



INDEPENDENT CONSUMER AND COMPETITION COMMISSION

2015 FLOUR INDUSTRY PRICING REVIEW



Final Report

30th October, 2015

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FOREWORD

Flour is a commonly used good within the formal PNG economy, both directly through the consumption of flour based products made at home, and indirectly through processed and manufactured food which uses flour as the primary input. The price of flour is important to many households in the more developed urban and semi urban areas throughout the country.

Prior to 2000, PNG's flour industry was characterised by one large manufacturer responsible for almost all of the flour in the supply chain. The industry now includes two manufacturers who mill and supply wheat, a number of importers who distribute or sell flour and flour premix products, and a diverse wholesale and retail sector. With this degree of competition in the market, the Commission has over the past decade reduced considerably the extent to which prices in these markets are regulated. In 2010, the Commission undertook a comprehensive review into the price setting arrangements for flour products. Following this review the Minister determined that prices of flour products should continue to be regulated under the provisions of the *Prices Regulation Act* (PR Act) and the ICCC Act via a price monitoring approach. The Commission considers that price monitoring is a relatively light handed approach to regulation and one step removed from complete deregulation. The 2010 decision expired on 30 June, 2015. Consequently the Commission has undertaken this investigation into what would be the appropriate level of regulatory oversight into the future.

The Commission has followed a public and transparent process in establishing the appropriate form of regulation for the flour industry for the next five years. As part of this process, the Commission is now releasing its final Report.

The submissions received in response to the requests for information by the Commission from relevant stakeholders and information received from targeted consultation, have been invaluable to the Commission in developing this report. The Commission would like to thank those stakeholders who assisted it in completing this review. Should you require any further information, please feel free to contact the Commission.

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Mr. Paulus Ain

Commissioner and Chief Executive Officer

Independent Consumer & Competition Commission

Inquiries

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In accordance with the provisions of the ICCC Act, the Commission has made this review process as transparent as possible. Submissions received by the Commission as part of this review are generally available for public inspection. Exceptions to this occur when, based on a request from the relevant stakeholder, the Commission considers that all or part of the submission should remain confidential due to commercial sensitivity.

Citation

ICCC 2015, *Flour Industry Pricing Review – Final Report*, 30th October, 2015, Port Moresby, Papua New Guinea.

About the ICCC

The Independent Consumer & Competition Commission (the Commission) is a statutory body established under the provisions of the *Independent Consumer and Competition Commission Act 2002* (the ICCC Act) to promote competition and fair trading, regulate prices of certain declared goods and services, and to protect consumers' interests, and other related purposes.

The Commission is empowered under the ICCC Act to have one full time Commissioner and two part time Commissioners which forms the ICCC Board. At the time of compiling this Report, the Board comprised of;

Mr Paulus Ain – Commissioner and CEO;

Dr. Eric Omuru – Associate Commissioner (Resident); and

Mr. Edward Willett – Associate Commissioner (Non-Resident).

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ABBREVIATIONS AND GLOSSARY

ABS	Australian Bureau of Statistics
AML	Associated Mills Limited – a subsidiary of Goodman Fielder PNG
CIF	Cost, insurance and freight
GDP	Gross Domestic Product
GFI	Goodman Fielder International (PNG) Ltd
ICCC	Independent Consumer & Competition Commission
ICCC Act	Independent Consumer & Competition Commission Act
MSG	Melanesian Spearhead Group
NGTB	Niugini Tablebirds – a subsidiary of Mainland Holding Limited
NZ	New Zealand
NZD	New Zealand Dollar
PNG	Papua New Guinea
PR Act	Prices Regulation Act
SKU	Stock Keeping Unit
USD	United States Dollar
NZS	New Zealand Statistics

2 EXECUTIVE SUMMARY

2.1 Findings

The Commission has completed its five year review of flour prices in PNG and has made the following findings.

Market Definition

For the purpose of analysis the Commission defined three markets for flour.

Wholesale Market

- A national market for flour. This includes all types of flour and includes supplies to manufacturers and retailers.

Retail market

- Separate geographic markets for flour, where other starches cannot be substituted.
- Separate geographic markets for starch where the cost of transport increases the price of flour and consumers might purchase other starches if they are cheaper than flour.

Findings on Competition

Overall the Commission found that all three markets had effective competition.

- No barriers to entry were identified.
 - While some submissions suggested that building a mill was a barrier to entry into the wholesale market, the Commission concluded that owning a local mill was not a requirement to supply the market.
- There was evidence of price competition between participants in all three markets.
- Customers in the wholesale market have countervailing market power. As many of these customers are retailers this also supports competition in retail markets.
- Customers in all three markets are able to choose between different brands owned by different suppliers.

Overall the Commission found that no single supplier had sufficient market power to increase prices without losing market share.

Current state of the market

While the Commission found that the market has effective competition, the level of competition did not appear to have increased since its last review.

- AML had increased its overall market share and was the dominant provider.

- While imports are providing effective competition, they have generally lost market share and probably currently supply less than 10% of the market.

Overall the Commission found that prices had fallen in real terms. However, they continue to be high by international standards. At present flour prices in PNG are twice as high as the lowest price in New Zealand.

Import Tariffs

The Commission found that tariffs on imported flour are bad for consumers. Estimates indicate that tariffs are costing consumers K19 million per year and add approximately 14 toea per kilo to the price of flour. The direct benefits received from local jobs provided by mills appear to be considerably less than this.

From the evidence presented to the Commission it appeared unlikely that local mills need the tariffs in order to survive. Gross margins for local mill operators appear to be healthy.

Because imports are an important contributor to competition, the Commission believes that consumers would be better off if tariffs on flour were removed completely.

Freight Costs

As for most consumer products, freight is a significant driver of costs. The Commission found that;

- Coastal shipping does not have effective competition. In light of this the Commission intends to carry out a review to consider what regulation might be introduced in order to protect consumers.
- Road freight has little or no barriers to entry and therefore competition is able to develop in order to meet market demand. While road freight costs are considered by many to be high in PNG, the Commission believes this is generally a reflection on the poor quality of roads and security issues rather than a lack of competition.

Monitoring

The Commission has determined that it will continue to monitor prices although it has made some changes to monitoring requirements.

- Factory gate price monitoring will be changed from listed prices to actual prices paid by customers net of discounts.
- The Commission will begin to monitor prices for flour sold by major importers where they exist. A major importer is defined as anyone who imports more than 10,000 tonnes of flour per year.
- The Commission will start to collect retail data on the lowest price available in retail outlets. This will allow it to compare prices more directly with internationally available indexes.

- The Commission will continue to collect retail and wholesale price data on major brands.

The Commission has also changed its use of international indexes:

- In response to the submissions, the Commission decided that it is more appropriate to compare factory gate price movements to international wheat price movements.
- Retail prices will be compared to other international retail price measures. In particular, the Commission will continue to use the Statistics New Zealand Food Price Index “Flour – white (supermarket only)” SAP0125 for 1.5kg of flour¹.

2.2 Determinations

Under the provision of Section 25C (3) of the PR Act, the Commission has made the following Determinations:

- Price regulation, through the price monitoring regime which currently applies to the ex-factory gate price of flour, will continue with additional data requirements, as set out in section 11.4 of this report, over the next five years.
- The declaration of price regulatory arrangements will apply for a five year period and will expire on 30 June, 2020.
- The form of price regulation to be applied will be:
 - Price monitoring of the ex-factory gate price net of all discounts for flour products under the provisions of Section 32A of the PR Act.
 - The Commission will require AML, NGTB and any other local mill owners to provide the Commission with the information listed in section 11.4 of this report
 - The Commission will require any importer, who imports more than 10,000 tonnes of flour per year, to supply the information listed in section 11.4 of this report.
 - The Commission will compare both miller’s factory gate prices and major importers prices to international wheat prices. In the event that there is a deviation between the monitored price movements and international wheat prices, the Commission may at its discretion require AML, NGTB, and other major importers to provide information on the reasons for the divergence. Such information could include the impact of the following costs and activities on the overall price of flour in PNG.
 - landing costs;

¹ See for example

http://www.stats.govt.nz/browse_for_stats/economic_indicators/prices_indexes/FoodPriceIndex_HOTPFeb15.aspx for February, 2015 data.

- labour costs;
- packaging costs;
- energy costs;
- advertising and marketing costs; and
- other costs

3 BACKGROUND AND CONTEXT

The current regulatory arrangements for flour products began on 1st July 2010 and ceased on 30th June 2015. Under these arrangements, the Commission has monitored the ex-factory gate prices of flour products. These ex-factory gate prices are submitted on a quarterly basis to the Commission by the two PNG based flour millers.

The two millers, who produce most of the flour consumed in PNG, are Associated Mills Limited (AML) and Niugini Table Birds Limited (NGTB). Both organisations have been providing the Commission with the required pricing information throughout the regulatory period. The Commission established an independent comparator price index which is used to benchmark the movement in the price of flour in PNG with the prices faced in New Zealand. The basis of the index was changed to New Zealand data after the Australian index that was originally being used was discontinued in June, 2011.

Associated Mills (AML) and Niugini Table Birds (NGTB) import wheat from overseas and mill the wheat at their respective flour mills in Port Moresby and Lae. Locally produced flour faces competition from companies importing flour into PNG for resale or for use in catering and bakery businesses. Over the last five years the number of flour importers has increased and in 2014 some 60 different organisations imported flour products.

The reasons for the increase in imported flour products over the last five years are likely to be reductions in import tariffs and growing imports from the Melanesian Spearhead Group of countries who are exempted from tariffs.

3.1 The Previous Review of the Flour Industry

In 2010, the Commission undertook a comprehensive pricing review of the flour industry under the provisions of Section 25A (6) of the PR Act to determine whether price regulation of flour products was still necessary given the changes in industry circumstances. Issues considered related to the manufacture, supply and import of flour and other flour based products, wholesaling and distribution of these products and the retailing activities of the industry.

The main finding of the review was that there was a case for regulation to continue in some form. Based on the findings of the review, the Commission, under the provisions of Section 25C (3) of the PR Act made the following determinations for the five-year regulatory period commencing 1 July, 2010:

- The Commission decided to continue to monitor the ex-factory gate price of flour from the two millers;
- The Commission decided to cease the monitoring of the in-country sea and road freight rates for flour products;

- The Commission decided to maintain the use of the existing ABS index to monitor the ex-factory gate price of flour from the two millers. The index was subsequently changed to New Zealand based data, as the Australian index was discontinued in 2011.
- In addition to the data provided via the monitoring arrangement, the Commission also decided to retain the option of requesting from millers information to support any changes in flour prices that are not consistent with the ABS index; and
- The Commission decided that a five year regulatory period was sufficient for the monitoring of the price of flour starting from 1st July, 2010 to 30th June, 2015.

3.2 Monitoring

The Commission currently receives standard price lists from both AML and NGTB. The lists provide prices before any discounts are applied. The price lists include a price per tonne and a price per bag. The list of packages included for each miller is shown Table 1.

TABLE 1: LIST OF PRODUCT PACKING ON MILLERS PRICE LISTS

Product	AML	NGTB
Plain Flour	5 x10kg, 10 x 5 kg, 20 x 2.5kg, 6 x 2 kg, 12 x 1kg	50Kg, 25kg, 10kg, 5 x 5kg, 10 x2.5kg, 6 x 2kg, 12 x 1kg, 18 x 500g
Self-Raising Flour	50kg, 5 x 10kg, 6 x 2kg, 12 x 1kg	50Kg, 25kg, 10kg, 5 x 5kg, 10 x2.5kg, 6 x 2kg, 12 x 1kg, 18 x 500g
Wholemeal	25kg, 5 x 10kg, 10 x 5 kg, 20 x 2.5kg	50Kg, 25kg, 10kg, 5 x 5kg, 10 x2.5kg, 6 x 2kg, 12 x 1kg,
Other Products including SKON, Premixes, Bakers Flour, Crackers, Biscuits	Various	Various

The Commission also collects retail and wholesale prices as listed in Table 2.

TABLE 2: PRICE DATA COLLECTED BY THE COMMISSION

Product	Retail Package sizes	Wholesale Package sizes
Plain Flour	10kg, 5kg, 2kg, 1 kg	5 x 10kg, 10 x 5kg, 6 x 2kg, 12 x 1kg
Self-Raising Flour	10kg, 5kg, 2kg, 1 kg	5x10 kg, 10 x 5kg, 6 x 2kg, 12x 1kg
Wholemeal Flour	10kg, 5kg, 2kg, 1 kg	5x 10 kg, 10 x 5kg, 6 x 2kg, 12x 1kg

The Commission currently collects price data from retail sites in major centres where the Commission has permanent staff. The particular suppliers currently surveyed are shown in Table 3 and Table 4. From these tables it can be seen that some suppliers are both wholesalers and retailers.

TABLE 3: LIST OF RETAILERS SURVEYED BY THE COMMISSION

Momase Region - Lae	Niugini islands Region - Kokopo	Highlands region - Goroka	Southern region - NCD
8-6 Shop	Papindo	Bintangor	RH Vision City
Food Mart	Tropicana Kokopo	New Century/Goroka FoodMart	SVS Koni
Andersons Foodland	K-Central	Daewon/Papindo	J Mart-Erima
Papindo	John J & H Seeto Kokopo	Istana	SNS-North Waigani
Zero City	A & J Trading - Rabaul	Seng Da	TST-Gerehu

TABLE 4: LIST OF WHOLESALERS SURVEYED BY THE COMMISSION

Momase Region - Lae	Niugini islands Region - Kokopo	Highlands region - Goroka	Southern region - NCD
Seeto Kui Wholesale	Tropicana Kokopo	Bintangor	Choulai Trading
Rabtrad	John J & H Seeto Kokopo	Goroka FoodMart	Patrick's Trading
SVS	K-Central	Daewon	Eliso-Erima
RH Hypermart	Tropicana Rabaul	Istana	Seeto Kui-Gordons
Raumai 18	John J & H Seeto Rabaul	Seng Da	RH Hyper Mart

3.3 Legislative Requirements

The current regulatory arrangements applying to flour products are governed under Sections 10 and 32A of the Price Regulation Act (PR Act). Under Section 10 of the PR Act the Government, through the Minister for Treasury, has declared that it is necessary that flour be price regulated until such time that there is a public dis-benefit from regulation.

Section 32A of the PR Act provides the Commission with powers to monitor the prices of flour products.

The provisions of Section 25A (6) of the PR Act provides for the Commission to initiate a review on its own accord when it considers appropriate. Section 25B outlines the process by which a review of a Pricing Order can be undertaken including:

- The timelines for such reviews to be undertaken;
- The requirement to publish details of its decision; and
- The form of decision that can be made as a consequence of such review.

Furthermore, Section 25C (3) of the PR Act specifies that as a result of a review, the Commission may decide to:

- Continue to operate the existing price control arrangements in their present form;
- Vary the existing price control arrangements; or
- Terminate the present price control arrangements.

The provisions of the PR Act provide the Commission with some degree of flexibility in undertaking reviews. Under a price monitoring arrangement, if it is evident that price movements are not reflective of appropriate competitive market benchmarks, the Commission can recommend to the Minister for Treasury that the relevant goods or services be re-declared for full price control.

The Commission, in undertaking this review in accordance with the above provisions of the PR Act, will have regard to the confidentiality and public disclosure provisions of the ICCC Act on information received from submissions and the current and prospective state of the flour industry in PNG.

Under Section 32A of the PR Act (Chapter 320), the Government through the Minister for Treasury, has declared the following flour products which are subject to price monitoring:

- Bakers Flour;
- Biscuit Flour;
- Soft Flour;
- Plain Flour;
- Wholemeal Flour; and
- Self-raising Flour.

3.4 Review Process

This review has been carried out under the provisions of Section 25A (6) of PR Act. The process followed by the Commission sought to facilitate stakeholders and public comments and transparency at all stages of the review period.

