CASTALIA

Private Labels, Buyer Power and Remedies in the NZ Grocery Sector

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Executive summary

In this report, we examine the effects of private labels on consumer outcomes in the retail grocery market and the implications for intervention. Given the high concentration of the retail market in New Zealand, we find that private labels are likely to accentuate and entrench the strong imbalance of bargaining power held by retailers for many grocery suppliers. We derive this conclusion by extending the bargaining framework used by the Commission to examine the balance of power between retailers and suppliers to additionally consider the effects of private labels.

The accentuated buyer power provided by private labels heightens the need for intervention to address the harmful consequences of buyer power abuse and to reduce barriers to competition for entrant retailers.

Whether private labels enhance, or harm consumer outcomes depends on the specific market context

When viewed across different market contexts, private labels are not categorically positive or negative for consumer outcomes. Concentration in the retail market plays a significant role in determining whether a private label is likely to have a detrimental effect on outcomes.

If a private label's presence increases product range, reduces retail prices, and incentivises innovation by suppliers, then consumers will be better off. However, private labels may stifle suppliers' incentives to invest and innovate if they enable abusive and discriminatory practices through accentuated buyer power.

Private labels can alter the balance of bargaining power between retailers and suppliers

If a retailer introduces a private label that is a sufficiently close substitute for an existing named brand, then the retailer's bargaining power will increase if the named brand cannot easily switch to its supply to other retail channels. The private label gives the retailer an outside option which improves the retailer's negotiating position (and conversely harms the supplier's negotiating position).

In diffuse retail markets, private labels will generally enhance consumer outcomes

In a diffuse (unconcentrated) retail market, private labels are likely to have sustained positive impacts for consumers over the long term. Consumers would benefit from an increased product range and lower prices, and the private label is unlikely to result in a concerning level of buyer power. In the same way that a private label gives retailers an outside option during negotiation, alternative retail channels provide suppliers with their own outside option. If a retailer attempts to force burdensome terms on suppliers, then the supplier can seek out an alternative retail channel.

In highly concentrated retail grocery markets such as in New Zealand, control over the retail channel to market provides retailers with strong buyer power, which is accentuated by private labels

In a highly concentrated retail market, an individual retailer has control over a key channel to market, providing the retailer with strong buyer power. The Draft Report finds that the two largest retailer groups account for 80 to 90 percent of the retail grocery market in New Zealand. The high concentration in New Zealand means that many grocery suppliers must secure a supply arrangement with at least one of the two retailers to achieve scale to supply efficiently in New Zealand. As a result, retailers hold a strong imbalance of power in the retailer-supplier bargaining relationship.

Aside from suppliers that have significant sales through other channels, most suppliers will be forced to accept terms demanded by the duopolists. For example, the Commission categorises the types of behaviour by supermarkets in New Zealand that stem from strong buyer power as: transferring costs and risks to suppliers, reducing transparency and certainty over terms of supply, and limiting suppliers' ability or incentive to provide favourable supply terms to other grocery retailers.

The Commission uses a bargaining framework when examining the extent of buyer power. Extending this framework to private labels shows that duopolists' use of private labels heightens the imbalance in bargaining power in favour of retailers.

Private labels in New Zealand are highly likely to have a net negative long-term effect on consumer outcomes

In concentrated retail markets, the imbalance in bargaining power enables retailers to take advantage of research and development by label brands and discriminate in favour of their private labels. This type of behaviour discourages supplier entry, investment, and innovation, to the detriment of consumers.

In highly concentrated retail markets, retailers' private labels can expropriate the product development of rival brands

Retailers have the ability to take advantage of suppliers' product development and innovation for the benefit of the retailers' private label—either through using confidential information about product development provided as part of the buyer-seller relationship, or by effectively requiring a supplier to incorporate a newly developed innovation in a private label.

