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Draft Report
Market Study Into the Retail Grocery Sector

Submitters: Vegetables New Zealand and Horticulture New Zealand Incorporated

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Introduction

1. Vegetables New Zealand and Horticulture New Zealand welcomes the opportunity to make a submission on the Commerce Commission's draft report published on 29 July 2021. We look forward to further engagement as the Commission progresses this study and have applied to take part in the Consultation Conference.

2. In preparation for making this submission, we consulted with the horticulture industry's growers and representative groups. Their views and feedback are accordingly incorporated into this document. This submission is jointly made by Vegetables New Zealand and Horticulture New Zealand, on behalf of the horticulture sector. This submission is also supported by the following organisations: Central Otago Fruitgrowers Association, Horticulture Canterbury Growers Society, Katikati Fruitgrowers Association, NZ Apples and Pears, NZ Asparagus Council, NZ Kiwifruit Growers, Potatoes NZ, Process Vegetables NZ, Pukekohe Vegetables Growers Association, Strawberries Growers NZ, Summerfruit NZ, Tomatoes NZ.

3. The New Zealand horticulture industry supplies the majority of the country's fresh and processed fruit, berries and vegetables. Imports from other countries supplement what is consumed in New Zealand. Supermarket operations, in part due to the perishable nature of fresh fruit, berries and vegetables, make a significant mark up on these products. When there are supply shortages, the price of the fresh product increases, as does the mark up, but often, this does not result in any significant sharing of the increased margin with the supplier.

Transparency for Margin and Costs of Production

4. The Government's directive to the Commission largely focused on the price that consumers pay for their groceries, at the two supermarket chains in New Zealand. An integral part of the price that consumers pay is the mark up charged by all of the supply chain participants and the cost of production. When price increases for fresh produce are endured by consumers, the public's and media's focus is not on the margin that each of the supply chain participants are making but rather, what is the reason. More often than not, the reason is climatic either because of slower growing in winter or some adverse event like a hail storm or heavy rain. The other reason could be that there is not enough product ready for harvest, due to growers' planting decisions or there being only a small number of growers producing the product.

5. A number of resolutions are proposed by the Commission to ensure more effective competition. **This submission will only focus on the supply of fresh and processed produce, as that is within our core remit.** We do submit however that one of the most effective methods of ensuring pricing equity for consumers and suppliers alike is making public all of the supply chain participants' margins and the cost of production. This could be done electronically in real time. If this information was to be made public, it would be an immediate check on excessive profit being made in time of short and even normal supply. The result would be strong incentives for an equitable sharing of margin and the cost of production. It is important to note that the cost of production is likely to be higher in times of short supply, due to reduced yields and difficult operating conditions. The key point is the cost of trucking, distributing and selling that produce is no higher in this situation than it is in normal circumstances. Our understanding is that supermarkets can receive up to 100% gross margin on fresh vegetables and higher margin during times of short supply, as compared to dry goods, which have around 17.5% gross margin.

6. Even in times of "normal" supply, public transparency for the margins and cost of production would drive greater economies and due to public scrutiny, reduce the ability of any of the supply chain participants to charge higher than reasonable margins. A fair sharing of the margin and costs of production may well result in both the consumer paying less and the grower making a more reasonable return on what they are growing. In this situation, both the consumer and grower would be better off, and the supermarket would be making what could be considered to be a reasonable margin.

7. In our first submission, made at the beginning of the year, we provided evidence that grower margins have been static for many years. Given that the cost of production is increasing, adjustment to growers' returns is needed to ensure continued production and supply of fresh produce in New Zealand.

Commission's Supplier Recommendations

8. We fully support the Commission's recommendations to consider both a supplier code of conduct and to allow suppliers to collectively bargain. We submit that it will not be just one initiative or change that will change the competitive dynamic, as explained in the Commission's draft report. It will be the combination of a series of initiatives. In our submission, these initiatives will need to include margin and cost of production transparency, which is needed to balance the power differential between supermarkets and growers. As the Commission's draft report has found, this is because the supermarket duopoly and market share mean growers have limited market opportunity for selling. This, as has been shown in our submission made earlier this year, results in growers being unable to maintain their margins in the face of increasing costs of production.