Stage	Action	Date
1	Public announcement of the inquiry, release of a Public Notice and invitation for submissions to be made on the Review.	31 st October, 2014
2	Release of the Draft Report and the invitation for submissions on the Draft Determination.	22 nd May, 2015
3	Closing date for submissions.	19 th June, 2015
4	Release of the Final Report and Final Determination.	30 th October, 2015

Copies of submissions received by the Commission in the conduct of this review (unless treated as confidential) are available for public viewing at the Commission’s office on a ‘Public File’ or copies can be obtained from the Commission at a nominal cost for photocopying. This Report is also a public document and can be obtained from the Commission’s office or through the Commission’s website on www.iccc.gov.pg.

The Commission thanks those stakeholders who have participated in this review process by providing comments and information to assist the Commission. The organisations which provided submissions are listed in Appendix 2.

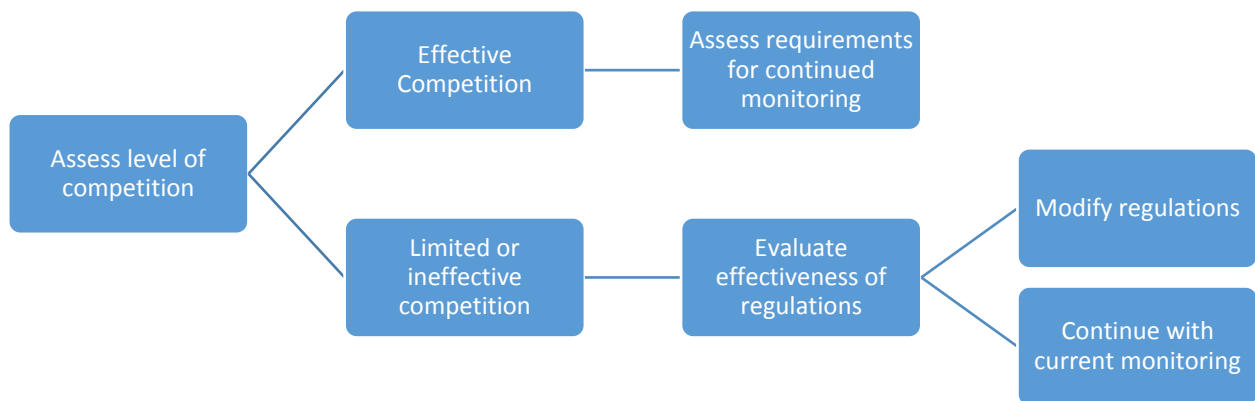
3.5 Framework for analysis

The Commission is required, under the provisions of Section 25C (3) of the PR Act, to consider whether to:

- Continue to operate price monitoring arrangements in their present form;
- Vary the existing price monitoring arrangements; or
- Terminate the existing price monitoring arrangements.

The steps in this process are shown in Figure 1 below:

FIGURE 1. COMMISSION’S CONSIDERATIONS AND APPROPRIATE STEPS



In order to make its decision, the Commission must assess the level of competition currently occurring in the flour market in PNG. If there is effective competition in the market then the Commission should remove existing regulations. However, if competition is limited or ineffective, then the Commission must consider what can be done in order to protect the interests of consumers.

This report describes the Commission’s assessment of competition. The assessment is based upon the evidence available to the Commission and the Commission’s determination as described in this report is based upon this assessment.

4 THE FLOUR INDUSTRY IN PNG

Though wheat is not commercially grown in PNG, wheat is imported and milled in the country to produce flour. Flour is used in the country for a number of purposes including the manufacturing of bread and biscuit products. It is also used in direct household consumption through homemade products such as scones and flour balls.

This Chapter describes the Commission’s view of the flour market and provides context for the Commission’s determination.

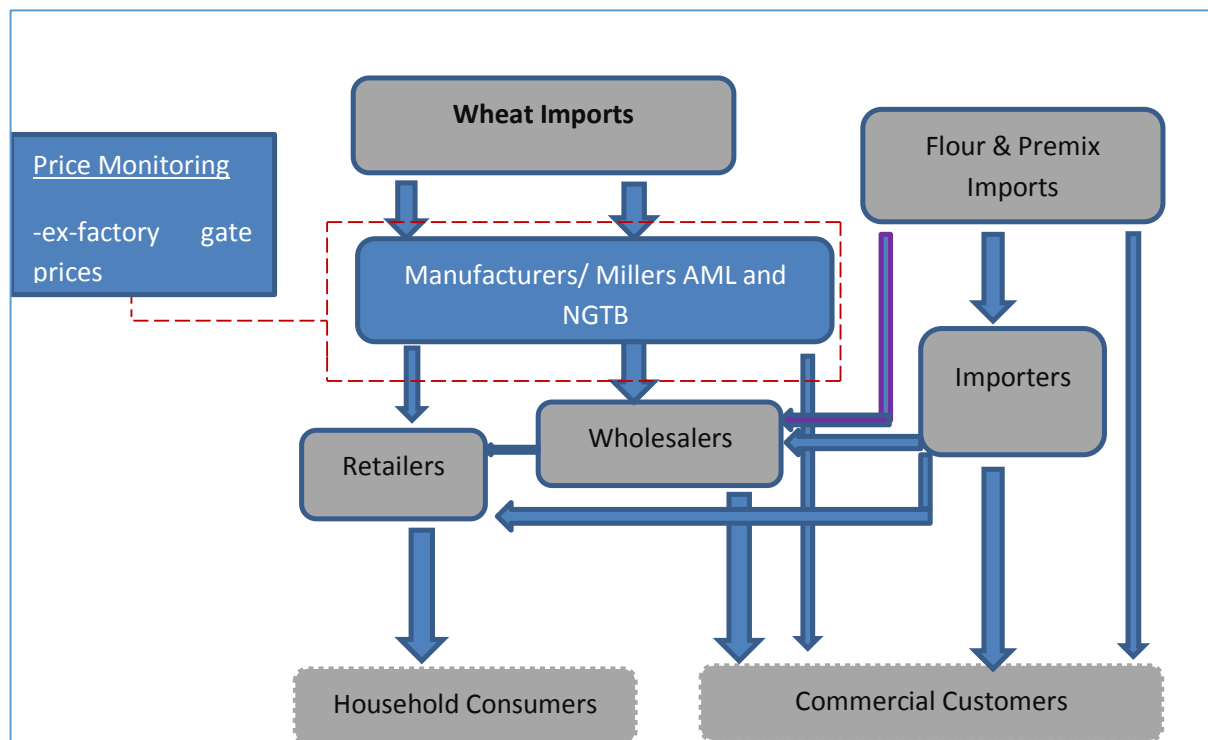
4.1 Market Structure

The flour industry in PNG has played an important part in the economic and social development of the nation. It has contributed to addressing food security issues for the nation. Each year 120,000 to 140,000 tonnes of flour are produced locally or imported. The market structure is shown in **Figure 2** and consists of;

- two companies who mill and distribute flour products
- a number of companies who import packaged flour and premixes, including commercial consumers
- wholesalers and retailers who supply flour products to both commercial and household consumers.

Wheat is not commercially grown in PNG thus the local millers import raw wheat mostly from Australia and process it into flour at their mills in Port Moresby and Lae.

FIGURE 2: BASIC MARKET STRUCTURE IN THE PNG FLOUR MARKET 2015



4.2 Manufacturers and Importers

There are only two flour manufacturers in PNG that import wheat and mill in the country to produce flour. They are:

- Associated Mill Limited (AML) - a subsidiary of Goodman Fielder PNG. Goodman Fielder was acquired by Wilmar International and First Pacific Company Limited on 17 March 2015.
- Niugini Tablebirds Ltd (NGTB) - a subsidiary of Mainland Holdings Limited.

Domestic manufacturing activities primarily involve the milling of wheat to meet specific flour grade requirements and the packaging of products for domestic sale. Flour comes in pack sizes ranging from 1 kg to 50kg and is distributed to major customers such as bakeries, biscuit companies, wholesalers and retail outlets/supermarkets. AML has mills in Port Moresby and Lae.

- NGTB has a mill in Lae.
- Both flour manufacturers have their products distributed nationally.
- Customers of the mills purchase their flour at the factory gate price and then arrange for transport to their main distribution points.
- Millers have minimum quantities which customers must purchase.

For AML the minimum order quantity is 4 tonnes and 1 tonne for any sku within an order.

Under the 2005 price monitoring arrangements transport costs to the main ports of Lae, Port Moresby, Rabaul, Madang and Wewak from the respective factories in Port Moresby and Lae were monitored by the Commission. But freight on-costs from the main distribution points to more remote areas were not monitored. The Commission decided to cease monitoring freight rates for flour under the 2010 Review.

Imports of flour to PNG are subject to a tariff (unless from a Melanesian Spearhead Group member), which over time has been reducing. In 2010, the tariff on Wheat Flour was 15 per cent. This was reduced to 12.5 per cent on 1 January, 2012, and then to 10 per cent from 1 January, 2015. Tariffs on a separate import category of “mixes and dough for the preparation of bakers’ wares” is set at a rate per tonne, and this has reduced from K124 per tonne in 2010 to K120 per tonne on 1 January, 2012 and K115 per tonne on 1 January, 2015.

Imports from a Melanesian Spearhead Group (MSG) member country (Fiji, Solomon Islands and Vanuatu) are exempt from import tariffs. The agreement between the MSG member countries on Trade Permits has remained effective for more than a decade and states that certain goods, including flour, be exempt from import tariffs.

The major importers of flour and flour mixes to the PNG market are listed in Table 5 (Source: Customs data):

TABLE 5: DESCRIPTION OF MAJOR IMPORTERS

Punjas Ltd	<ul style="list-style-type: none"> • Fiji based flour company which is established in Lae. • Entered the market in 2010 • Only sells 50kg bags of bakers flour • Supplies flour to Momase and the Highlands provinces. • Have established distribution networks. • Imports its flour from Fiji • Takes advantage of the free trade agreement under the MSG group and therefore does not pay import tariffs.
Lae Biscuit Company	<ul style="list-style-type: none"> • A major biscuit company in PNG, • Have a factory in Lae. Sources supplies from the two local millers but import only a small quantity of soft flour from abroad.
Garamut Enterprises Ltd	<ul style="list-style-type: none"> • A retail and wholesale business • Based in Wewak. • Expanded into opening a new mega mall at Harbour City, Food World Water Front mall. • Specialises in selling grocery lines and other products.
BNG Trading Co Ltd	<ul style="list-style-type: none"> • is a large importer, distributor and marketer of grocery products in PNG. • Has a wide range of products covering food, beverage, health & beauty and non-food items. • Trades in international brands and has also developed and launched a diverse range of its own private label brands. • Supplies the Bakery and Foodservice sectors • Has its own brand of bread pre-mixes and yeast. • Has two bakery development centres in Port Moresby and Lae.

It was noted during the last review that it is likely that the tariff itself is having a negative impact on the degree of competition in the flour market. The Commission expects that the removal of the tariff is likely to allow more competition in the market with a subsequent reduction in prices. Because tariffs on flour have continued to reduce, it is expected that flour prices have become more competitive. However, at the same time, this protective barrier has supported the development of a local milling industry. There was an expression of concern by NGTB in

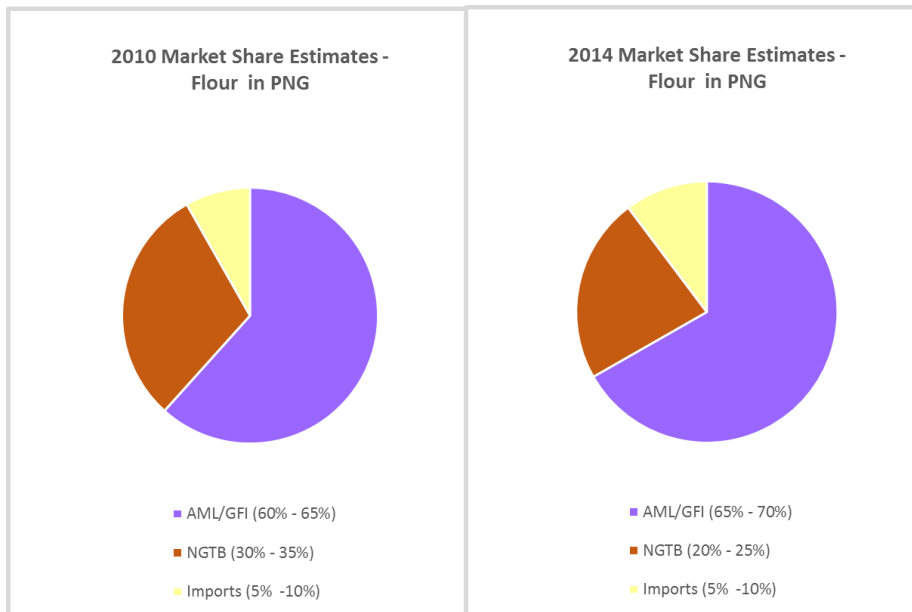
their submission that reducing tariff barriers is putting local jobs at risk, and they called for additional tariffs². However, tariff levels are set by the Government and not the Commission.

The total value of flour product imports increased dramatically in 2013, and this increase was maintained in 2014. The growth in the wheat flour import category has come from tariff free MSG countries. This issue is covered in more detail in section 8.

4.3 Market Share

Exact figures on market share in the PNG flour market are commercial-in-confidence. However, submissions, consultation and the Commission’s analysis indicated that market share is changing compared with the market situation outlined in the 2010 Review. In the last review, AML’s market share was reducing and NGTB and importers was increasing. However in the current review, the Commission’s market share estimates suggest that AML has increased its market share at the expense of NGTB. Imports appear to have lagged slightly behind market growth over the last 5 years. **Figure 3** below compares the market share in 2010³ and 2014 as per the Commission’s high-level analysis.

FIGURE 3: MARKET SHARE ESTIMATES IN THE PNG FLOUR MARKET 2010 AND 2014



From this the Commission observed that AML have increased their market share. While the market share of both imports and NGTB has decreased.

² NGTB submission, January, 2015, page 3.

³ This chart is based off the latest data submitted to the Commission, covering 2010 to 2014 and commission analysis. It differs from the chart presented in the 2010 Flour Industry Pricing Review p15, which had a higher upper estimate for imports, and a smaller lower estimate for AML share.

The Commission's assessment of the available market share data suggests that the total consumption of flour products in 2014 was around 130,000 to 140,000 tonnes. This is lower than the assessment during the last Review of 150,000 tonnes, though the Commission's current analysis suggests the total market has grown between 2010 and 2014 by around 12%. This suggests the previous total market estimate was too high, or that a fairly dramatic drop in total demand occurred during 2010, which seems unlikely. On a per capita basis, these figures give a per capita consumption of flour products of around 19kg per person for PNG, which is low on a worldwide scale. For example, consumption in the United Kingdom is around 70kg per capita.

In their submissions, the two millers indicated that they see considerable competition from imported flour products in the market. They think that tariff reduction is helping to encourage further importation in competition with the local millers.⁴

However, the Commission notes that while tariffs have fallen overall during the regulatory period, the local manufacturers have held their ground or slightly increased their market share.

4.4 Wholesale and Retail flour markets

The wholesale and retail sector of the flour industry includes;

- wholesalers,
- major supermarkets,
- cash and carry businesses,
- mini or small supermarkets and
- trade stores.

Wholesale and retail activities are independent from the operation of the millers. Although they act as competitors to the millers, when they are directly importing flour products from overseas. Recently, evidence has begun to emerge that some retailers are sourcing flour at discount rates based on quantity⁵.

Wholesalers are different from the millers in that they will sell smaller quantities of product to a retailer. For example, AML's minimum order size is 4 tonnes while a wholesaler will sell a single package of 12 x 1kg of plain flour. In some cases a company can act as both a retailer and a wholesaler.

4.5 Sea and road freight

⁴ AML submission on the Public Notice, January, 2015, p.6 and NGTB submission on the Public Notice January, 2015, p.3

⁵ The Commission has undertaken some interviews with retailers and wholesalers, who indicated that they do receive discounts for purchasing larger quantities.

The majority of flour in PNG is bought at factory gate prices from the two flour manufacturers and distributed to major distribution points including Goroka, Mt Hagen, Kavieng and Rabaul. Freight is usually arranged and paid for by flour purchasers rather than the manufacturers. Most land deliveries are managed by trucking companies with coastal shipping companies managing sea transport.