In highly concentrated retail markets, retailers with private labels may discriminate against rival brands

In a highly concentrated retail maker, retailers may discriminate in favour of their private goods to maximise their margins. Discriminatory behaviour to favour the private label may include:

- Superior product placement of private labels and greater in-store promotion or advertising
- Levying charges on rival brands while not applying the same charges to private labels
- Maintaining a "price gap" between the private label and the named brand

In highly concentrated retail markets, long-term consumer outcomes will be harmed

Consumers may benefit from lower prices initially for the private label, but these will not necessarily endure as the private label becomes established. The Commission's finding that cost savings are not passed through to retail prices indicates that wholesale price reductions that result from private label introduction would not be passed through the consumers.

Additionally, suppliers may be disincentivised to invest in product innovations due to the risk that retailers may use suppliers' innovations in their own private labels. The risk that suppliers would be disadvantaged by not having the same opportunities for shelf space and in-store promotion and advertising further disincentive investments. Ultimately, this will reduce product variety for New Zealand consumers.

Relevant remedies

Mechanisms are required to effectively address buyer power abuse, and to address strategic barriers to entry, including restrictions on access to sites that may be suitable for supermarkets and retailers acting to restrict rivals' access to suppliers' products.

A mandatory code of conduct that is overseen, monitored, and enforced by an independent body is necessary to reduce the harm that results from high retail market concentration. Whistle-blower protections are required – for example to allow suppliers to notify the independent body if a retailer requires suppliers to limit the supply of a product to the retailer's rivals. In addition, provisions to prevent boycotting (through delisting) would be necessary.

These interventions provide low-cost ways to help improve competition in the retail market and address the imbalance of bargaining power between suppliers and retailers.

International outcomes indicate that New Zealand has the scale to support more independent large supermarket retailers. Numerous comparable countries to New Zealand (in terms of population and geography) have four or even more independently owned large supermarket chains. Therefore, if the strategic barriers to entry can be addressed, a new entrant may enter the retail market without the need for more intrusive intervention.

The Commission could revisit the state of the sector either after a set time period, or conduct annual monitoring to determine whether further invention is required in future, if sufficient retail entry does not occur.

1 Introduction

The New Zealand Food and Grocery Council (FGC) has asked Castalia to prepare a report that considers the impact of private labels on consumer outcomes, and comments on necessary intervention in the New Zealand retail grocery market. Our report is prepared in the context of the Commerce Commission's consultation on the Market Study into the Grocery Sector – Draft Report (the "Draft Report").

Private labels are products that retailers sell under their own brand. Retailers typically contract a third party to produce the private label product. We examine how market context determines the effect of private labels on consumer outcomes (Section 2), assess how private labels affect outcomes in the New Zealand grocery sector (Section 3), and comment on regulatory or government intervention that could enhance competition and consumer outcomes (Section 4).

2 Market context determines how private labels affect consumer outcomes

Private labels are not categorically positive or negative for consumers. The ultimate impact of private labels depends on how they affect the bargaining relationship between suppliers and retailers.

When a retailer's private label improves the balance of bargaining power between the retailer and supplier, private labels can be positive for consumers. However, when retailers already have strong buyer power—which is typically the case in a concentrated retail market—private labels accentuate this buyer power. The strengthened buyer power can lead to abusive and discriminatory behaviour by retailers, which harms suppliers, and ultimately harms consumers through reduced product variety, less supplier innovation, and increased prices in the long run.

2.1 Retailer buyer power can lead to abusive practices which harm suppliers, and consumers in the long run

The Commission notes that most relationships between grocery retailers and suppliers fit within a bargaining framework because they typically enter bilateral supply agreements.[1] Within this framework, suppliers and retailers use their bargaining power to negotiate terms of supply.

In these negotiations, bargaining power depends on the outside options of each party. An outside option is the next best option for a party if that party walks away from negotiations.

[1] Draft Report, para 8.21.

