 I propose to commence a Commerce Commission market study into any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand.
- 17 This scope reflects the fact that under the Act, market studies are inquiries into the supply or acquisition of goods or services, rather than into particular participants in those markets. I therefore propose to require that the scope of the study should focus on the supply or acquisition of groceries by retailers, which will enable the Commerce Commission to look at any factors affecting competition by supermarkets.
- 18 In my view, there is a clear public interest in carrying out a market study into New Zealand retail grocery markets. In particular, with reference to the public interest criteria outlined above, I consider that:

18.1 New Zealand has one of the most concentrated grocery retail sectors in the world. Foodstuffs (New World, PAK'nSAVE, and Four Square) and Progressive Enterprises (Countdown, SuperValue, and FreshChoice) (the supermarkets) cover approximately 75 per cent of the New Zealand grocery retail market. The following indicators may suggest there are lower levels of competition than I would expect in a workable competitive market:

18.1.1 Unequal bargaining power may allow supermarkets to push prices unreasonably low for suppliers which could impede investment in innovation and quality. The Food and Grocery Council of New Zealand has described the relationship between some stores and suppliers as overstepping "the line between robust negotiation and bullying". Whilst low wholesale prices are usually good for consumers, it is uncertain how much of this benefit is being passed through to consumers.

18.1.2 Research by the Productivity Hub (2019) showed that most of the competition measures for supermarkets, grocery stores, and specialised food retailers have tended to trend downwards over time, indicating decreased competition.

18.1.3 While genuine price promotions can be good for consumers, a recent Consumer NZ study has called into question the discounting practices of some supermarkets. The study suggested that some items are "on special" for prolonged periods and some online specials do not show the regular price next to the sale price – a practice which may mislead consumers.

18.1.4 Concerns about the availability of suitable land for potential competitors to enter markets due to strategic land acquisitions by the supermarkets.

- 18.2 The market is of strategic importance to the New Zealand economy:
- 18.2.1 Food prices impact all New Zealanders as roughly 17 per cent of the average New Zealand household's weekly expenses are on food. Statistics New Zealand estimates that \$22.3 billion was spent in supermarket and grocery stores in the 12 months to 30 June 2020. The 2019 Household Expenditure Survey showed average weekly household expenditure on food increased by 9.2 percent in three years to 30 June 2019 compared with an increase of 6.5 percent for other categories.
 - 18.2.2 The retail grocery industry is an important path for small-to-medium grocery suppliers growing to become exporting companies.
- 18.3 Based on similar studies overseas, there are likely to be feasible policy options to address any issues identified in the sector, although the nature of these options would depend on the specific issues identified (if any). Overseas examples of outcomes include a code of conduct for relationships with suppliers, removing restrictions on land use and tenancy in shopping malls, and provision of better information to consumers.
- 18.4 A market study by an independent and expert competition agency with mandatory information gathering powers would shine a light on the extent of competition in this sector and provide valuable insights to Government and the public. Understanding the commercial relationships between different market participants will be vital to understanding any possible competition problems. There has not been an in-depth market study carried out by any agency on the retail grocery sector in recent times.
- 19** It should be noted that this study will focus on promoting competition in the retail grocery sector. It will not be an inquiry focused on the particular conduct of supermarkets over the last several months while New Zealand has been under heightened Alert Levels. That is not to say that the impacts of the lockdown will not be relevant to the study, particularly if they have had any lasting impacts on competition. For example, the growth in online retailing as a consequence of the lockdowns may have a significant impact on the retail grocery sector.

Notice to initiate study

- 20** In line with the requirement of the Act, I have prepared a draft notice (terms of reference and timeframe) for a study into any factors that may affect competition for the supply or acquisition of groceries, and have consulted on this with the Commerce Commission. The proposed notice is attached as Annex 1.

Judgements in developing the notice

- 21** In developing the notice for the study, I have made the following judgements:
- 21.1 The term 'grocery retailers' has been used rather than 'supermarkets'. While the supermarkets may be the only major grocery retailers, the study will find out if there are other participants that are also of importance. For example, the

supermarkets have often claimed that they face many competitors and it will be important for the study to test these types of claims. If the study is too narrow in its focus there is a chance that it will not be able to fully investigate these important lines of inquiry.

- 21.2 The study will look at both the relationship between supermarkets and their suppliers, and the relationship between supermarkets and consumers. The Commerce Commission will likely investigate if supermarkets' purchasing practices are restricting innovation and output by suppliers, and whether any savings are being passed through to consumers. The Commerce Commission may also look at supermarkets' discounting practices, loyalty schemes and use of house brands.
- 21.3 The Commerce Commission may carry out a comparison of grocery prices for key items with those in Australia and other comparative countries. However, some price differences may relate to market dynamics in other countries rather than the level of competition in New Zealand.
- 21.4 No particular consultation requirements with departments, agencies or classes of persons are specified in the proposed notice. I consider that the Commerce Commission will carry out an open and transparent market study process and additional consultation requirements are not necessary.