Transport of flour within PNG is independent of the operation of millers and importers. Flour transport can be delayed for a number of reasons including;

- Truck or ship break downs,
- Bad road conditions,
- Shipping delays and
- Port congestion.

Road and sea shipments can also be affected by looting. Because of the impact of these factors on transport, the availability of flour products varies. Limited availability of flour products ultimately means consumers of flour pay higher prices during the period of limited supply.

5 SUBSTITUTION AND MARKET DEFINITION

The existence of substitute products can reduce the ability of a producer to take advantage of market power. Substitutes are effectively competitors to a producer's product. They place limits on the ability of a firm to exercise any market power which they may or may not have.

In evaluating whether or not a business has market power, it is necessary to first define the market in which a company operates. The most common approach to defining markets for regulatory purposes is to identify the presence of substitutes in that market.

5.1 Substitution

Flour is a key input into the production of goods such as:

- Biscuits;
- Bread;
- Scones;
- Cakes; and
- Buns.

These foods can be either produced by manufacturers on a commercial basis or by consumers at home.

The Commission is considering whether there are any substitutes which may exert competitive pressures on flour prices and therefore constrain the ability of flour producers to charge inflated costs.

In its submission at the commencement of the review, AML stated the following:⁶

“Flour products, and food/meals made with flour products, are substitutable for rice, noodle and other starch products by PNG consumers. As such, these products represent a constraint to the pricing of flour products and consumers will change their meals and eating behaviours by substituting flour products with rice, noodle and other starch products if the price of flour products becomes uncompetitive with those substitutable products.”

AML have defined their substitutes as starch products rather than carbohydrates. Starches are a subset of carbohydrates. This essentially means that AML are excluding sugars as substitutes for flour. The Commission thinks this is a reasonable distinction as sugar and flour are used in different ways.

⁶ AML Submission on the Public Notice, January, 2015, p 5.

AML identify two potential substitutes to flour in the form of rice and noodles/pasta. Noodles can be made from wheat or rice, and pasta is made from wheat flour. So the price of locally produced noodles or pasta will depend on PNG flour prices. Importation of these products may provide a constraint to the pricing of locally produced products.

The Commission makes the observation that there are essentially four possible situations with regard to substitution of alternative foods for flour based products:

1. No direct substitute where a product must be made with flour, e.g. bread or pastry.
2. Substitution of the starch component of diet with another type of starch, such as changing to local vegetables, instead of bread or flour based products.
3. Substitution of a locally made flour based product with an imported flour based product.
4. Substitution of a locally made flour based product with imported starches such as rice or noodles.

This is illustrated in Table 6 below.

TABLE 6: SUBSTITUTES FOR FLOUR

	Flour Based	Non-Flour Based Starch
Locally produced	Food made from flours made from <ul style="list-style-type: none"> • Wheat, • corn, • rice, • nuts, • legumes or • other grains 	Locally grown food such as <ul style="list-style-type: none"> • Taro • Yams • Kaukau • English Potatoes • Bananas. • Cassava
Imported	Imported products made from some type of flour. This might include <ul style="list-style-type: none"> • Pasta • Biscuits 	Imported starches such as rice

Substitutes are generally available from the same retailers who offer flour and flour-based products. The Commission has analysed import data from Customs for rice and pasta, and notes that import “value for duty” for both categories has grown since 2010. While the value of imported rice has shown more modest growth of around 15% since 2010, pasta import value has risen significantly and is now more than ten times what it was in 2010. The value of pasta imports was around 1% of the value of rice imported in 2010, while it represented around 30% of the value of imported flour in 2010. The value of pasta imported in 2014 was around twice the value of imported flour⁷. It appears that imports of flour based products are increasing, and they are therefore becoming a more significant part of the PNG diet.

⁷ The levels of tariff on pasta is similar to that on flour, while rice is free of tariff.

5.2 Market Definition

Markets can typically be defined over multiple dimensions. The following table identifies a set of dimensions and provides comments on each one.

Dimension	Comments
Product	<p>The Commission is only considering flour as a food item. As a food item, flour is primarily considered to be a starch. Although it does contain other food groups. The Primary substitutes would therefore be other starches.</p> <p>Flour can be manufactured from wheat, corn, rice, nuts, legumes and some fruits and vegetables. The original minister’s declaration describes the type of flour to be regulated as</p> <ul style="list-style-type: none"> • Bakers Flour; • Biscuit Flour;; • Soft Flour; • Plain Flour; • Wholemeal Flour; and • Self-raising Flour. <p>It is however silent on the raw material required to manufacture flour. It does not specify that it must be wheat based flour. The Commission therefore is of the view that the declared market is any flour regardless of whether or not it is wheat based flour.</p> <p>The Commission thinks that there are two markets from a product perspective. Some customers will purchase flour because they specifically require flour while others are simply purchasing a starch. For example, in the flour market a bread maker must purchase flour. Other starches are not viable alternatives for making bread. However, a household who is looking for a source of starch for their family diet might choose starches other than flour if these were cheaper.</p>
Manufacturers	<p>Some manufacturers will have specific product requirements. This might include the proportion of “hard” or “Soft” wheat, used to create the flour they require. It is common for bakers to have very specific and customised requirements.</p> <p>Another requirement for a manufacturer might be that they wish to purchase flour in bulk. This relates to ease of handling larger quantities where delivery is via a specialised bulk flour truck rather than in bags which must be manually handled. This is likely to provide an advantage to a local manufacturer who can supply in bulk.</p>
Finished Goods	<p>Consumers can choose to either buy bread or pasta or to make their own. If a consumer chooses to make their own bread, pasta or other products then they will use flour as an input along with other inputs including their own labour.</p>

	Because finished products include other inputs in addition to flour, they are not in the same market as flour. So while foods such as bread and pasta might be seen as substitutes for flour, they are not in the same market as flour.
Geographic	For the starch market, the Commission notes that fresh vegetables appear to be more difficult to source in Port Moresby than in other places. This means that the range of starches such as Taro, Yams and Kaukau will be less available in Port Moresby and therefore there will be fewer alternatives available. This will impact the level of competition in the broader starches market but not the more narrow flour market described under the product section above.
Customer	<p>The Commission notes that there are two general groups of customers. Manufacturing customers and direct consumers, such as households and restaurants. Manufacturing customers purchase flour generally for the purpose of producing other products such as bread, biscuits and pasta. Direct consumers use flour directly in cooking meals to be immediately consumed.</p> <p>The Commission believes that manufacturers are more likely to have countervailing market power than direct consumers because of the quantities of flour they purchase. In particular manufacturers may choose to directly import their own flour. For this reason, the Commission believes they are a different market from direct consumers.</p> <p>Manufacturers are generally supplied directly by Wholesalers, while direct consumers of flour are supplied by retailers.</p>
Supplier dimension	<p>Suppliers can be split into two types.</p> <ul style="list-style-type: none"> • Domestic Millers • Importers of pre-packaged product <p>The Commission does not think that there is a supplier dimension to the market definition for flour. Suppliers of different types compete directly with each other and therefore compete in the same market.</p>
Pricing	The Commission did not identify any pricing structure elements which will create a separate market for flour. However, higher transport costs for fresh foods in some larger centres, do have an effect on the availability of substitutes. If a food item is significantly more expensive, then it will not be a viable substitute for flour.
Time	Flour by nature can be stored and kept for six to eight months. Because of this property, the Commission does not think there is a time element which would create a separate market for flour.

The information available supports a view that when customers resort to other products in the major centres in response to increased flour prices this constitutes “cellophane fallacy” substitution. An explanation of the fallacy can be found in Wikipedia.
⁸ https://en.wikipedia.org/wiki/Cellophane_paradox If goods substitutes for flour were

⁸ https://en.wikipedia.org/wiki/Cellophane_paradox

available, such that those products were in the same market as flour, then a price rise for flour would not be possible. When flour prices rose consumers would substitute readily to those other products. If the relevant retail markets were broader than flour, then it would not be possible to monopolise those markets by controlling flour supply. Thus the Commission believes that there is at least a portion of the market which is separate from the starch market. From this analysis the Commission has defined three markets as follows.

Wholesale Market

- A national market for flour. This includes all types of flour and includes supplies to manufacturers and retailers.

Retail market

- Separate geographic markets for flour, where other starches cannot be substituted.
- Separate geographic markets for starch where the cost of transport increases the price of flour and consumers might purchase other starches if they are cheaper than flour.

6 COMPETITION

6.1 Rationale for Competition as the Basis for Assessment

The primary objectives of the Commission are specified in Section 5 of the *Independent Consumer and Competition Commission Act 2000* (ICCC Act) and in Section 21 (2A) of the price regulation Act. They are;

- to enhance the welfare of the people of Papua New Guinea through the promotion of competition, fair trading and the protection of consumers' interests;
- to promote economic efficiency in industry structure, investment and conduct; and
- to protect the long term interests of the people of Papua New Guinea with regard to the price, quality and reliability of significant goods and services.

Competition is normally the most effective way to ensure that the interests of consumers are protected and enhanced. Where competition is effective, there is generally no need for price regulation. Regulated prices will almost always be an imperfect substitute for prices determined by competitive processes. They are likely to impose costs and distortions not present in a competitive market. Because regulators have imperfect information, regulated prices are likely to be set either too low, or too high. If they are too low they will deter investment and innovation. If they are too high then this is to the detriment of consumers. Further, regulated prices often lack the flexibility of market prices. Price regulation is only justified where markets are not competitive, where regulation can improve market outcomes, and the benefits exceed the costs.

Section 5 of the ICCC Act also notes that in seeking to achieve its primary objectives, the Commission shall have regard to the following facilitating objectives:

- to promote and protect the bona fide interests of consumers with regard to the price, quality and reliability of goods and services;
- to ensure that users and consumers (including low-income or vulnerable consumers) benefit from competition and efficiency;
- to facilitate effective competition and promote competitive market conduct
- to prevent the misuse of market power;
- to promote and encourage the efficient operation of industries and efficient investment in industries;
- to ensure that regulatory decision making has regard to any applicable health, safety, environmental and social legislation; and
- to promote and encourage fair trading practices and a fair market.

The common theme of the Commission's primary and facilitating objectives is competition.

Competition in the provision of a good exists where there is rivalry (or potential rivalry) between two or more businesses seeking to secure the business of a customer. In order to obtain the business of any individual customer, the businesses are under pressure to offer the most attractive product in terms of price and quality.

Competition drives companies to continually seek new and improved ways of providing products and services. Competition can be thought of as delivering more efficient production in three ways:

- *Productive efficiency.* Competition for customers requires that companies continually seek the lowest cost way of producing their products and services. If a new business can enter a market and produce and sell the same product at a lower price, any existing businesses can expect to lose market share and may be forced out of business. Competition therefore compels businesses to continually seek to reduce costs.
- *Allocative efficiency.* Competition for inputs among businesses selling differing products directs resources of the economy to where they are most valuable. This ensures that society as a whole is better off because the limited resources of the economy are being used in the most effective and efficient manner.
- *Dynamic efficiency.* Competition compels businesses to seek new and improved ways of doing things. For example, if a business is able to invent a new and more efficient way of manufacturing its product (or create an entirely new product), it will benefit by attracting additional customers.

The overall effect of competition is to drive businesses to;

- produce goods and services at a least cost,
- allocate the labour and material inputs to the production of goods and services to where they are most valued, and
- to seek new and improved ways of serving customers.

However, competition is not an end in itself. Rather, competition is in most situations the most effective mechanism by which customers receive low priced, high quality products suited to meet their needs.

Based on the primary objectives and facilitating objectives of the ICCC Act and the above discussion, it is the Commission's view that competition in the provision of a good, such as flour, is the most effective way to protect the long-term interests of consumers and deliver efficient prices to customers. It is for this reason that the Commission is considering the competitive state of the PNG flour market as the most important issue when assessing whether to continue, alter, or cease the existing price monitoring arrangements.

6.2 What is a Competitive Market?

The definition of a perfect competitive market described in textbooks exists rarely, if at all, in the real world. As such, it is necessary for the Commission to adopt a real-world definition that can be applied usefully.

The approach often adopted is to consider whether a market is ‘effectively competitive’. Where a market is ‘effectively competitive’ (sometimes also referred to as ‘workably competitive’) then;

- There is sufficient rivalry between businesses to ensure that they strive to deliver the goods and services consumers demand at least cost.
- Resources move relatively freely between and within markets in response to consumer demand and price signals.
- Consumers will have access to a reasonable degree of information to allow them to make choices and participate in the market.
- Businesses may have a degree of market power associated with product differentiation or innovation, but that market power will not be substantial or sustainable and will be subject to competitive erosion over time.
- At any particular point in time, resources may not be employed in their most valuable use, prices may deviate from costs and technologies can deviate from the most efficient ones available. However, over time, effective competition will drive the market towards efficient outcomes.
- Businesses will continuously strive for competitive advantage against actual and potential rivals. They will seek out new profit opportunities to deliver the goods and services that consumers want, and the market may always appear to be in a state of disequilibrium and change.

The Commission’s approach to evaluating effective competition is guided by the approach adopted in the development and application of competition law and policy. The following definition of effective competition has been applied by the Australian Competition Tribunal:

“As was said by the U.S. Attorney General’s National Committee to study the Antitrust Laws in its report of 1955 (at p. 320): ‘The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new or potential entrants in the field, would keep this power in check by offering or threatening to offer effective inducements...’.”

Conversely, the Hilmer Committee identified the characteristics of markets in which effective competition does not exist:

“Where the conditions for workable competition are absent – such as where a firm has a legislated or natural monopoly, or the market is otherwise poorly contestable – firms may be able to charge prices above the efficient level for periods beyond those justified

by past investments and risks taken or beyond a time when competitive response might reasonably be expected. Such ‘monopoly pricing’ is seen as detrimental to consumers and to the community as a whole.”⁹

THE EXTENT OF COMPETITION WITHIN A MARKET MAY ALSO VARY OVER TIME. MATURING MARKETS CAN BE CHARACTERISED AS PROGRESSING TOWARDS A MORE COMPETITIVE STATE AS SHOWN IN FIGURE 4 BELOW.
Error! Reference source not found.. THE CONTINUUM OF COMPETITION

In addition, the dynamic nature of markets over time demands that a forward looking approach to the state of a market be adopted. Clearly, regard must be had to evidence of what has actually been happening in a market but the most important question is:” what is likely to happen going forward?”

The Commission, in its assessment of the PNG flour market, has been guided by the definition of an effectively competitive market while noting that markets change and evolve over time and that a forward-looking approach is appropriate.

Based on the primary objectives and facilitating objectives of the ICCC Act and the above discussion, it is the Commission’s view that competition in the provision of a good, such as flour, is the most effective way to protect the long term interests of consumers and to deliver efficient prices to customers. It is for this reason that the Commission is considering the competitive state of the PNG flour market when assessing whether to continue the existing price monitoring arrangements. This approach is evident in other reviews and inquiries undertaken by the Commission.

In considering the competitiveness of the PNG flour market the Commission has investigated the following list of characteristics:

- Import Competition;
- Barriers to entry (and exit) for new participants;
- Substitutes;
- Competition between existing market participants;
- Countervailing market power; and
- Exercise of choice by customers.

6.3 Import Competition

Imported goods compete with those produced locally. A business that can import a product can avoid the need to establish its own manufacturing operations locally. The extent to which imports may contribute to an effectively competitive market depends on the cost of importing those goods. This in turn is reliant on factors such as the cost of shipping and import tariff levels.

⁹ National Competition Policy Review Report, The Hilmer Report, 25 August, 1993, page xxxiii

The quality of the imported product may also be a factor.

Imports can exert competitive pressure on the flour market in PNG as potential flour product suppliers can avoid the cost of actually setting up and operating a mill in the country, as discussed in the previous sections.