Control over the retail channel to market can give retailers buyer power

Retailers have buyer power when they hold the balance of bargaining power. Nevo and Van den Bergh (2017) define buyer power as "the ability of a buyer to reduce price profitability below a supplier's normal selling price or the ability to obtain terms of supply more favourable than a supplier's normal terms."[2]

In the grocery market, a retailer gains buyer power in proportion to how important the retailer's channel is to the supplier. In a hypothetical scenario where one retailer controls the only effective channel to end-consumers (that is, the retailer is a monopsonist), that retailer would have significant buyer power. In this scenario, a supplier has no viable outside option. The supplier can either conclude a deal on terms set by the retailer or walk away from negotiations and lose access to all end consumers.

Retailers can abuse buyer power which can harm consumers

Retailers can use buyer power to improve their purchasing terms, such as reducing the price of wholesale goods. The impact on consumers, however, depends on the market context. In a competitive retail market, retailers will pass-through cost savings, and this will benefit consumers. However, in a competitive retail market, a retailer will not have buyer power because suppliers have many outside options (due to the competitive nature of the retail market). In a less competitive retail market, retailers are more likely to retain the cost savings that they achieve through using buyer power, and not pass these cost savings on to consumers.

As the Commission explains, strong buyer power may "ultimately lead to higher prices, less choice and lower product quality for consumers."[3] This is because strong buyer power can:

- **Stifle suppliers' innovation and investment:** As retailers use their buyer power to transfer risks to and extract price discounts from suppliers, suppliers are likely to reduce their investments in product quality and innovation to compensate for their lower profits.[4]
- **Limit retail competition through restrictive supply arrangements**: Retailers may seek to limit retail competition by requiring that suppliers do not supply potential entrants at all, or that suppliers do not provide favourable terms to potential entrants. For example, retailers may threaten to delist the supplier's product if the supplier does not comply with the retailer's demands.

The Commission concludes that "The more effective competition is at the retail level, the less likely it is that retailers having significant buyer power will ultimately harm consumers."[5] And "… the more competition there is at the retail level of the grocery market, the less likely it is that retailers will have significant buyer power."[6]

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[2] Nevo, Hila & Van den Bergh, Roger "Private Labels: Challenges for Competition Law and Economics" (2017) World Competition 40, no. 2, at p.278.

[3] Draft Report para 8.30.2

[4] Draft report para 8.30.1

[5] Draft Report 8.31

[6] Draft Report 8.32

2.2 Private labels can exacerbate the negative effects of strong buyer power

Just like buyer power, the ultimate impact of private labels on consumer outcomes depends on the market context. Private labels can be positive for consumers within a diffuse (unconcentrated) retail market where there is little buyer power. Conversely, in a concentrated retail market where retailers already have strong buyer power, private labels can exacerbate the negative effects of strong buyer power.

Private labels increase buyer power by giving retailers an additional outside option

The Commission's bargaining framework can be applied to the case of a retailer selling a private label. The private label gives the retailer an additional outside option when negotiating with a named brand supplier. The more that consumers view the private label as a substitute for a supplier's product, the greater the increase in buyer power is likely to be.

To demonstrate this dynamic, consider a named brand such as Coca-Cola which has strong recognition and customer loyalty. A retailer's private label soft drink is likely a poor substitute for Coca-Cola products. Therefore, a private label may have only a limited impact on the retailer's buyer power. However, for many other products where private labels that consumers view as sufficiently substitutable for named brands, the private label will increase the retailer's buyer power.

Whether the introduction of a private label will increase buyer power also depends on whether the supplier has alternative channels to retail customers.

2.2.1 Private labels likely benefit consumers in diffuse (unconcentrated) retail markets

In a diffuse retail market, retailers' private labels are unlikely to give retailers strong buyer power. This is because suppliers have good outside options due to the variety of retailers they can negotiate with.

Provided the retail market remains diffuse, a private label will not provide strong buyer power to the retailer, and private labels should benefit consumers. Private labels commonly provide consumers with low-cost, low-quality options. Additionally, some private labels have targeted niches within the quality spectrum which are not currently satisfied by existing branded goods. The increased variety benefits consumers.