Code of Conduct

9. During our consultation process with growers, we have identified a number of factors that we recommend be taken into consideration when considering a code of conduct.

10. Due to the different supply chains and the perishable nature of fresh produce, we submit that if there is to be a code of conduct, that there be a dry goods / frozen code and a completely separate code for fresh produce. The fresh code will need to uniquely provide for:
    - Quantity and quality standards for the fruit, berries and vegetables.
    - Timely delivery requirements.
    - When and under what conditions product may be rejected.

11. We submit that the code needs to be legally mandatory. The Australian experience is that voluntary codes did not work. We submit that it also would need to apply to all distributors and retailers, so that everyone is operating on an "even playing field"; be clearly drafted and be precise to avoid mis-interpretation. As a minimum, in addition to points set out in the preceding paragraph, key provisions of the code should cover:
    - Making retailer, distributor and supplier contracts mandatory and for these contracts to be in writing with an obligation to act in good faith
    - Setting out a formula or method for supplier / grower payments
    - Setting out the circumstances when payment may be withheld, or deductions made
    - Providing clear processes for category review, deletions, credit
    - Including independent dispute and appeal processes.

12. Feedback from growers has raised the issue of the supermarkets using their buying power to abrogate the intellectual property (IP) rights of growers, and packaging and marketing concepts developed by growers. We have specific cases where growers have developed their own retail brands. Supermarkets have then forced these growers to relinquish their brands and pack into house-branded packs. This maintains the ability of the supermarkets to "switch out" packers and rides over both grower IP development, and packaging and marketing concepts. We therefore submit that protection be offered to growers through the code of conduct to enable competitive outcomes to be achieved.

13. We submit that supermarket and distributor requirements around the packaging and packing crates be also addressed by the code of conduct. This is because, through the disparity of negotiating power, these costs are more often than not transferred to the growers. We submit that the code of conduct specifically address this point.

Suppliers Collectively Bargaining

14. We endorse for further consideration the Commission's view that *"Another method of addressing any power imbalance would be the introduction of collective bargaining on behalf of suppliers"*. We are of the view that this will most likely require an exemption from the Commerce Act. We submit that industry good organisations be able to administer and co-ordinate the collectively bargaining be one of the options. In our consultation with growers this option received strong support for further consideration. But we are also of the view that collective bargaining by suppliers will not be sufficient, on its own, to overcome a significant power imbalance between suppliers and major grocery retailers.

15. We note that the Australian Competition and Consumer Commission has recently introduced class exemptions for collective bargaining by small firms a collective annual turnover of less than $10 million. We submit that this monetary limit is far too low to make any appreciable difference, as the majority of growing operations involved in the supply of retailers individually would on their own exceed this monetary limit.

Conclusion

16. A fundamental issue has been referenced in part by grower feedback. Growers are trapped in a market dynamic that makes it very difficult for them to plan and "future proof" their businesses. The imbalance in market dynamics means the suppliers of fresh produce are unable to develop and improve both their products and their production practices, to better align with consumer preferences and environmental regulatory requirements.

17. As New Zealand and the world recovers and moves on from Covid-19, anyone in the business of selling anything will need to re-evaluate their business model. They will also need to assess how they can create enduring returns so that they can stay in business.

What worked before Covid-19 struck will not necessarily work in the post-Covid world. It will be necessary to reassess what is being offered and how it is being offered to the purchasers of the product. Current supermarket dynamics in New Zealand will not support the fundamental need to re-evaluate and innovative.

18. Fruit, berries and vegetables have four significant advantages over other products:
    1. Healthy food. Covid-19 has taught the world the importance of healthy food..
    2. Tiny environmental footprint. In New Zealand, we grow all our fruit and vegetables on less than 100,000 hectares.
    3. Sustaining rural communities. The fruit and vegetable industry employs a large number of people and although there is increasing mechanisation, we will always employ many people.
    4. Provenance. New Zealand has the reputation as one of the best places to grow high quality healthy food.

19. These four factors drive a value equation for consumers. But the challenge facing many of New Zealand's producers of fresh produce is how to continue to grow and deliver to New Zealand fresh produce in the current supermarket environment. We are advocating for improvements and ask that the Commission consider all possible ways and means to achieve an outcome that fits with the New Zealand market.