6.3.1 Submissions on imports

The submissions from the two millers have highlighted the impact of imports. AML sees significant competition for local flour suppliers from imported flour and observes that:

*“The main import player in this space is Punjas from Fiji. However, there are also significant imports from competitors in Australia, Malaysia and Indonesia, with new importers testing the market on a regular basis”.*¹⁰

NGTB also comment that there is a significant amount of imported flour impacting the sales of GFI and NGTB, with imports from Europe, Australia and Fiji. They also see competitive pressure from imported flour products:

*“The flour from Punjas, Fiji in particular, has taken bakery volumes from the local manufacturers and highlights a concerning trend where manufacturers from lower cost producing countries such as Fiji and Australia can enter PNG and displace locally produced flour.”*¹¹

AML submitted¹² that the short term nature of supply contracts is an indication that customers can easily and quickly shift to importers, thereby enjoying the advantage of any lower prices offered by importer of flour products.

NGTB raised concerns about the tariff rate:

*“As a manufacturer in PNG, Niugini Tablebirds would therefore request additional assistance in the form of additional tariff protection to offset the risk of imports as they are placing PNG local jobs at risk by not reflecting the huge disparity in costs of manufacturing in Fiji and Australia vs the costs associated in manufacturing in PNG.”*¹³

The millers’ submissions suggest that the continued drop in tariff rates for flour is allowing more flour imports into the market and exerting competitive pressure on the industry.

¹⁰ AML submission on the Public Notice, January, 2015, p.5.

¹¹ NGTB submission on the Public Notice January, 2015, p.3.

¹² AML submission on the Public Notice, January, 2015, p.4.

¹³ NGTB submission on the Public Notice January, 2015, p.3.

Punjas made the following comments;

"The miller's ability to charge prices above comparable international prices is curbed by imports - Imports keeps prices in check and the beneficiaries are consumers. We concur with Commission findings that existing & potential importers provide competitive pressure though small in nature on Local manufacturers thereby keeping pricing in check. Importers & millers are competing in terms of product differentiation. "

6.3.2 Advantages for Local Millers

In discussions with Stakeholders, it was suggested that local millers do have some advantages over importers. The following table discusses these.

TABLE 7: ADVANTAGES FOR LOCAL MILLERS OVER IMPORTED FLOUR

<p>Providing a tailored product to local customers</p>	<p>While a local miller may be more likely to tailor its product specification to local customer needs, there is no reason why an international manufacturer might not produce product which was customised to meet the needs of a specific customer in PNG. However, the customer would need to place orders which were large enough to make this type of customisation worth-while for the international manufacturer.</p> <p>The Commission expects that the larger the scale of a miller, the larger a customer's order would need to be to justify a customised product. So, if local millers were small in scale compared to international millers then they may have an advantage in this respect. However, the Commission would also expect that the large scale international miller would be likely to have a cost advantage because of their scale.</p> <p>In the Commission's view this dynamic reflects a firm's competitive strategy and is a healthy part of a competitive market.</p>
<p>Providing a fresher product</p>	<p>There seems to be a range of opinions about how long flour will last. However, the Commission understands that the shelf life of flour;</p> <ul style="list-style-type: none"> • Depends upon how it is stored. It will last longer if it is refrigerated or frozen. • Whole Wheat Flours where all the germ and bran is in the flour have a shorter shelf life. This is related to the oil in the flour that will go rancid over time. • Proteins and gluten in flours decay over time which means that their nutrient value declines with age. • Older flour will not rise as well when making bread. <p>A general web search indicated that for white flour a customer could expect the product to last for 12 months in the pantry.</p>

	<p><i>“If properly sealed or wrapped, all-purpose flour should last safely on your shelf for 10-15 months.”¹⁴</i></p> <p>However some sources indicated that shelf life may be shorter than this. For example see Table 8.</p> <p>From this the Commission expects that imported flours will have a shorter shelf life than locally milled flours due to the time it takes to import the product. In addition to the shipping time, Imported flour will spend time waiting to be loaded onto and off of ships, and waiting for customs clearance. The Commission does not have firm evidence of this, but expects that the shipping time will range between three to six weeks depending upon the origin. So imported flours may be up to 2 months old by the time a customer in PNG receives delivery of the product.</p> <p>From this it appears that freshness may be a factor when considering imported flours for some customers such as bread makers. However, the Commission does note that some bread makers have been importing their own flour. So while freshness is a factor, it is not a barrier to imports.</p> <p>The New Zealand Commerce Commission makes the following comments in regards to flour imported into New Zealand;</p> <p><i>“Industry participants viewed imported flour, which is generally sourced from Australia, to be the same or better quality than New Zealand milled flour. (Those parties who thought Australian Flour was a higher quality advised the Commission that this was because of the higher number of sunshine hours in Australia, which it was said, lead to higher protein content in the wheat)”¹⁵</i></p> <p>From this the Commission, concludes that imported flour can still be high quality.</p>
<p>Delivering in bulk to reduce handling costs</p>	<p>A local miller can deliver flour in bulk using a vehicle which is customised for this purpose. This avoids the customer having to handle flour in bags which is labour intensive and therefore more expensive. The Commission does not have information about the magnitude of cost savings available from bulk handling.</p> <p>The Commission expects that it would also be possible to deliver bulk flour internationally using sealed container liners or specialised containers. However, the Commission is not aware of any circumstances where flour is transported internationally in bulk. Food requirements are likely to place limits on shipping methods. Specialised containers would also be likely to incur the cost of returning the empty container to the point of origin.</p> <p>The New Zealand Commerce Commission noted that;</p>

¹⁴ <http://americanpreppersnetwork.com/2012/12/flour-facts-you-need-to-know.html>

¹⁵ New Zealand Commerce Commission decision 599, March, 2007, Paragraph 176, page 24

	<p><i>“The Commission understands that it is infeasible to import bulk flour due to difficulties in keeping moisture away from unpackaged flour.”¹⁶</i></p> <p>Whatever the reason, the Commission notes that there are difficulties associated with importing bulk flour. So the Commission agrees that it is likely that bulk delivery by the local miller is likely to provide at least some cost advantage.</p>
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TABLE 8: SHELF LIFE OF FLOUR¹⁷

	Pantry	Refrigerated	Frozen
Whole Wheat Flour		6- 8 months	1 to 2 years
All Purpose White Flour	6- 8 months	1 year	1 to 2 years

6.3.3 Analysis of Customs’ Import Data

The Customs’ data shows that flour is imported from Australia, Malaysia, Indonesia, US, UK and Hong Kong, as well as from MSG countries. Some wholesalers and bakeries are now directly importing flour for their own use.

Customs data analysed by the Commission shows that the values of total recorded imports under category 19.01.20, “Mixes and dough for the preparation of bakers’ wares of heading 19.05” have not varied substantially between 2010 and 2014, apart from 2012, where levels were around half¹⁸. Refer **Figure 4** below.

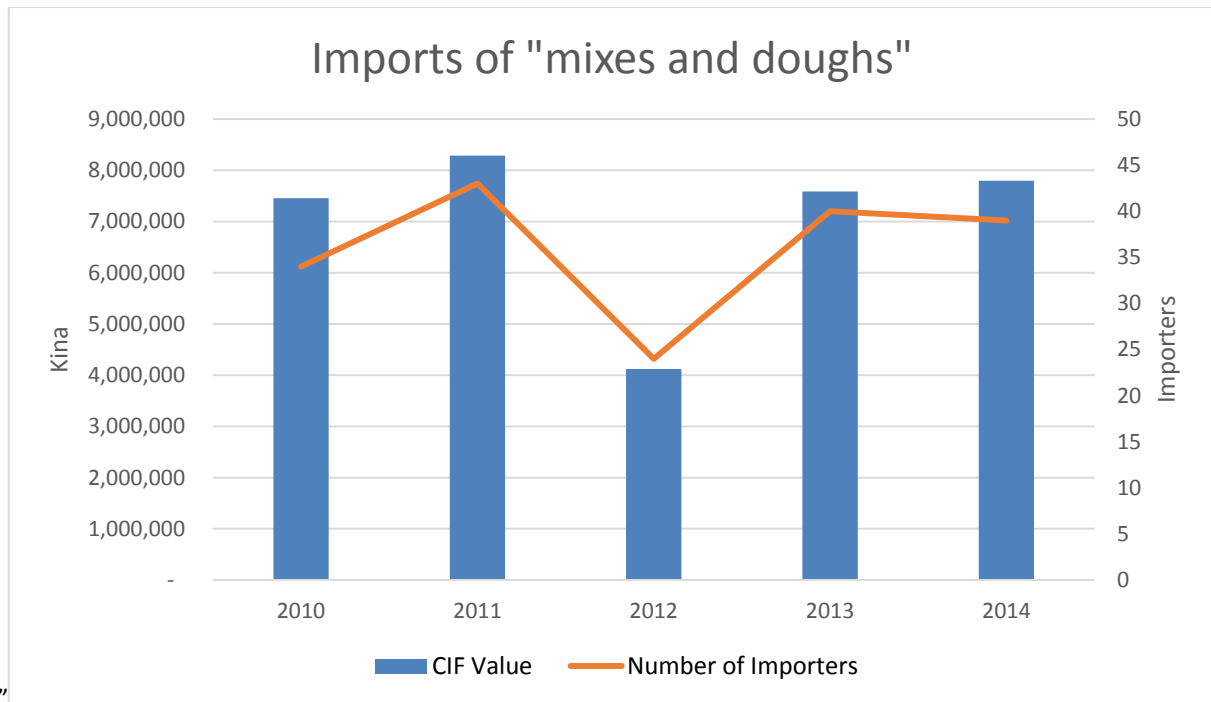
The number of importers during this time has varied between 24 and 43.

FIGURE 4: IMPORT VALUE AND NUMBER OF IMPORTERS “MIXES AND DOUGH FOR THE PREPARATION OF BAKERS’ WARES”

¹⁶ New Zealand Commerce Commission Decision 599, March 2007, paragraph 175 page 24.

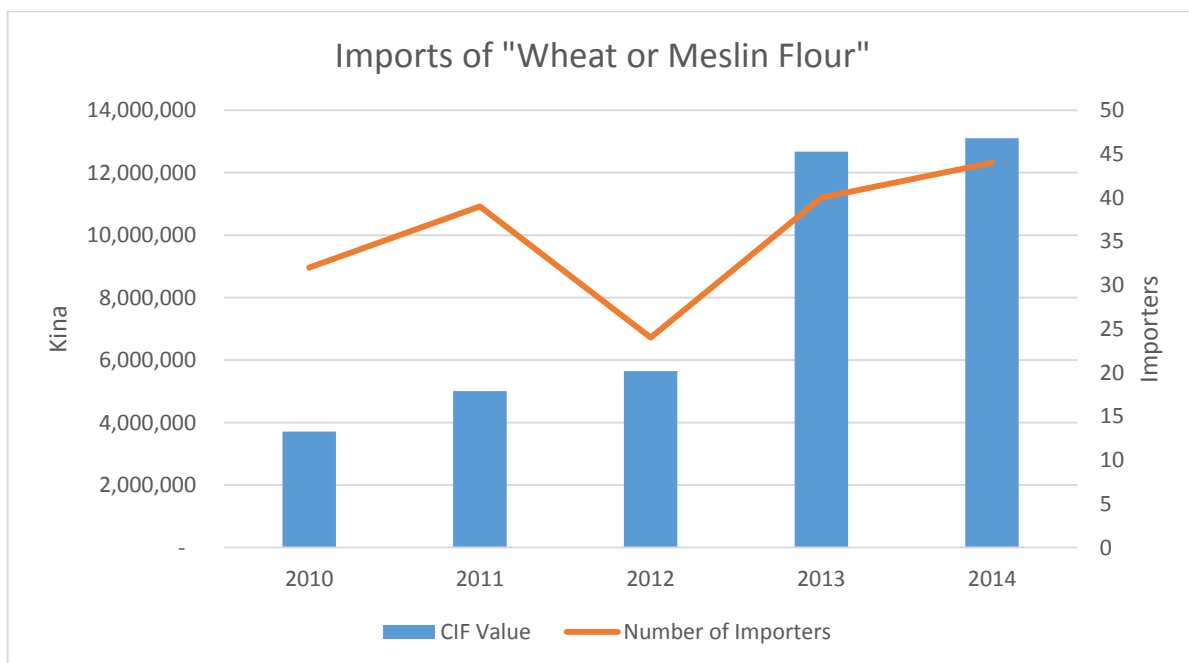
¹⁷ Boyer, Renee, and Julie McKinney. "Food Storage Guidelines for Consumers." Virginia Cooperative Extension (2009): n. pag. Web. 7 Dec, 2009

¹⁸ Average value of around K8.1 million excluding 2012.



Category 11.01, “Wheat or Meslin flour”, on the other hand, has shown considerable growth in total value between 2010 and 2014, with a dramatic increase in 2013, and a small increase in 2014 compared to 2013. Refer to **Figure 5** figure below. The total numbers of importers have also grown from 32 in 2010 to 44 in 2014. However, this is not as significant as the growth in the value of imports.

FIGURE 5: IMPORT VALUE AND NUMBER OF IMPORTERS FOR “WHEAT OR MESLIN FLOUR”



As already noted, the total number of importers has fluctuated over the last four years. However, the ease of entry into the flour market in PNG is supported by the change in the companies who are importing. The list of importers in tariff category 11.01 in 2014 contains

about a third of those on the list of importers in 2010. The actual number of importers on the list has grown from 32 in 2010 to 44 in 2014. So, fewer than 25% of importers in 2014 were also importing products in this tariff category in 2010.

The growth in imports suggests that imports continue to be an important source of competition for local millers. It should be noted however that the market share of imports (about 10%) has not changed significantly since 2010. But the growth in imports does show that imports continue to be a viable alternative to the two local mills.

In addition to the economic benefit of tariff reduction, the free trade zone established in 1993 is still in effect. Importers importing from the MSG group are not paying import duties on flour, thus allowing them the opportunity to charge lower prices. It appears that about 60% of imports are from the MSG group countries. However, in spite of this advantage, about 40% of imports are still coming from non MSG countries. The Commission does not have any information on how much of this specialised flours which are not provided locally.

Punjas has been identified as the major importer of flour from Fiji, taking advantage of the free-trade arrangement. It is clear from the import data, that Punjas has grown the value of its imports significantly. Other major importers include the Lae Biscuit Company, Garamut Enterprises Limited and BNG Trading Company Limited.

This report discusses import tariffs in section 8.

6.3.4 Conclusions on import competition

Based on:

- The Commission's analysis of the Customs data on imports,
- Information from the submissions to date, and
- The continuing drop in the level of tariffs.

It is clear that a level of import competition exists. A number of organisations are taking the opportunity to import flour products.

There is evidence that;

- The quantities imported have significantly increased over the last 5 years, as the total market size has grown.
- Market share of imports appears to continue to be about 10% of the total market.
- The number of importers has grown.
- There are a few importers that are importing significant volumes.
- These importers have the ability to compete for business with the local millers.
- The millers' ability to charge prices above comparable international prices is curbed by imports.
- The fact that one of the largest importers is not subject to a tariff enhances competition.

From this, the Commission concludes that imports are providing both actual competition and also the threat of increased competition to local millers. This conclusion applies to the national wholesale market.

6.4 Barriers to entry for new participants

In any typical market, barriers to entry can be detrimental to effective competition. Barriers to entry restrict the ability of new businesses to enter a market and compete against existing participants. If barriers to entry are high, then competitive constraints will depend on existing rivals. Barriers can be artificial or natural due to factors such as regulation (e.g. government monopoly) or economies of scale in production.

6.4.1 Submissions on barriers to entry

The only barriers, identified by AML in their submission¹⁹, are the high cost of purchasing milling equipment and purchasing or leasing land on which to operate a flour milling facility. The Commission notes that these are potentially the barriers to local milling of flour, but not barriers to importing flour.

¹⁹ AML submission on the Public Notice, January 2015, p.7.

Punjas also raised the “Irregularity and high cost of Shipping Services”²⁰ as a possible barrier to entry. However, this is a factor faced equally by all competitors in the market and therefore is not a barrier to competition.