2.2.2 Private labels likely harm consumers in concentrated retail markets

In a concentrated retail market, private labels are likely to give retailers excessive buyer power. Suppliers lack good outside options (due to the lack of retailers), while retailers gain a strong outside option in their private label. This bargaining power imbalance likely harms consumers in the long run.

Retailers can use their buyer power to favour their private labels by discriminating against rival brands and expropriating their product innovations

In a concentrated retail market, retailers already have strong buyer power, which can stifle innovation and reduce competition in the long run (as discussed in section 2.1). Because private labels further add to this buyer power, they exacerbate these negative effects. Additionally, private labels can lead retailers to undertake further discriminatory practices which leverage dominant buyer power.

Retailers’ private labels can expropriate the product development of rival brands

The retailer has the ability to take advantage of suppliers’ product development and innovation for the benefit of the retailer’s private label – either through using confidential information about product development provided as part of the buyer-seller relationship or by effectively requiring a supplier to incorporate a newly developed innovation into a private label.

Retailers with private labels may discriminate against rival brands

Retailers are both a customer and competitor of named brands when they market their own private labels. When retailers have market power (such as in a concentrated market), the retailer may be incentivised to discriminate in favour of its private label. This is because the retailer’s margins from private labels increase in conditions of poor retail competition. As Tarzjian (2003) explains “a retailer’s gain from marketing private labels is higher when there is a lower competition at the retail level.”[7]

The retailer’s discriminatory behaviour to favour the private label may include:

- Superior product placement of private labels and greater in-store promotion or advertising,
- Levying charges on rival brands while not applying the same charges to private labels, and
- Maintaining a “price gap” between the private label and the named brand

A recent article by McKinsey & Company notes that private labels have traditionally relied on price and shelf placement to drive purchases and states that:

> 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.[8]

Excessive buyer power, which is further strengthened by private labels, eventually reduces product variety, and may increase the costs for consumers

Strong buyer power will, over time, hollow out the upstream supplier market. As retailers take profits from suppliers, some suppliers may leave the market, and the remaining ones will likely reduce investments and innovation. Retailers’ ability to discriminate in favour of their own brands and to expropriate named brand innovations and developments will further discourage innovation, or new entrants into the supplier market.

Furthermore, as the market share of private labels grows, suppliers become more economically dependent on retailers, which further increases retailer buyer power. Suppliers

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[7] Jorge Tarzijan (2003) *Private Labels and Retail Market Concentration* ABANTE, Vol. 6, Nº 1, pp. 1-20, at p. 16. The same article further explains: “The retailer’s margin, the total margin of the vertical structure and the proportion of the retailer’s margin in the total margin are increasing in the concentration of the retail market” at p. 14.

[8] Steven Begley and Angus McOua (October 30, 2020), “Turning Private Labels into Powerhouse Brands, https://www.mckinsey.com/industries/retail/our-insights/turning-private-labels-into-powerhouse-brands

may undertake idiosyncratic investments (such as changing the location of factories to reduce transport costs or adapting packaging) to increase their chances of winning large supply contracts with retailers.[9] These investments make it harder for the supplier to switch to an alternative retail channel.

In a concentrated market, private labels may cause retail prices of both named brands and private labels to rise

Economic literature suggests that in a concentrated market, consumers will receive price benefits from private label presence in the short-term, regardless of retail concentration. Tarzijan (2003) found that "for any level of concentration of the retail market, the marketing of private labels decreases the wholesale and the consumer's price of the national brand… these results confirm that the introduction of private labels is conducive to cost and price reductions."[10]

However, the anti-competitive effects of strong buyer power—which is exacerbated by private labels—will likely lead to price rises over time. Tarzijian (2003) found that as retail concentration increases, the price of both named brands and private labels increases (proportionate to how closely the products substitute for each other).[11] This is because retailers in a concentrated market can use their market power to coordinate prices.

