Promoting Competition in New Zealand

Chapter 4: Code or rule-making powers and other matters

Issue 8: Industry Codes or Rules

21 Do you consider that industry codes or rules could either:

a. Fill a gap in the competition regulation regime or
b. Provide a more efficient and appropriate response to addressing sector-specific competition issues rather than developing primary legislation

Introduction

There are significant issues with high-cost structures in New Zealand for many goods and services, with lack of both scale and competition being significant contributing factors.

I have senior level experience working in the oil, food and postal industries, and have owned and operated a SME in the construction industry. In this time, I have observed many instances of behaviour that restricts competition and prevents lower prices.

In this submission, the focus is on access pricing, and examples of how code or rule making powers could make a relatively quick and significant difference to market prices.

I propose that industry codes be able to, and encouraged to, create access pricing rules to enable any current or future market participant to purchase products and services at the same net prices directly from suppliers. This would be on the basis of defined order quantities, depending on the industry (eg pallet, truckload).

The key counter argument from large market participants is that the scale of their purchases should create scale efficiencies for suppliers, which should in turn result in lower prices for them compared to smaller participants. However, in price sensitive markets, this can have the effect of restricting or in the worst case eliminating competition.

Below are examples where use of access pricing under a code or rule making powers could lead to lower prices.

The oil industry

Historically, two of the least profitable downstream (distribution) markets globally were the United Kingdom and Australia. The key differentiating feature of these markets was a regulatory framework requiring terminal gate pricing. This enabled any market participant to turn up with a tanker and purchase fuel at the same price as any other participant.

In the NZ context, requiring terminal operators to supply to any participant would expand competition in geographical areas without the requirement to invest in terminal assets. As an example, Gull has expressed interest in gaining terminal access in the South Island and Wellington in order to compete in those local markets.

The challenge would be ensuring fair access where terminal supply is constrained and establishing a fair terminal pricing structure.

The grocery industry

One of the key barriers to both entry and growth for participants in grocery retailing is access to products at competitive prices. (media commentary from the Warehouse and Supie). The existing wholesale regime has not been able to deliver similar net prices to participants that enable them to compete with the existing two big participants (Woolworths and Foodstuffs). This is because the majority of discounts paid by suppliers are related to the store networks (in the form of promotional discounts, space payments, merchandising services), rather than any wholesale operations.

Suppliers have also been reluctant to offer new or smaller market participants the same net pricing as the two big participants. Possible reasons are:

- They believe that the purchasing power of large market participants should be rewarded with lower prices
- They are happy with their financial returns and the relationships with the existing participants
- They fear retaliation from the big participants if lower prices appear in the market (this would likely take the form of product deletions, store space reduction, reduced promotional frequency, refusal to take new products). Note that any retaliation would likely be subtle and over a long timeframe to avoid any regulatory spotlight

Access pricing rules requiring suppliers to treat all market participants equally could quickly result in increased competition:

- Existing smaller participants would have immediate access to loewr pricing (eg the Warehouse, Costco, independent store operators)
- New local participants could be encouraged to enter with a lower cost base (eg Asian supermarket operators, dairy operators)

Construction – the plasterboard example

Fletcher Building, through its Winstones subsidiary has in excess of 90% of the plasterboard market with its GIB brand. If customers wish to purchase GIB products, they must purchase them through one of the building supply merchants (Placemakers, ITM, Carters, Mitre 10 or Bunnings). However, the vast majority of deliveries are made direct from Winstones to the customer's building site, by-passing the distribution systems of the building supply merchants. The building merchants earn a margin for just running a billing service, much to the frustration of many customers. This also creates an incentive for the supply merchants not to stock competing products, for which they would likely have to operate the physical distribution.

If a code required plaster board suppliers to sell at the same price for the same delivery quantity, customers would most likely immediately switch to direct billing from Winstones to lower costs. If building supply merchants wanted to participate in the plasterboard market, they would most likely need to import their own supply of alternative products.

By way of comparison, the Fletcher company Laminex, which has a large competitor in the laminated board market, operates accounts direct with the end customers. In this market, there has been a gradual shift away from billing through building merchants by customers to reduce costs.

Comments on the existing Grocery Supply Code

The Grocery Supply Code appears to exist for the purpose of creating fairness between suppliers and retailers. A quick study of the feedback to the Review of the Code is virtually all focused around fairness in these relationships.

It is not clear, that this focus on fairness will lead to lower prices for consumers, which should be a key focus of any code of conduct.