Submissions have highlighted the fact that there are very low barriers to entry for imported flour. Both of the millers’ submissions stated that there has been significant growth in imports over the last several years, and that flour products can be cost effectively imported to compete with locally produced flour²¹. The recent growth in importers (refer section 6.3) suggests that there are no barriers to new importers.

Most organisations wishing to begin to trade in flour products in PNG will see cost efficiency in importing flour into the country rather than starting a mill. Once a flour trader has sufficient volume in the PNG market, they might consider the option of investing in milling equipment if this made economic sense compared to other options available to that supplier.

6.4.2 Mill investment as a barrier

There are two millers of flour in PNG;

- AML, which has two mills, one in Lae and the other in Port Moresby and
- NGTB, which has only one mill in Lae.

Prior to 2000, AML was the sole miller in PNG. Since the entry of NGTB in 2000 no other millers have entered nor exited the market.

Prior to the establishment of its milling business, NGTB was well established in Lae through its business as a chicken supplier. The entry of NGTB into the flour market in 2000 indicates that, at that time at least, any barriers to entry were not so large as to discourage market entry.

The costs of constructing a new mill and purchasing or leasing land are the only barriers to entry that the Commission has identified. Obviously in considering entry into a market, a possible entrant would estimate the upfront costs of establishing themselves in that market. A new entrant will only build a new mill if it has a reasonable expectation that it will be able to recover the cost and make a return on investment over the life of the mill. As already noted, it is more likely that a new entrant would initially begin by importing flour, rather than with local milling.

The Commission notes the comments made by the New Zealand Commerce Commission in its 2007 decision to allow Goodman Fielder to acquire River Mill Bakeries;

“The Commission considers the barriers to entry to the market for the production and wholesale distribution of flour is high, in particular the cost of setting up a new plant.”²²

²⁰ Email to the Commission from Mr Sunit Kumar, 5 January 2015.

²¹ AML submission on the Public Notice, January 2015, p.6 and NGTB submission on the Public Notice, p.3.

²² New Zealand Commerce Commission Decision No. 599, March 2007, Bullet 199, Page 26.

The Commission understands that there are some economic advantages that come from the scale of a flour mill. The sources of these advantages are derived from:

- Economies of scale from transport of grain resulting in lower shipping cost per tonne; and
- Economies of scale from labour costs. The same number of people can be used to operate a large scale mill as for a small scale mill, depending upon the level of automation.

These same economic benefits should be able to be derived regardless of where the mill is located. So if imported flours can compete in PNG, then a supplier can enjoy the benefits of scale regardless of whether or not it is located within PNG.

The key to deciding whether or not a mill located in PNG has an economic advantage must therefore be evaluated in terms of freight costs. The Commission understands that there are advantages where flour can be delivered in bulk (see Table 7). Because flour cannot be imported in bulk, the Commission concludes that having a local mill does have some an advantage in this regard. This advantage will be limited to the number of customers who purchase product in bulk. In the PNG context, this is likely to be limited to customers who have direct road access to the mill (Port Moresby or Lae).

In discussions with AML, they identified that they are currently considering the business case to replace and upgrade their existing plant. This consideration is being driven by:

- High maintenance costs due to the age of their existing plant;
- Constraints on production capacity. As the plant has aged, it is no longer able to produce to its design capacity due in part to maintenance outages;
- Improved yield available from newer plant; and
- Improved economics available from a new plant.

The Commission notes that this decision is being considered by an existing market participant with an existing market position and a strong market brand. This is a completely different decision from the situation where a new entrant might consider building a new mill in the country.

Importing, on the other hand:

- has low barriers to entry in terms of set-up costs;
- provides a wide variety of industry participants with a supply option;
- gives access to flour products that may not currently be available locally;
- is much lower risk than investing in a mill; and
- allows suppliers flexibility as market demand fluctuates.

From this, the Commission concludes that it does not appear that building a mill is a requirement for entry into the market. While having a local mill does provide an advantage for supplying customers in bulk, in PNG the number of these customers is likely to be limited.

If a third supplier were to build a new mill, the Commission would expect that they would already have sufficient established flour customers in PNG to warrant the investment. The Commission is not aware of any flour suppliers to PNG who are in this position. In view of this, it is unlikely in the Commission's view that any company other than AML and NGTB will build a mill in PNG during the next regulatory period.

6.4.3 Barriers to Retail

Flour is generally sold by retailers who sell a wide variety of groceries and food products. The Commission is not aware of any barriers to retailers selling flour or any barriers to new retailers establishing a new retail business. The only possible limitation to a new retailer, which the Commission is aware of, might be finding an appropriate site to establish their business. However, the Commission believes that there are opportunities to build new retail outlets in all major centres in PNG including Port Moresby.

The Commission does not therefore believe that there are barriers to entry for new retailers.

6.4.4 Conclusion on Barriers

Overall the Commission has determined that there are no barriers to entry for new entrants to supply flour to any of the three markets identified (see section 5.2).

The exception to this conclusion is suppliers who sell flour in bulk. For these suppliers, having a local mill will be an advantage and building a mill is likely to be a barrier to entry into this portion of the wholesale market.

6.5 Competition between existing market participants

Competitive markets normally exhibit competition between existing market participants. This competition keeps a continual check on prices and forces the participants to consider new and improved ways of operating in order to maintain and attempt to increase their market share.

Competition between existing market participants is characterised by activities such as businesses actively seeking new customers and businesses developing new products and services.

6.5.1 Competition in the Wholesale Market

As previously noted, the major market participants in the PNG flour market are the two millers (AML and NGTB) and Punjas, an importer of flour under the MSG agreement, with imports exempt from tariffs²³.

In its submission to the Public Notice, AML made the following statements²⁴:

“There is strong competition between the two existing local flour millers in PNG, being AML and Mainland Holdings/New Guinea Table Birds (NGTB), across all categories within the PNG flour market. There are frequent shifts in volume between AML and NGTB as to who supplies which customers in the market given the highly commoditised nature of flour and the short term nature of supply contracts.”

In this Report, the Commission has investigated the extent to which the above market participants are competing to sell flour to wholesalers (for subsequent sale to retailers) and direct to retailers (for subsequent sale to customers). The Commission notes that competition between existing suppliers is often characterised by the development and offering of new and differentiated products and services and through businesses actively seeking to maintain or expand market share.

With respect to new and differentiated products, the Commission notes that there are a relatively broad range of products available. These include:

- Baker’s Flour;
- Noodle Flour;
- Biscuit Flour;
- Plain Flour;
- Wholemeal Flour; and
- Self-raising Flour.

The submission by NGTB characterised flour pricing and the market in PNG as being highly competitive, especially in the commercial sector. NGTB provided a list of brands that are available in the market²⁵ as follows;

- 3 Roses (NGTB);
- Flame; (AML)
- Punjas;
- Fama’s Gold;
- Baker’s delight
- Village Flour;
- Besto;
- Black and Gold;
- White Wings; and

²³ Melanesian Spearhead Group member countries, Fiji, Solomon Islands and Vanuatu, are exempt from tariffs.

²⁴ AML submission on the Public Notice, January 2015, p.2

²⁵ NGTB submission on the Public Notice January, 2015, p.2

- Western Milling

These various brands are available in different sizes ranging from one kilogram up to fifty kilograms.

During the Commission's consultation, AML stated that discounts to standard prices are given to customers. In its submission, NGTB wrote ²⁶:

"Over the most recent period there has been quite intense competition between suppliers Goodman Fielder (PNG) and Niugini Table Birds, which has translated to reduction in prices seen particularly in Baker's flour. This has had an impact of benefiting our customers, the bakeries throughout PNG. In addition Niugini Table Birds has gained distribution to more retail outlets and that has provided a much enhanced choice to the consumers of flour throughout PNG offering quality Three Roses Flour in retail packs at a price advantage to consumers over the Flame brand. This increase in distribution is expected to continue into the next few months as Three Roses looks to gain access and provide much more choice to customers throughout PNG."

Submissions to the Commission from both millers say that discounts are being offered in attempts to capture additional business. AML have stated this in discussions with the Commission, and NGTB's submission makes several references to competitive pricing²⁷:

"...local companies have to be very price competitive to make sales"

"The very high levels of competition.....having a significant impact on the local manufacturers and resulting in high levels of competition and price reductions."

In interviews conducted by the Commission with wholesalers/retailers and bakeries, there was an agreement that suppliers did offer discounts.

In addition to competition between millers and importers for wholesale and retail customers, the Draft Final Report in 2010 identified evidence of competition further down the supply chain at the retailer-customer level. At this level, the 2010 Review found different brands were promoted actively to consumers by way of promotional pricing offers and advertisements in local media such as newspapers.

The Commission has concluded that there is evidence currently available to demonstrate that the millers and flour importers continue to compete by using product differentiation. In retail outlets around PNG, competing brands are presented side by side for sale to consumers.

The Commission has also observed evidence of changing market shares (refer section 4.3). This also supports a view that competition between existing market participants is exerting competitive pressure on the PNG flour market. This has although resulted in one supplier gaining more market share.

²⁶ NGTB submission on the Public Notice January, 2015, p.2

²⁷ NGTB Submission on the Public Notice January, 2015, p 4.

6.5.2 Competition among retailers

Retail prices are controlled by retailers. It is within a retailer’s discretion to decide whether or not to set the price of one product at a higher or lower price compared to another. Just because a wholesaler provides a discount to a retailer this does not mean that the retailer must necessarily pass this on to its customers.

However, in a competitive environment there will be pressure on retailers to reduce their prices where they can. If one retailer passes discounts on to its customers while another one does not, this is likely to encourage consumers to purchase from the retailer with the lower price.

Figure 6 and Figure 7 compare prices for AML and NGTB in the Momase and Niugini Islands regions. From this we can see that over the review period retail prices have varied. In the Momase region they have diverged and then converged again. In the Niugini Islands region AML’s prices increased in 2014 while NGTB prices did not. AML’s prices then reduced again. In the Commission’s view this is consistent with a competitive market.

FIGURE 6: COMPARISON OF RETAIL PRICES IN MOMASE REGION

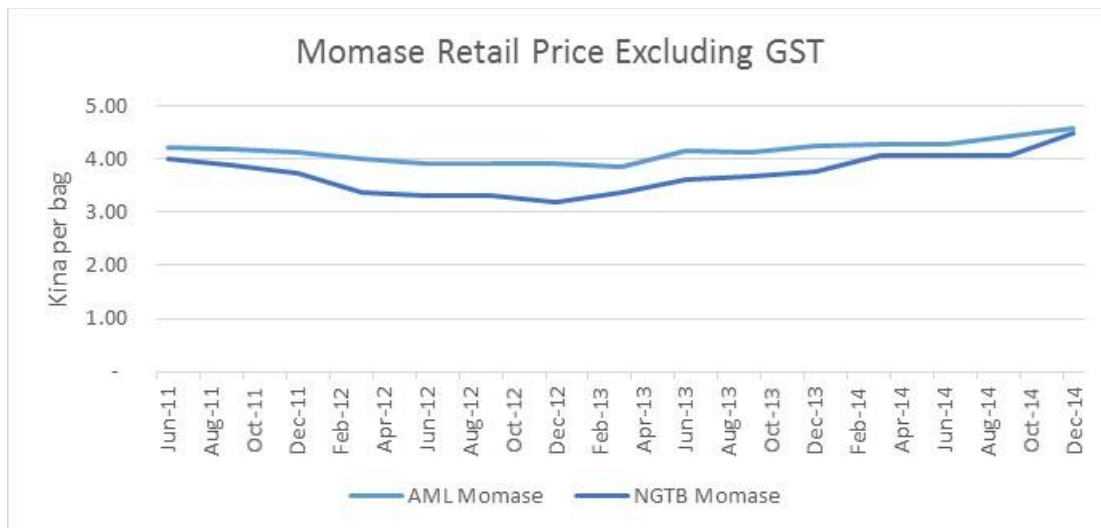


FIGURE 7: COMPARISON OF RETAIL PRICES IN THE NIUGINI ISLANDS REGION



In the draft report, the Commission sought input on whether discounts obtained by larger customers of the millers and importers, such as the wholesalers, retailers and bakeries, are passed on, at least in part, to consumers via reduced prices? The Commission received no submissions on this issue. However, the movement of prices in the above charts is consistent with retailers passing on cost savings in at least some instances.

6.5.3 Commission’s Conclusions

The Commission has found that there is evidence of competition between market participants. This is true in both the Wholesale markets and Retail markets.

6.6 Countervailing market power

Countervailing market power exists where a customer is able to exert some influence over a supplier to cause the supplier to amend its supply arrangement or vary the price of its good, thereby succumbing to the demands of the customer. Countervailing market power is therefore, most likely to exist for large customers where the loss of business suffered by the supplier is more significant if the customer rejects the offered terms.

In the PNG flour market, individual customers with potential countervailing market power consist predominantly of bakeries and biscuit makers (noting that wholesalers and retailers are also large customers who potentially have the ability to import directly from flour producers in other countries to limit the market of millers).

The extent of this countervailing power is reliant on the availability of alternative supply options of similar quality and quantity. The evidence available to the Commission indicates that there are alternative supply options given that each of the mills and major importers offer a similar range of products. This provides larger customers with the opportunity to ‘shop around’ and obtain the best supply arrangement. Large customers also have the opportunity to import

directly, thus providing another source of flour. Analysis of import data suggests that some importers are bringing in relatively small volumes of product, which may mean importing is also viable for some medium or even small customers. In addition, AML has indicated to the Commission that large customers are able to negotiate discounts below the advertised price lists, when these customers purchase larger quantities. NGTB's submission refers to price reductions in more general terms as a consequence of competing with importers such as Punjas, but obviously larger customers would be expected to have greater power to negotiate discounts.

AML seems to be observing some level of customer countervailing market power as customers move business between various suppliers:

*"There are frequent shifts in volume between AML and NGTB as to who supplies which customers in the market as customers move their volume between the suppliers in response to competitive pricing offers."*²⁸

Based on the evidence available, it appears that large customers potentially hold a relatively significant degree of countervailing market power that keeps a check on the prices able to be charged by any one supplier in the PNG market.

However, while large customers may possess a degree of countervailing market power, it is unlikely that smaller customers such as households are able to exert any influence on the price of flour charged by the millers and importers.

The Commission's 2009 review into the wholesale and retail market²⁹ concluded that there was sufficient competition in wholesale and retail markets to exert pressure on retail margins. Therefore, despite smaller households being unable to enter into negotiations directly with the millers and importers, they would be expected to benefit from the existence of countervailing market power at the wholesale, retail and bakery level. The Commission sees no evidence that this will have changed.

AML submitted in response to the Public Notice that:

*"The PNG flour market is highly competitive, with imported products, countervailing power of customers and substitutable products all providing meaningful competitive constraints to an already competitive domestic flour market"*³⁰.

Punjas wrote in their submission;

*"It is noteworthy that the commission findings indicates that there is a countervailing market power with large consumers of flour- like big bakeries and retailers - exert on flour suppliers, which keeps prices in check. There is no room for any player with uncompetitive pricing."*³¹

²⁸ NGTB Submission on the Public Notice January, 2015, p5.

²⁹ Final Report PNG Wholesale and Retail Industry Review, 12 October, 2009

³⁰ AML submission on the Public Notice, January, 2015, p7.

³¹ Punjas Submission 15th July 2015.

The Commission also notes that small consumers in the starch market can choose to purchase substitute starch products instead of flour. On the face of it this would appear to be a form of countervailing market power. However the consumer will most likely purchase these substitute starches from the same retailer who is selling flour. If the retailer adds the same margin to all products, then this effectively removes any countervailing market power from the small consumer. The small consumer will therefore be reliant upon the existence of competition between different retailers within their local geographic area.

6.6.1 Conclusions on countervailing market power

The Commission's findings are that customers in the wholesale market have countervailing market power. But customers in both the retail flour market and the retail starch market do not.