It is likely impossible to disaggregate the impacts of private labels from the general negative effects of excessive buyer power. However, the German study cited by the Commission found a correlation between general price levels and the penetration of private labels. Over a five-year period, the study found:[12]

> A rise in price level of national brands and private labels in all outlet formats studied – both per product as well as per kg – was recorded during the study period. The low prices of private labels, so often perceived by consumers, only exist because the national brands are used as 'reference products' by retailers when setting their prices. That means that the prices per kg of private labels are kept below those of the national brands, although at an ever-rising level.

3 Private labels will likely have net-negative impacts in New Zealand

New Zealand's grocery retail market is concentrated, and it is likely to remain concentrated (subject to Government intervention) for the foreseeable future. Therefore, private labels will likely exacerbate retailers' already strong buyer power. Over time, this imbalance of bargaining power will likely reduce product variety and increase the general prices of grocery goods for New Zealand consumers.

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9 Nevo and Van den Bergh, at p. 279.

10 Jorge Tarzijan (2003) *Private Labels and Retail Market Concentration* ABANTE, Vol. 6, Nº 1, pp. 1-20, at p. 4.

11 Tarzijan (2003), at p. 11.

12 Rainer Olbrich, Gundula Grewe, "Consequences of Competition Between National Brands and Private Labels. Empirical Results from Different German Outlet Formats" (2009) 37 Int'l J. Retail & Distribution Mgmt, 933, at p. 10.

3.1 New Zealand's grocery retail market is concentrated, which gives the major grocery retailers' strong buyer power

New Zealand's retail grocery market is concentrated, and it is likely to remain concentrated in the future

The Commission found that New Zealand's retail grocery market is heavily concentrated. Approximately 80 to 90 percent of the market is shared between Foodstuffs and Woolworths.[13]

This concentration is likely to persist into the future. The Commission states that "the future competitive environment in the grocery retailing market is likely to remain relatively stable."[14] This is due to New Zealand's high barriers to entry, such as low population density and restricted supermarket site availability. A new entrant would also struggle to compete with Foodstuffs' and Woolworths' cost advantages, which they achieve through the scale of their operations, as well as their vertically integrated wholesale and distribution operations.[15]

Market concentration gives New Zealand's major grocery retailers significant buyer power

If retail concentration remains, Woolworths and Foodstuffs will continue to have strong buyer power. Suppliers depend on the major grocery retailers to sell their products to consumers. While there are alternatives channels such as food kit providers and specialist grocery stores, these channels are unlikely to be effective outside options for suppliers. The Commission notes:[16]

> "… the ability for most suppliers to transfer significant volumes to alternative sales channels or to diversify their customer base is limited by the structure of the [New Zealand] retail grocery sector… Given that the majority of grocery products are sold by the major grocery retailers, alternative channels are unlikely to generate sufficient sales for most suppliers to operate profitably."

The major retailers will retain this buyer power so long as there are no viable alternatives for suppliers. New Zealand's duopoly situation may give suppliers some bargaining power in their ability to switch between Foodstuffs and Woolworths. However, the major retailers may be unwilling to provide attractive terms to suppliers. The Commission found that "price competition between the major grocery retailers is considerably less than we would expect to see in a workably competitive market."[17]

The number of suppliers reduces the bargaining power of individual suppliers

New Zealand grocery retailers source their products from many suppliers. Most of these suppliers sell less than $1 million of their product in a year.[18] Due to the number of suppliers, retailers have a strong outside option which gives them buyer power. If a retailer does not secure a contract with one supplier, it can seek out a competing supplier.

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[13] Draft Report, at p. 128.

[14] Draft Report, at p. 115.

[15] Draft Report, at p. 176.

[16] Draft Report, at paras 8.52-8.53.