Timing of the study

- 22** I understand that there is significant interest in a timely report into the competition matters in this sector, given its importance to New Zealand consumers and the competition and consumer concerns that have been raised about supermarket practices. Therefore, I propose to give the Commission 12 months to complete the study. While the Commission has said it would prefer a longer time period to expand the scope and depth of its analysis, it has said that 12 months is achievable.
- 23** There are some risks in requiring the Commission to issue a report within 12 months, rather than allowing more time. The grocery sector's product range and supply chains are complex, and information about the sector is likely held by a wide range of stakeholders. In addition, the study will begin just before Christmas, the busiest time of the year for the grocery sector. This will place a burden on participants to respond to information requests by the Commission during this time.
- 24** However, I am confident that these risks can be mitigated. The depth and scope of the study and the level of stakeholder engagement can be scaled to enable the study to be completed within 12 months while still being appropriate and fair to participants, and producing a robust and high-quality result.
- 25** I intend for the study to commence in November 2020, and for the Commission to publish its final report by 23 November 2021. The Commission will publish and consult on a draft report several months prior to the publication of the final report, which will provide a strong indication of the Commission's conclusions. Should the ability for the industry or other interested parties to participate in the study be drastically reduced, for example due to a return to heightened Alert Levels, the Commerce Act allows for the deadline to be extended.

- 26 A 12 month market study into supermarkets will also enable a building products market study to begin in late 2021 or early 2022, and completed within the current Parliamentary term.

Impact on businesses

- 27 The study may impose some additional costs on grocery retailers outside the core supermarkets (such as the Mad Butcher franchise, the Warehouse) as they participate in the study, but this will enable a more complete picture of competition within the retail grocery sector. It is also these businesses that I would expect to benefit from any improvements to competition that may come from the study.
- 28 I expect the Commission to take into consideration the cost to businesses when considering issuing mandatory information requests compelling them to participate in the study.

Financial Implications

- 29 The Commerce Commission has a dedicated appropriation of \$2.43 million in 2020/21 and \$2.58 million in 2021/22 to carry out market studies and, with an approved expense transfer of \$0.4 million for 2020/21, it will have sufficient funding to cover the cost of this study.

Legislative Implications

- 30 There are no legislative implications arising from this paper.

Human Rights

- 31 The proposals in the paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

- 32 The Commerce Commission and the Treasury have been consulted on the Notice. The Department of Prime Minister and Cabinet (Policy Advisory Group) have been informed.

Communications

- 33 I intend to issue a media statement announcing the initiation of this market study. The notice for the market study will be published in the Gazette in order to initiate the study, and will also be posted on the Ministry of Business, Innovation and Employment's website.

Proactive Release

- 34 The Ministry of Business, Innovation and Employment will publish this Cabinet paper on its website in whole within 30 business days of decisions being noted by Cabinet.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

- 1 **note** that the Commerce Act 1986 gives the Minister of Commerce and Consumer Affairs the ability to require that the Commerce Commission undertakes a market study;
- 2 **note** the Labour Party's 2020 Election Manifesto included a commitment for the Minister of Commerce and Consumer Affairs to direct the Commerce Commission to undertake a market study into supermarkets;
- 3 **note** that the Minister of Commerce and Consumer Affairs intends to require the Commerce Commission to undertake a study into any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand, in line with the notice set out in Annex 1;
- 4 **note** that the Minister of Commerce and Consumer Affairs intends to require the Commerce Commission to publish its final report for this market study by 23 November 2021;
- 5 **note** that statutory consultation with the Commerce Commission on the notice for the market study in Annex 1 has occurred;
- 6 **note** that the Commerce Commission will publish and consult on a draft report several months prior to the publication of the final report, which will provide a strong indication of the Commission's conclusions;
- 7 **note** that this Cabinet paper and the notice for the market study will be published on the MBIE website.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs

Annex 1: Draft notice for a competition study into the retail grocery sector

Draft Notice for a competition study into the retail grocery sector

I, Dr David Clark, Minister of Commerce and Consumer Affairs, pursuant to section 51(1) in Part 3A of the Commerce Act 1986, require the Commerce Commission to carry out a competition study into any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand. Matters to be considered in the study may include, but are not restricted to:

- 1 the structure of the grocery industry at the wholesale and retail levels
- 2 the nature of competition at the wholesale and retail levels of the grocery industry
- 3 the pricing practices of the major grocery retailers
- 4 the grocery procurement practices of the major grocery retailers and
- 5 the price, quality, product range and service offerings for retail customers.

The Commerce Commission should make its final report for this study publicly available by 23 November 2021.