6.7 The exercise of choice by customers

Competitive markets are normally characterised by an ability of a segment of the customer base to access relevant information and exercise choice in their purchases. The ability of a segment of the customer base to exercise choice and switch between competing products compels producers to offer goods at competitive prices and with a high level of quality and service. If a producer does not offer goods at competitive prices, a decision by customers to switch to alternative suppliers offering more competitively priced goods will lead to a loss of market share and may lead to a producer going out of business. The more active customers are in responding to the offers by competing businesses, the greater the pressure on businesses to set cost-reflective prices.

The exercise of choice by customers, demonstrated through a willingness to alter purchasing behavior and switch from one brand to another, can place a significant competitive constraint on producers. While there is no direct evidence available to the Commission with respect to customers switching brands based on price and quality levels, there is indirect evidence in the form of the marketing and advertising activities being undertaken by the different brands.

Marketing and advertising is undertaken in attempts to maintain and grow market share. If the different brands did not believe customers would alter their purchasing behavior based on differences in price and quality, there would be no need to participate in the advertising and marketing activities. As already noted in this report, a range of brands of flour can be seen in the PNG market.

NGTB certainly see competition in brand terms:

"In addition Niugini Table birds has gained distribution to more retail outlets which has provided a much enhanced choice to the consumers of flour throughout PNG offering

quality Three Roses Flour in retail packs at a price advantage to consumers over the Flame brand.”³²

AML also believe that customers can and do exercise choice:

“The commoditized nature of flour means that flour suppliers’ products are substitutable and customers can quickly replace any uncompetitive offering with alternative sources of supply.”³³

And AML, like NGTB, see brand as an important facet of competition:

“NGTB, through their 3 Roses brand, are a strong #2 player in the flour market.”³⁴

The Commission observes that Retailers in PNG generally stock more than one brand of flour. This creates the opportunity for small consumers to compare prices and easily switch between brands. Small consumers can also choose between local retailers where multiple retailers are present.

Further evidence of customers choosing to change brands of flour can be seen from the change in market share over the review period (see section 4.1).




6.7.1 Conclusion on customer choice

The Commission finds that customers have the ability to choose between brands in both wholesale and retail markets.

6.8 Competition in the Wholesale Market

From these observations about factors of competition, the Commission’s findings about competition among millers and importers are shown in **Table 9**.

TABLE 9: SUMMARY OF WHOLESAL MARKET COMPETITION

Factor	Assessment		Comments
Barriers to Entry	Bulk Product		The Commission does not consider the high cost of building a mill to be a barrier to entry. This is because importing is a viable alternative to local production. The exception to this is bulk delivery to large customers which requires local production.
	Bagged Product		
Import Competition	High		Existing and potential importers will provide a significant amount of competitive pressure within the market in PNG.

³² NGTB Submission on the Public Notice, January, 2015, p3.

³³ AML Submission on the Public Notice, January, 2015, p4.

³⁴ AML Submission on the Public Notice, January, 2015, p5.

Competition between Participants	Medium	☹️	There is evidence of competition between market participants and that this is exerting competitive pressures in retail markets.
Countervailing Market Power	Some for large retailers	☹️	There is a degree of countervailing market power for larger customers and potentially medium sized customers, given the import data shows importing by market participants of extremely small volumes of flour product from a total market perspective.
	None for small retailers.	☹️	
Customer Choice	Medium	☹️	Customers do have the opportunity to exercise market choice and switch between brands.



The Commission concludes from this analysis that it is unlikely that any one flour supplier at the wholesale level has sufficient market power that they could increase prices without losing market share.

6.9 Competition in Retail markets

From these observations about factors of competition, the Commission’s findings about competition among millers and importers are shown in **Table 10**.

TABLE 10: RETAIL MARKET ASSESSMENT (FLOUR AND STARCH)

Factor	Assessment		Comments
Barriers to Entry for New Retailers	Medium	☹️	The main barrier in urban areas is access to a suitable site.
Retailer Access to Products	High for large retailers	😊	Large retailers can access a wide variety of products via imports, aiding competition. Tariffs have been generally reducing.
	Low for medium/small retailers	☹️	Small to medium retailers are reliant upon wholesalers due to their low volume requirement.
Access to Substitutes	Low Urban	☹️	Home grown food unlikely to be a viable alternative in urban areas.
	Medium Rural	😊	Home grown food is a viable alternative in rural areas.
Competition for customers between retailers	High urban	😊	Customers have easier access to a wide variety of stores in urban areas.
	Medium to low Rural	☹️	Much less choice in rural areas, and some distance to competing stores.
Customer Countervailing Market Power	Low	☹️	Generally no one customer of a retail outlet will have enough influence to cause a variation in the prices offered.

Retail Customer Choice	High Urban		Marketing occurs in urban areas as the numerous outlets compete, providing greater customer choice. Also a variety of outlets offering convenience (e.g. petrol station) or lower prices (e.g. supermarket).
	Low Rural		Fewer outlets in rural areas. Also reduced range of some food goods as transport and storage more challenging.

In the Commission’s view the retail market exhibits the characteristics of a competitive market in urban areas. However, in rural areas, because there may be a limited number of retailers available to customers in a particular geographic area and because small consumers have no countervailing market power, it is possible that some retailers may be able to inflate prices without significant loss of market share.

7 INTERNATIONAL PRICE MONITORING

7.1 Background

In 2005, the Commission developed a price monitoring arrangement based on the price of 2 kilograms of plain flour in Australia as reported by the Australian Bureau of Statistics (ABS). The average price from the ABS statistics was converted into Kina using an average Australian dollar/kina exchange rate from the Bank of Papua New Guinea. The monitoring arrangements were then to be based on the movement in the kina equivalent of the Australian price over time compared to movement in the PNG price of the relevant flour products.

In the 2010 Review the Commission noted that these arrangements had proved effective in providing the Commission with a basis against which to monitor PNG flour prices and analyse divergences between the two indexes. As such, the Commission concluded it was appropriate to maintain the use of the ABS index and the option of requesting from millers information to support any changes in flour prices that were not consistent with the ABS index.

However, during the last review period the Australian index was discontinued. The Commission therefore decided to use data from New Zealand. The data series used is now the Statistics New Zealand Food Price Index “Flour – white (supermarket only)” SAP0125 for 1.5kg of flour³⁵.

7.2 Review of price movements

Over the 2010 to 2014 regulatory period, the Commission has monitored flour prices as shown in Table 11: Prices monitored by the Commission. Not all the information shown in the table has been consistently collected because;

- Not all varieties are always available in all bag sizes.
- Retail data collection only began in June, 2011.
- Factory gate data was collected from the March, 2010.

TABLE 11: PRICES MONITORED BY THE COMMISSION

	Location	Bag Sizes	Varieties
AML Wholesale	Factory Gate (List Price)	1 kg, 2 kg, 5kg, 10kg	Self-Raising, Plain, Wholesale
NGTB Wholesale			
AML Retail	Momase, Niugini Islands, Highlands, Southern		
NGTB Retail			

³⁵ See for example

http://www.stats.govt.nz/browse_for_stats/economic_indicators/prices_indexes/FoodPriceIndex_HOTPFeb15.aspx for February, 2015 data.

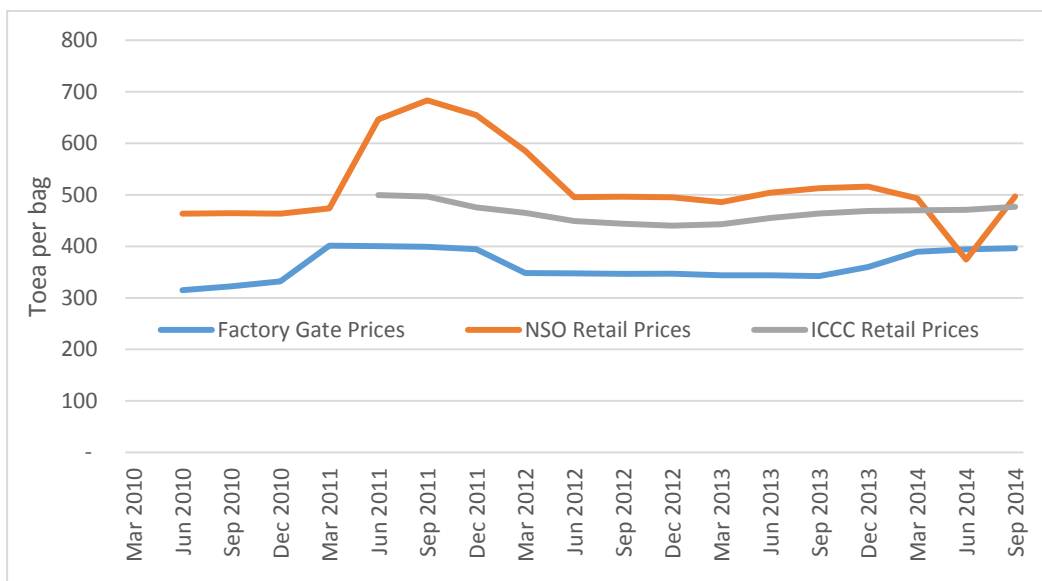
Factory Gate prices are the list of prices provided by AML and NGTB as specified by the Commission. However, it should be noted that these are not the prices normally paid by wholesalers/retailers. The Commission understands that most wholesalers/retailers receive a discount off the list price.

AML make the following comments about factory gate prices in their submission

“In line with the previous requirement of the Commission, AML has been submitting ex-factory prices on a regulator basis. However, this measure does not give the true sales pricing position for AML given the extensive levels of discounts we offer on our list price to many customers. Indeed almost all customers will receive a discount of one form or another, with larger customers attracting a cheaper price per tonne than comparatively smaller customers.”...“while the list price has grown steadily over the years, once discounts are stripped out, our effective price per tonne or Net Sales Value (NSV) has remained relatively flat. Discounts have risen significantly over the years as a cost of doing business for AML in an increasingly competitive market”...“NSV per tonne has increased only 2.3% whereas the wheat index has increased 40% in a similar period.”³⁶

In addition to the price monitoring carried out by the ICCC, the National Statistics Office (NSO), also monitors flour prices. Figure 8 shows how prices for a one kg bag of plain flour have varied over the regulatory period.

FIGURE 8: AVERAGE PRICE PER 1 KG BAG OF PLAIN FLOUR (REAL TERMS 2010)



Note: Prices shown are an average of AML and NGTB across all monitored regions.

The Commission notes that the NSO monitored prices show some significant variations which are not shown in the ICCC data. For example, from March, 2011 to September, 2011 the NSO data indicates that prices increased by over 50%. This is not consistent with the ICCC data. The

³⁶ AML submission July, 2015, Section 3

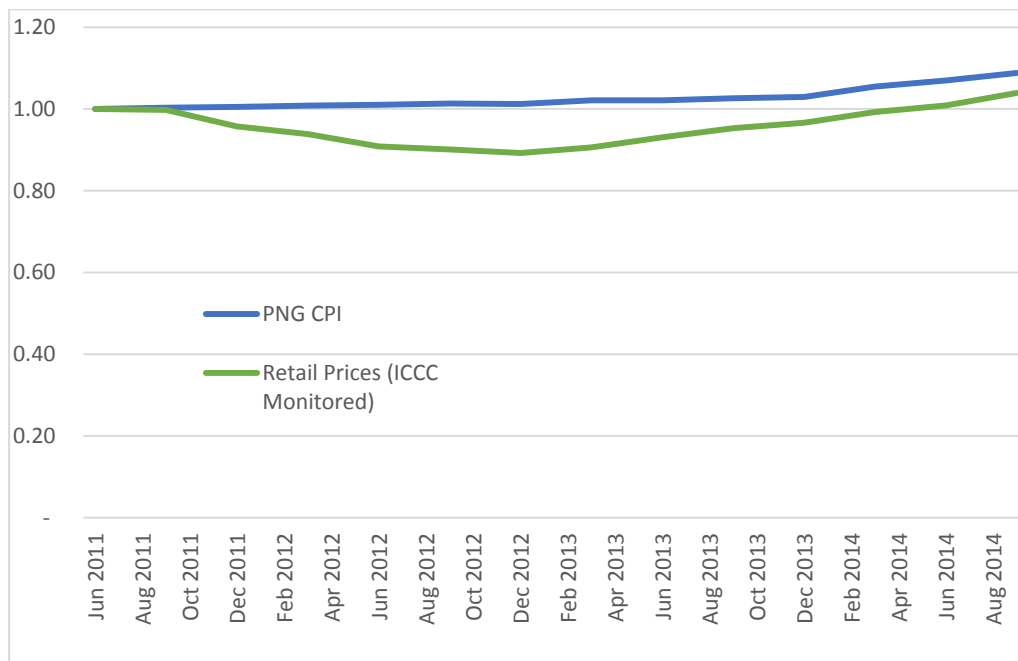
Commission thinks it is unlikely that prices increased by this magnitude during this time period. By June 2012, the NSO data series returns to a level which is more consistent with the other two data series. The Commission thinks that it is likely that there is some inconsistency in the collection of the NSO data. For this reason the Commission has not used the NSO data but has relied upon the data collected by Commission staff.

The Commission also notes that the difference between Factory Gate prices and Retail prices decreases in 2014. Without knowing the actual discounts received by retailers the Commission is not able to confirm the reason for this change. However there are two possible reasons;

- Increased competition among retailers driving down retail margins and prices.
- Increased discounting from Factory Gate Prices by wholesalers.

Another way of viewing the change in prices relative to inflation is shown in Figure 9. The CPI index shows how prices for a bundle of products and services have moved over the period. The reader can see that while the price of the bundle has gone up consistently, the price of flour has moved independently. Initially flour prices declined and then they rose at a slightly faster rate than the bundle.

FIGURE 9: RETAIL PRICES COMPARED TO CPI



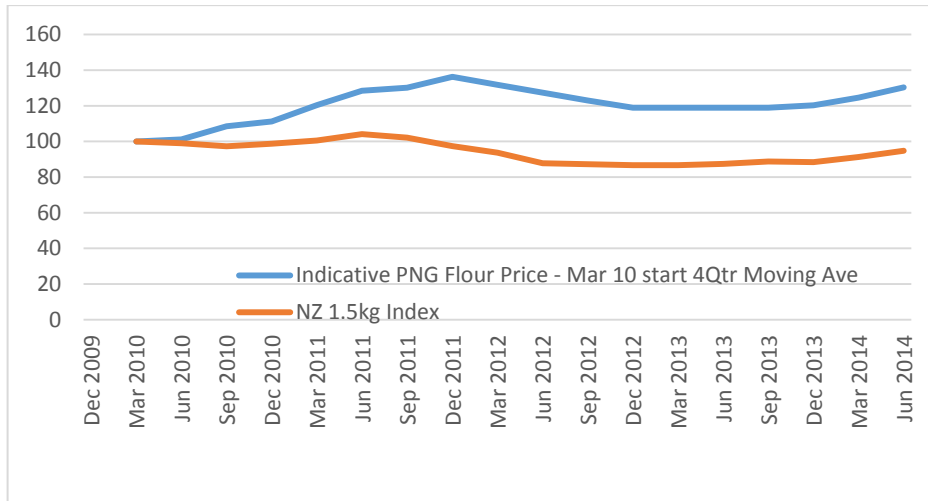
Note: Retail prices are the average across regions for a 1kg bag of flour then converted to an index.

In the Commission’s view this is consistent with a competitive market.

7.3 AML Submission

In the draft report the Commission presented the graph shown in **Figure 10** in order to compare PNG Prices to the NZ Benchmark. This was similar to the approach taken in the 2010 review with the exception that at that time the Commission was using an Australian Benchmark.

FIGURE 10: CONSOLIDATED PRICE MONITORING RESULTS



Note: The Indicative PNG Flour Prices are ex-factory Gate prices. NZ 1.5kg index are retail prices. Both have been converted to PGK before being converted to an index.