[17] Draft Report, at para 5.115

[18] Draft Report, at para 8.60

While there are some suppliers that have strong bargaining power (due to strong brand recognition or strong outside options such as the ability to export), the Commission concluded that "in most cases, there appears to be an imbalance of bargaining power in favour of the major [New Zealand] grocery retailers."[19]

3.2 Private labels will likely negatively impact New Zealand consumers over the long term

Private labels give retailers an additional outside option which further strengthens their buyer power. In the New Zealand context, this will strengthen retailers' already strong position of buyer power. This will exacerbate the negative effects of strong buyer power, as well as expose New Zealand suppliers to discriminatory practices.

Private labels will expose New Zealand suppliers to discriminatory practices

Private labels can incentivise retailers to undertake discriminatory practices in favour of their private labels (see section 2.2.2). This economic theory is supported by several reported instances of New Zealand retailers discriminating in favour of their private labels.

The FGC has identified instances in New Zealand where the major grocery retailers appear to have expropriated the intellectual property of named brands. Some of the most extreme examples include forcing suppliers to supply their innovative products as private labels (as opposed to allowing that product to be sold under its own differentiated brand).

The FGC also identified situations where New Zealand retailers appear to have engaged in preferential treatment in favour of their private labels. For example, the FGC has identified that Zuru nappies (which is referred to as a 'controlled brand' but has most of the features of a private label) has received preferential treatment compared to named brand nappies. The result of the transfer of economic profits from suppliers to the retailer contributed to Treasures (one of New Zealand's few nappy manufacturers) exiting the supply market.[20]

Over time these practices will likely push marginal suppliers out of the market and discourage new entrants into the supply market.

Producers of private labels may also be harmed by private labels over time

Woolworths submitted that private labels "create growth opportunities for new suppliers to enter or expand by producing private label products on its behalf".[21]

While a private label contract with a retailer may provide an opportunity for the supplier in the short term, in the long-term it may harm the supplier. As private labels become a large share of a supplier's production, the supplier is less likely to invest in its own named brand, and these two factors make the supplier increasingly dependent on its retailer which further increases the retailer's ability to extract favourable terms from the supplier.[22]

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[19] Draft Report, at para 8.58

[20] More detail can be found in the NZFGC submission "Market study into the retail grocery sector: Draft report Comments by New Zealand Food & Grocery Council".

[21] Quoted in the Draft Report, at para 8.152.4.

[22] Nevo and Ven den Bergh (2017), "The potential foreclosure effect of these practices [retailer abuses of buyer power] will be strongest for suppliers who mainly produce retailers' private labels; they will suffer more from buyer power than suppliers who also sell their own branded products" at p. 282.

If the grocery retail market remains concentrated, private labels will likely harm New Zealand consumers in the long run

While private labels may give New Zealand customers more product variety in the short term, the cost effects may be mixed. While theory suggests that private labels lead to a decrease in price, the reduced state of competition in the New Zealand retail market may mean that retailers keep price discounts it extracts from suppliers. As noted by the Commission, "there is limited evidence of retailers passing through cost reductions to consumers."[23]