In response to this AML made the following comments in their submission;

“While the price of flour in New Zealand will be influenced by some of the same factors that will influence the price in PNG, we feel there are too many other factors impacting each specific market, such that the comparison will lose much of its meaning. These factors include, but are not restricted to:

- *Currency exchange fluctuations (NZD v PGK v USD).*
- *Significantly higher costs of manufacturing and distribution in PNG.*
- *New Zealand has a much shorter and increasingly efficient route to market compared to PNG. There are fewer intermediaries and often the manufacturer will market ‘Private Label’ type products direct to the retailer.*
- *The NZ benchmark is based on “the cheapest available brand or variety in each retail outlet at the time of price collection” according to SAP0125 of the food price index. The ex-factory price in PNG is an average across all products.*
- *The NZ food market has changed considerably over the last 4 years with significant downward pressure on price caused by the commoditisation of core food categories. Private Label is the dominant part of the flour market (...) and is increasing its share. The key retailers are also using frequent promotional activity to encourage shoppers to switch retailer, sometimes using short term ‘super specials’ that are likely to influence the food price index measure. Price has continued this flat to downward trend despite the wheat index increasing over the past 2 years in NZ (...).*

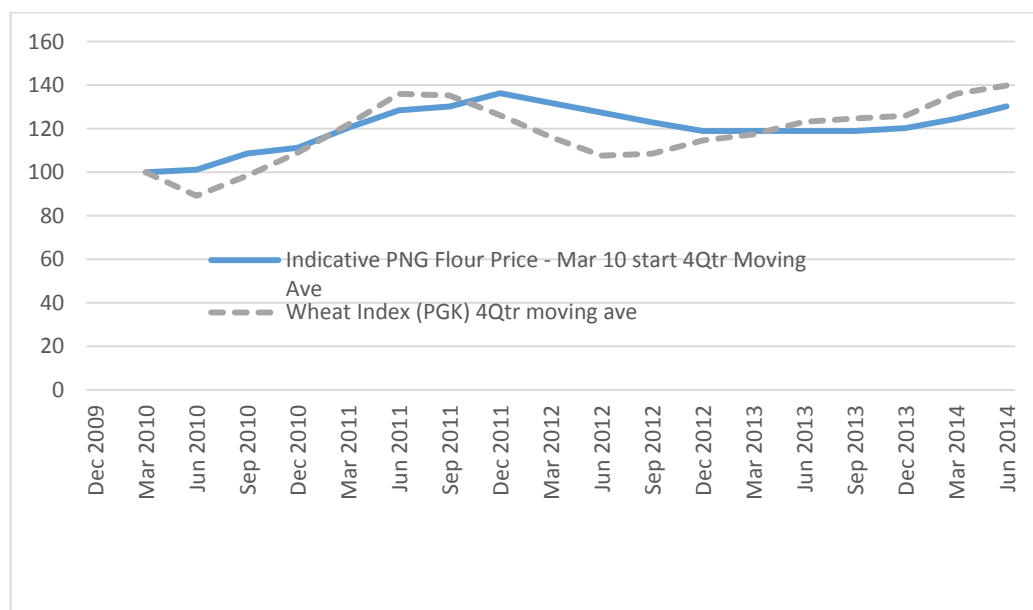
- *There has been much written in the business press in both Australia and New Zealand about these markets being home to some of the highest retail margins in the World and recent retail trends have displayed a correction of this historical anomaly, irrespective of input cost changes.*

Papua New Guinea operates in a much different wholesale and retail environment for flour with pricing influenced primarily by wheat costs (being around 65% of total manufacturing cost) along with costs such as sea freight, coastal freight, road transport, security and energy cost (approximately twice the cost of Australia’s). These costs and inefficiencies, added to the many intermediaries that handle the product before it is eventually sold to the consumer will further restrict the usefulness of the comparison between NZ retail pricing and PNG Ex-Factory pricing.

We contend that the best measure of comparison of the appropriateness of Flour pricing in PNG is a link to wheat costs as proffered in Figure 10 of the Commission’s draft report. Indeed this chart demonstrates very well the strong correlation between the two ...”³⁷

The “Figure 10” referred to by AML in their submission is as shown here as “Figure 11” for reference.

FIGURE 11: PNG FLOUR PRICE INDEX VS INTERNATIONAL WHEAT PRICE INDEX



Note: The Wheat index is the International Monetary Fund 2015 Commodity data index based on No 1. Hard Red Winter Wheat price FOB Gulf of Mexico, US\$ per tonne translated into PGK. It has been smoothed using a quarterly moving average.

In response to AML’s submission, the Commission makes the following observations.

³⁷ AML Submission July, 2015, Section 2.

- The Commission agrees with AML that the NZ index and the ex- Factory gate prices are not the same thing. Most notably;
 - One is a retail price and one is a wholesale price.
 - The Factory gate price is a gross price and does not reflect the discounts actually received by customers.
 - The NZ index is the lowest available price while the PNG Prices are an average price and only includes specified main brands.
- Many of the elements in New Zealand described by AML are likely to be the results of a competitive market. This includes private labels, efficient distribution and lower manufacturing costs. The extent to which these things are a reflection of competition adds to the validity of making comparisons between NZ and PNG for the purpose of this review.
- Differences in road infrastructure between PNG and NZ will create cost differences and these will not be a reflection of competition.
- The Commission notes AML’s submission that international wheat prices are about 65% of the manufacturing cost of flour. However, the Commission also notes that wheat costs are a much smaller proportion of retail flour prices (see Table 12).

TABLE 12: WHEAT COSTS AS A PROPORTION OF RETAIL FLOUR PRICES

	NZ (NZ\$)	PNG (PGK)
International Wheat Price (FOB Gulf of Mexico)	\$298	K607
Conversion Rate	76%	76%
Wheat Cost per Kg of Flour	\$0.39	K0.80
Domestic Retail Price (per kg)	\$1.23	K4.97
Wheat cost as % of retail price	32%	16%

Overall the Commission agrees with AML that the comparison shown in **Figure 10** does contain flaws and so the Commission has chosen a different approach using the data available.

Punjas in their submission wrote”

“Flour prices are mainly determined by wheat purchases outside PNG and kina devaluation.”³⁸

The Commission notes that both AML and Punjas agree that international Wheat prices are a good indicator of likely movement of domestic flour prices.

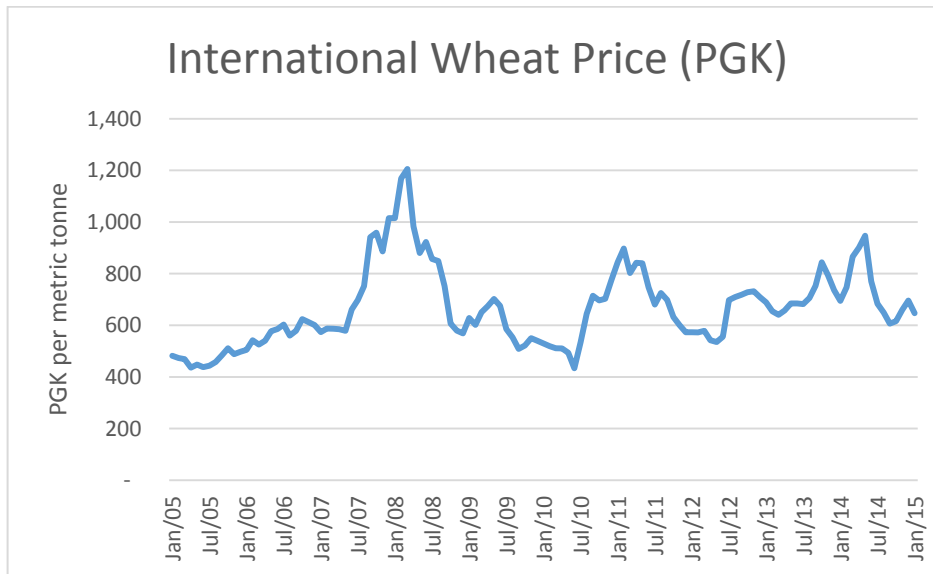
7.4 Wheat Purchases

Wheat is an internationally traded commodity in \$US. The PNG millers are price takers, given the size of PNG demand, and can have no impact on the world price of wheat. In the 2010

³⁸ Punjas submission 15th July, 2015

Review the Commission sourced a benchmark of international wheat prices and translated this price into PGK (this is the same index used in Figure 11). That analysis has been updated for this review, using the same source of data³⁹. The results are shown below in **Figure 12**.

FIGURE 12: INTERNATIONAL WHEAT PRICE (PGK PER TONNE)³⁹

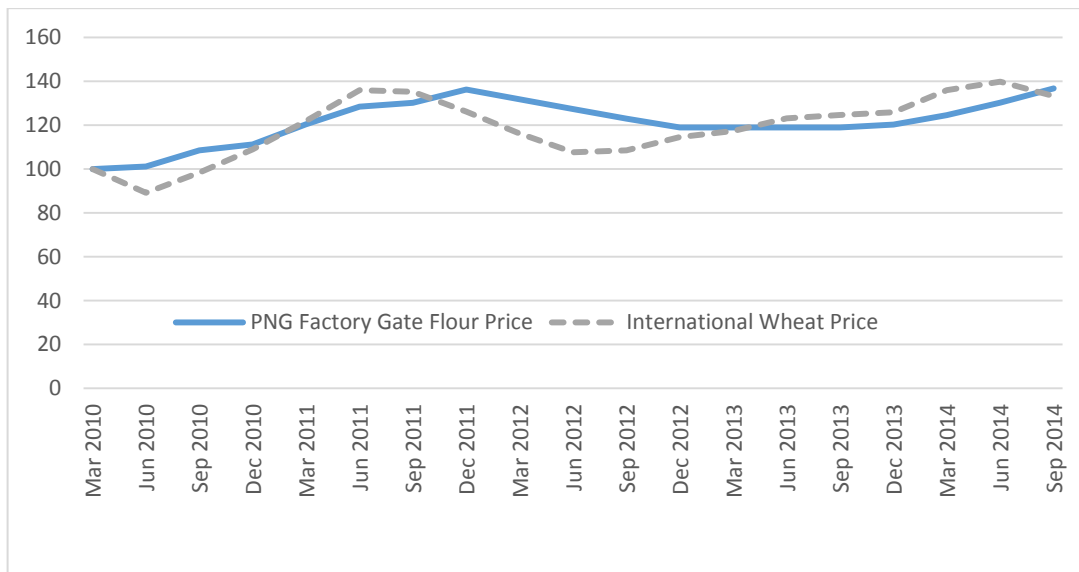


The 2010 Review noted that the price of wheat in the first half of 2010 had decreased to a level on a par with the 2005 price. The Commission at that time expected the combination of the reduced price of wheat and easing of inflationary pressures in PNG post the Global Financial Crisis of 2008 to result in a reduction in the upward pressure on flour prices. It can be seen that in fact the trend of lower international wheat prices in the first half of 2010 changed quite dramatically in the second half of 2010 to spike in early 2011 at a price that was around 70% higher than that at the beginning of 2010. While the international wheat price did subsequently reduce significantly, it continued to be quite volatile, and remains significantly above the early 2010 price.

To test the potential impact of the volatile international wheat price over the last 5 years, a comparison of an index of the international wheat price changes in PGK to the PNG flour price index has been constructed. See **Figure 13**.

³⁹ International Monetary Fund 2015 Commodity data index based on No 1. Hard Red Winter Wheat price FOB Gulf of Mexico, US\$ per tonne translated into PGK. See http://www.imf.org/external/np/res/commod/External_Data.xls

FIGURE 13: PNG FACTORY GATE FLOUR PRICE INDEX VERSUS INTERNATIONAL WHEAT PRICE INDEX (PGK)

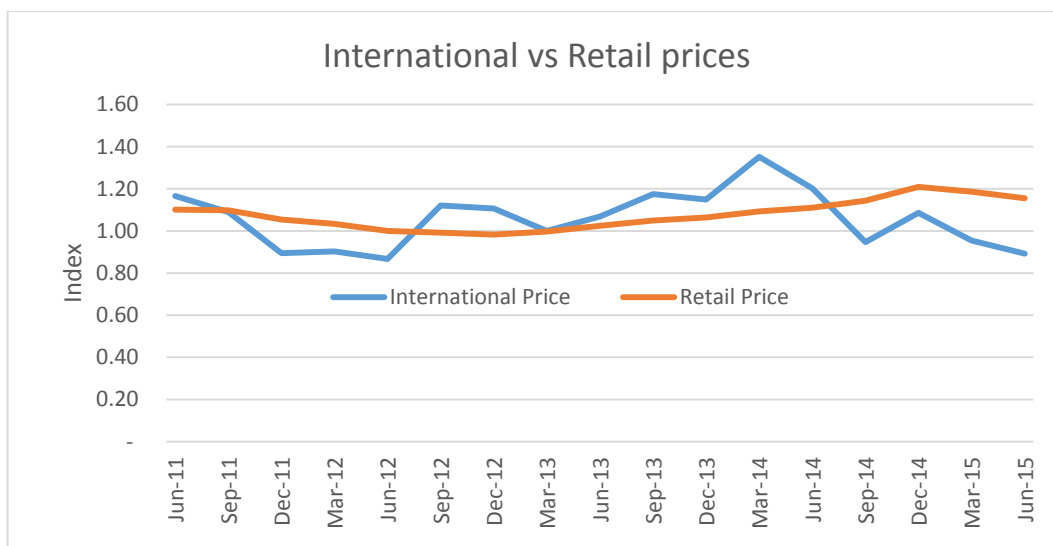


Note: Data have been smoothed using a 4 quarter moving average of plain flour in 1kg packs. International prices are FOB Gulf of Mexico.

The comparison of international wheat prices to the factory gate prices suggests that the factory gate flour price tends to follow the international wheat price in PGK, though with some lag of about six months. However it must be remembered that the factory gate price shown here is not the price that retailers actually pay.

The same comparison can be made between the retail price and international price as shown in Figure 14.

FIGURE 14: PNG RETAIL PRICE INDEX VS INTERNATIONAL WHEAT PRICE INDEX



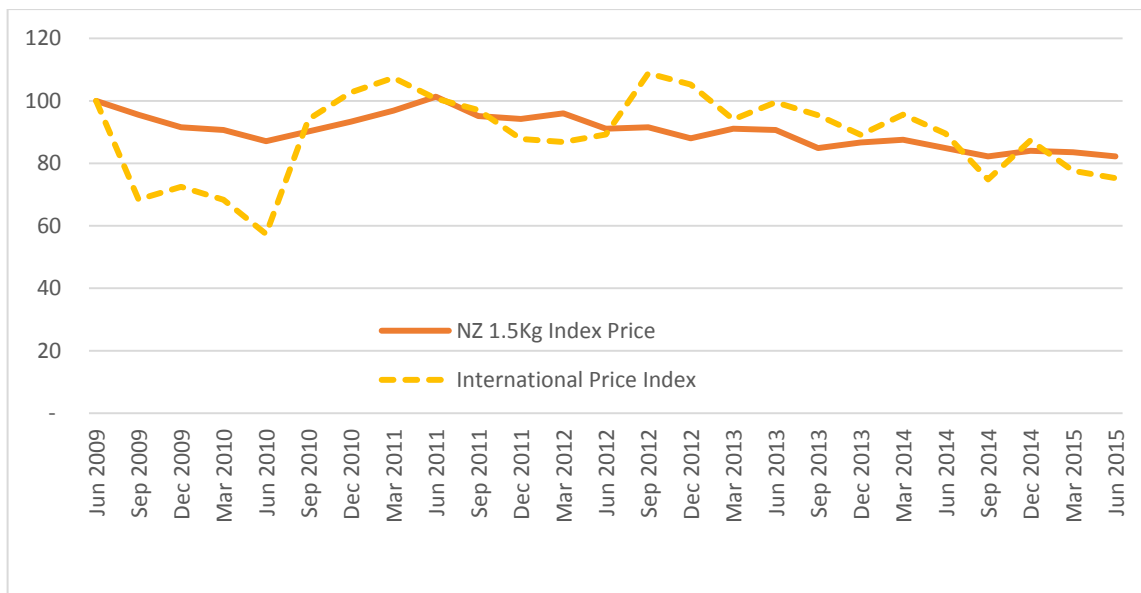
Note: The retail price is for 1kg packs of plain flour, averaged across the regions monitored by the Commission. The time frame is different than that used in

Figure 13, because the Commission’s retail price monitoring data only goes back to March, 2011.