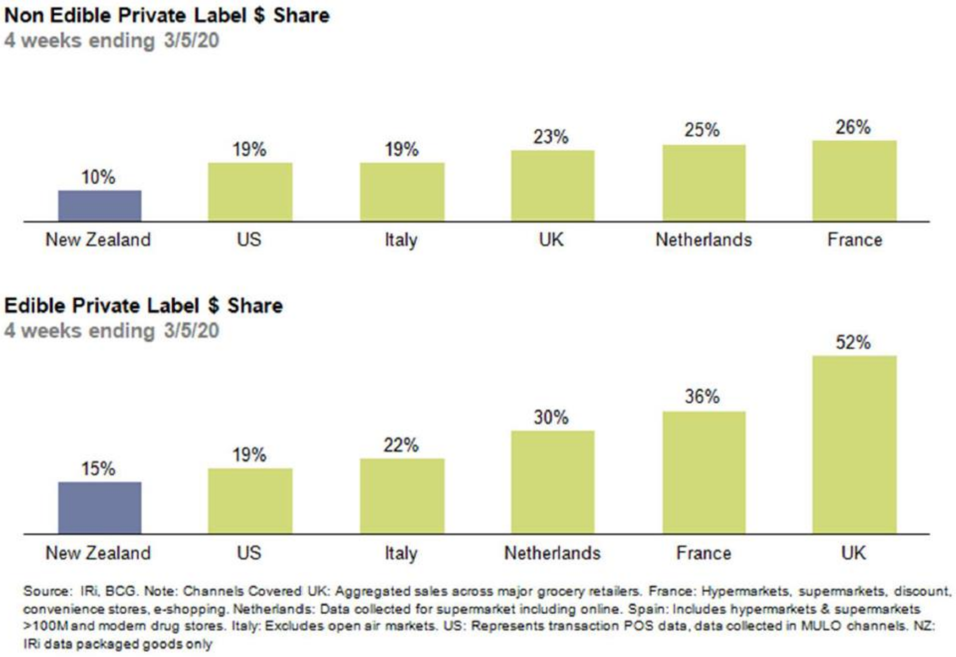
In the long term, private labels will likely contribute to the negative effects of sustained buyer power. Since the New Zealand retail market will likely remain concentrated, retailers will retain their buyer power in the future. Over time this will stifle product innovation, which will reduce the choices of New Zealand consumers, and may lead to price increases over time.

3.3 Interpreting the relative uptake of private labels

Higher private label sales in other countries do not alleviate concerns of the detrimental impacts of buyer power and private labels in New Zealand

The Commission observed that private label sales in New Zealand are growing but are relatively low compared to other jurisdictions.[24] This observation was supported by statistics provided in Woolworths' submission (reproduced in Figure 3.1 below)

Figure 3.1: Woolworths' graph showing penetration of private label products by jurisdiction



Woolworths NZ "Submission on retail grocery market study preliminary issues paper" (4 February 2021) at 66.

[23] Draft report, at para 8.138.

[24] Draft Report, at para 8.145.

The Commission did not draw an explicit conclusion from this observation. One possible conclusion—which is most likely implied by Woolworths' submission—is that private labels should not be a concern for the New Zealand retail grocery market because private label penetration is low compared to comparator jurisdictions. Such a conclusion, however, is not justified based on Woolworths' statistics alone.

To draw a meaningful comparison, Figure 3.1 would also have to include information about the market context in each jurisdiction – for example, the retail market concentration. As discussed above, in diffuse retail markets, buyers are generally less reliant on any one retailer as a channel to market than in highly concentrated markets. As a result, private labels are less likely to have a harmful effect on consumer outcomes in diffuse markets than in highly concentrated markets.

The retail concentration in those countries included in Figure 3.1 differs significantly from New Zealand. The Netherlands has at least five major retail grocery chains. The United Kingdom has eight chains with five percent or more market share, as well as a number of smaller chains. The impact of private label penetration will be very different in these countries compared to New Zealand, which has much greater retail concentration.

The international data does indicate that private labels are particularly prevalent in some countries. If private label sales in New Zealand continue to grow to the levels seen internationally, consumers would face little choice and poor outcomes, given the high retail concentration in the New Zealand market.

An updated chart, which also shows the volumes for the same period in 2021, would be useful to examine the speed at which private label sales are growing.

Granular data would provide greater insights

We also note that granular data that shows the volume of private label sales by price category would provide greater insight into the impact of private labels on suppliers in New Zealand.

4 Recommendations to address competitive risks from private labels

We recommend that remedies in the grocery sector should focus on introducing a Code of Conduct and addressing access to suitable sites. These remedies provide low-cost, relatively unobtrusive methods of addressing the imbalance in the retailer-supplier relationship, reducing the harms of excessive buyer power, and addressing key strategic barriers to entry.

The Commission could revisit the state of the sector either after a set time period, or through annual monitoring to determine whether further invention is required in future, if sufficient retail entry does not occur.

4.1 Mechanisms to address abuse of buyer power

The high concentration of the retail market, the resulting strong buyer power of retailers and the strong likelihood that buyer power is harming consumer outcomes in the grocery sector implies that:

- a mandatory code of conduct is a necessity, and
- compliance with the code should be overseen, monitored and enforced by an independent body.

The Code should address retailer use of buyer power to make unreasonable demands of suppliers and shifting risks to suppliers. It should also address the potential expropriation of suppliers' intellectual property and, to the extent possible, address preferential treatment of private labels. In addition, the Code should address the strategic barriers created by retailers attempting to influence or restrict the availability of suppliers' product to rivals, including new entrants.

Whistle-blower protections are required – for example, to allow suppliers to notify the independent body if a retailer requires suppliers to limit the supply of a product to the retailer's rivals. Code provisions should prevent retailers from boycotting (delisting) suppliers' products unreasonably.

While some of these types of conduct that would be addressed by the Code may also contravene the Commerce Act, these behaviours do not appear to have been effectively deterred. This is not surprising. A need to pursue lengthy and costly legal action means that the supplier would likely have long since been foreclosed from the market before the matter was heard before a Court.

4.2 Site access

The Commission identifies planning permission, the use of restrictive covenants and exclusivity covenants in leases as factors that appear to be impairing access to suitable sites for grocery retailing. While we do not provide detailed comments on these barriers to entry, we share the Commission's concerns that access to sites may be impeding entry. While in some cases, exclusivity covenants in leases may be justified, the burden of proof should fall on the party seeking the covenant.

4.3 Assessing the need for other measures to facilitate competitive entry

The Commission has identified a range of other possible interventions including wholesaling requirements and assisted entry. Whether these types of remedies are necessary hinges on whether less intrusive measures would result in retail entry.

Internationally, we observe that other comparable countries have more than two large supermarket groups. Ireland, which has a similar population to New Zealand, though is more compact, has seven competing supermarket chains. Norway, Finland and Sweden which, like New Zealand, have a long thin land mass, all have four major supermarket chains. Iceland, which has a much smaller population, also has four retailers. These international outcomes indicate that scale may not be a barrier to entry by least one to two additional retailers.

Table 4.1: List of supermarket retailers

Country	Number of Supermarkets	Supermarket brands	Source
Iceland[25]	4	Bónus, Krónan, Netto, Hagkaup	
Ireland[26]	7	Aldi, Dunnes Stores, Lidl, Super Value, Tesco, Eurospar, and Iceland	
Norway[27]	4	Bunnpris, **NorgesGruppen**, **Coop**, Rema 1000	
Finland[28]	4	**S Group, K Group**, Aldi, Tokmanni	
Sweden[29]	4	**ICA**, **Axfood**, Lidl, Coop	

This lists only the major supermarket chains. There could be smaller retailers that operate very few stores within/across regions. The retailers highlighted in bold are parent companies that operate multiple brand retailers within the country.

We note that the wholesale measures identified by the Commission will not address buyer power, and some of those measures could conceivably increase concentration at the wholesale level. As a result, the costs and benefits of such measures would need to be carefully considered.

We recommend that the Code of Conduct and remedies to address unjustified restrictions on access to sites suitable for supermarkets take priority. The Commission could then revisit the state of the sector either after a set time period, or through annual monitoring to determine whether further invention is required in future, if sufficient retail entry does not occur.

[25] https://skemman.is/bitstream/1946/38856/1/SandraBjort%26UnnurThordis_FINAL.pdf

[26] http://norma.ncirl.ie/3964/1/niamhdelaney.pdf

[27] https://refreshcoe.org/wp-content/uploads/2017/06/supermarkets-and-food-waste-FIVH.pdf

[28] https://www.nordeatrade.com/no/explore-new-market/finland/distribution

[29] https://www.sciencedirect.com/science/article/pii/S2211912418300646

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