From this we see that retail prices do not have the same level of volatility as international prices. As already noted the international price only represents 16% of the retail price. However, there is a general trend where by the retail price follows the international price.

The NZ index can also be compared to the international wheat price in NZD, and this is presented in Figure 15.

FIGURE 15: NZ 1.5KG FLOUR (RETAIL PRICE) INDEX VERSUS INTERNATIONAL WHEAT PRICE INDEX (NZD)



Note: NZ 1.5kg prices are for white flour sold in supermarkets. International prices are FOB Gulf of Mexico.

From Figure 15, it can be seen that New Zealand retail prices have generally followed international wheat prices. As already noted, the international wheat price represents about 32% of the retail flour price (see Table 12). As already noted by AML in their submission (see earlier section), there are variety of possible reasons for a declining New Zealand flour price. Possible explanations for this could be;

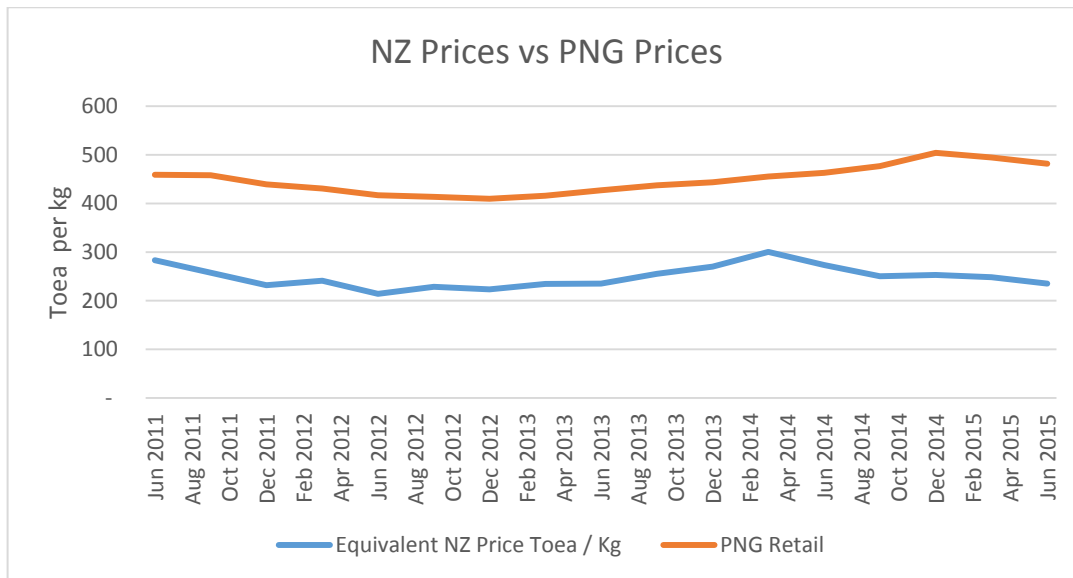
- Increasing competition in NZ driving lower retail prices which is reducing margins for retailers.
- NZ imports most of its wheat from Australia. Australian wheat prices may move independently from Gulf of Mexico prices upon which the International data is based.
- . The New Zealand dollar has gained in strength against the Australian dollar generally up until March 2015. So it is likely that actual wheat input costs to New Zealand flour mills may have been increasing over some of this period.

Overall the Commission sees no discrepancy between NZ retail prices and international prices. This supports, but does not prove, the supposition that there is validity in comparing changes in domestic prices to changes in international cost inputs.

7.5 Retail Prices

Figure 16 compares New Zealand supermarket prices for a kilogram of plain flour to PNG prices for a 1kg bag of plain flour. The Commission notes from the AML submission that this is a comparison of the lowest available price in a New Zealand supermarket against the average price of AML and NGTB brands in PNG Retail outlets. While the AML and NGTB brands represent the largest share of the PNG market, the Commission does not know what portion of the New Zealand market is represented by the cheapest available brand at any point in time.

FIGURE 16: NZ PRICES COMPARED TO PNG PRICES



Note: The Equivalent NZ Price shown is the NZ\$ price for 1.5 kg bag of plain flour converted to toea per kg using monthly average cross exchange rates.

From this comparison the Commission notes that as NZ prices have fallen, they have reached a point where they are half the price of flour in PNG.

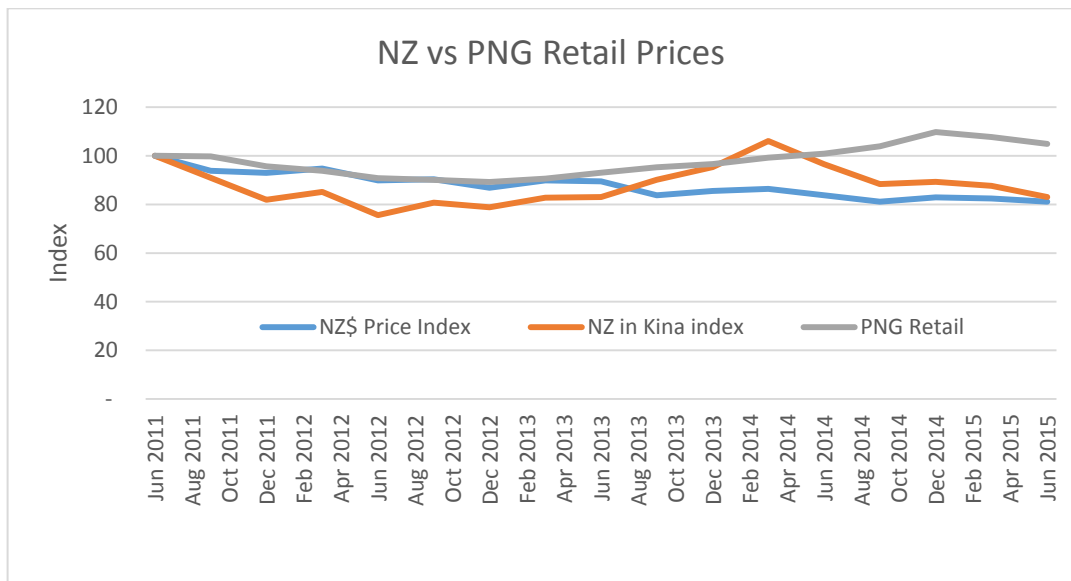
Punjas in their submission wrote;

“The general end consumer prices may be high (as per draft report) but the key reasons for it are the high operation cost - inclusive of Security/ high wage /lower productivity, weakness in kina, freight and other costs.”⁴⁰

⁴⁰⁴⁰ Punjas Submission 15th July, 2015

The Commission has also converted the prices shown in Figure 16 to an index, in order to compare the relative changes in PNG prices and New Zealand prices. This is shown in Figure 17.

FIGURE 17: NZ PRICES VS PNG PRICES EXPRESSED AS AN INDEX



Note: The “NZ in Kina index” has had NZ prices converted to Kina using monthly average exchange rates before indexing. The difference between the “NZ\$ Price index” and the “NZ in Kina index” is the exchange rate effect. Prices have not been adjusted for inflation.

Overall from Figure 17 the Commission notes that prices in New Zealand have fallen. In June 2015 New Zealand flour prices were about 20% lower than they were in June 2011. In contrast prices in PNG fell initially during the period then increased again. In June 2015 PNG prices are about 5% higher than they were in June, 2011.

7.6 Future Monitoring

The Commission has noted AML’s submission that Factory gate prices are not directly comparable to the Statistics New Zealand Food Price Index “Flour – white (supermarket only)” SAP0125 for 1.5kg of flour⁴¹. The Commission has therefore decided to begin to collect data which is as close as possible to the New Zealand index. Essentially this will mean collecting monthly prices on the lowest available price in shops for the nearest PNG equivalent packet size of plain white flour which appears to be 2kg bags. This information will be collected in addition to other monitored prices.

The Commission has also decided to change the ex-factory gate price information it collects. Currently it collects the list price. The Commission has decided instead to begin to collect the average price actually paid by customers.

⁴¹ See for example

http://www.stats.govt.nz/browse_for_stats/economic_indicators/prices_indexes/FoodPriceIndex_HOTPFeb15.aspx for February, 2015 data.

7.7 Commission findings from monitoring

From this analysis the Commission concludes that:

- Price movements are consistent with what would be expected in a competitive market.
 - Prices have moved independently of inflation. This is consistent with competition keeping prices down even when inflation is driving other prices up.
 - Retail prices have moved independently of Factory Gate prices. This is consistent with the presence of retail competition.
 - Price movements are consistent with international wheat costs. When cost inputs increase, then producers are forced to increase their prices. Reducing prices when cost inputs fall, indicates the presence of competitive pressure.
- Prices have not increased as much as inflation and therefore are lower in real terms than they were in 2010.
- Retail flour prices in PNG are now twice as high as the lowest retail flour prices in New Zealand.

The Commission has also determined that to improve the value of monitoring, some changes need to be made. In particular;

- The Commission will start to collect information about the lowest price available in retail outlets for 1.5kg of plain flour (or nearest PNG packet size). This will enable a fairer comparison with the New Zealand flour index.
- The Commission will change the current Factory Gate price information collected so that it is the average of actual prices paid by manufacturers' customers, instead of merely being their list prices.

8 IMPORT DUTIES

Import duties have been used in PNG to protect local millers. The rationale for this is assumed to be to;

- Promote local investment.
- Provide local employment.

Currently import duties are set at;

- K115 per tonne for mixes and dough for the preparation of bakers wares.
- 10% on other flour products.
- 0% if sourced from countries in the MSG (Melanesian Spearhead Group).

The Commission has estimated that consumers are paying an additional K19 million per year for flour products because of import duties. This equates to about 14 toea per kg of flour.

The value of local jobs provided by millers is estimated to be K9.6 million per year. There will be additional one off benefits when additional plant is purchased or replaced. However, the Commission has not estimated how much value from such investment might flow through to PNG.

Overall it appears that the cost paid by Consumers in PNG to protect local production of flour is more than the benefits received by the country as a whole.

8.1 Submissions on import duties

AML in their submission wrote:

“We feel that removing the tariff entirely or even reducing the current level of 10% any further will place significant pressure on local manufacturing compared to low cost imports.

Currently, local manufacturers such as AML face marked cost challenges in PNG versus low cost regional producers which include significantly higher energy costs, high costs associated with transport and security, higher wages costs as well as much higher cost of capital acquisition for mill improvement and maintenance. AML does need to upgrade our aged milling facility but the threat of imports and the removal of tariffs does cast a shadow over our investment decisions. We have conducted comparisons with regional imports and while the tariff remains, the cost differences are marginal, but removing the tariff would result in a significant cost advantage of importing, placing a large amount of pressure on local manufacturing.”⁴²

⁴² AML Submission July, 2015, Section 4.

Punjas made the following comments in their submission in regard to tariffs.

“The 10 % import duty levied on non MSG countries (compared to Zero percent from MSG countries) for flour and premixes is not a barrier for importation. These non MSG countries have economies of scale that balance the import duty.”

“... it is quite evident that despite Zero duty for MSG countries, the local millers have an advantage; as importers have to bear the ocean freight cost on not only the raw material (Wheat) but also on the finished product; as well as local freight for movement from Lae to POM and other territories. Hence the argument that tariff reduction will lead to increase in competition from imports - is unfounded and not correct.”⁴³

From this the Commission understands that Punjas are saying that local millers have inherent economic advantage over importers, driven by transport economics and therefore do not need tariffs to survive. However, the following comment seemed to indicate they thought there was some merit in having tariffs in place.

“..... tariff enough to deter fly by night operators but not enough for those who have serious interest in the economy and well-being of PNG in mind.”⁴⁴

By the term “Fly by night operators” the Commission assumes that Pujas is referring to suppliers who might only participate in the market in the short term. In the Commission’s view, provided all participants conform to local legal requirements, short term participants in the market provide a healthy contribution to competition in the interest of consumers.

Punjas also comment about the impact of imports on jobs;

“...importers have to deploy people in logistics and selling thereby creating jobs as well”⁴⁵.

Punjas conclude their comments on tariffs with;

“We also strongly recommend that there is no need for any tariff barrier as suggested by the local millers.”⁴⁶

8.2 Economics of importing flour

Currently local flour manufacturers import wheat in bulk and produce bagged flour in PNG. The Commission understands that this is cheaper than importing already bagged flour in containers for the following reasons.

- Bulk shipment costs are lower
- Stevedoring costs are lower due to more efficient movement of bulk product than containerised product.

⁴³ Punjas submission 15th July, 2015

⁴⁴ Punjas submission 15th July, 2015

⁴⁵ Punjas submission 15th July, 2015

⁴⁶ Punjas submission 15th July, 2015

- Unloading trucks with bulk product is more efficient than unloading bags of flour from containers.

In discussions between the Commission and AML, AML presented cost information comparing the cost of importing to the cost of local production. The Commission cannot present this information in this report due to commercial confidentiality. However, the Commission can observe the following.

According to AML;

- Recent quotes received by AML to import flour in containers indicated that the international flour supplier had manufacturing costs which were 35% lower than AML's current costs.
- If AML replace their mill in Lae with a new mill, then their local manufacturing costs will increase by about 80%.
 - Current costs for AML's Lae mill are low because it is an old plant and is almost fully depreciated.
- Overall the new plant will produce flour at a cost which is 280% higher than the implied costs from quotes they have received.
- While it is cheaper to transport bulk wheat than bags of flour in containers, the cost saving is not enough to be able to compete with international flour producers.
- AML argue that a 10% tariff on flour imports enables them to continue to be competitive even with the higher costs which will result from their new plant.

The Commission notes that;

- The Commission does not know if the information presented by AML is representative of all international suppliers, or simply a one off supplier who is looking for an opportunity to "dump" spare capacity.
- The Commission does not have details of the size and capacity of the AML's proposed new plant.

From the information provided by AML, the Commission has to conclude that the plant being considered by AML would not be internationally competitive. The reasons for this are not apparent to the Commission as;

- Labour is relatively low cost in PNG.
- Local transport costs are the same for international producers or domestic producers
- The new plant would be manufactured overseas, and must be assumed to be available to AML at the same cost available to any other international producer.
- Land rental costs are already built into the existing plant costs.

From this the Commission is confused as to why AML would seriously consider investing in new plant which was so economically inefficient compared to international producers. If such a plant is reliant upon the existence of tariffs to survive, then it would be a risky investment. A flour

plant is likely to have an economic life of between 20 and 40 years. Therefore, the tariffs would need to remain in place for a long time to protect it.

8.3 Millers' gross margins

The Commission has used information provided by millers to estimate their current gross margins. This information is commercially sensitive and cannot be included in this report. However, the Commission notes that the analysis indicated that margins were generally healthy and contributed a positive contribution towards the fixed and common costs of these businesses. There is no indication that removal of the tariff would squeeze these margins to the extent that they would need to close their local operations.

8.4 Conclusions about import tariffs

From the Commission's analysis of the available information, it must conclude that tariffs on flour are bad for consumers. Consumers appear to be paying about 14 toea per kg more for flour as result of tariffs. And the cost to consumers is greater than the benefits received by PNG from local production.

The Commission is not convinced that local producers necessarily need tariffs in place in order to remain competitive. Table 7 (in section 6.3) discussed the competitive advantages available to local producers over imports. In the Commission's view, AML have not provided a logical explanation as to why a new local plant would be so uncompetitive compared to other international plants.

It is not the role of the Commission to make decisions about import tariffs. However, the Commission is of the view that consumers would be better off, and that competition would increase, if tariffs were removed. The removal of tariffs will drive more efficient behaviour and avoid investment in inefficient milling capacity.

9 RETAIL MARGINS

9.1 Commission's Analysis in the 2009 PNG Wholesale and Retail Industry Review

Following the 2009 review, the Commission ceased regulation of wholesale and retail margins on the sale of flour, sugar and rice. At that time the Commission wrote;

"the average mark-ups earned on the sale of flour and sugar are higher than the Commission anticipated. This could be due to several factors including:

- *Relatively small sample size of observed prices (in Kokopo only one price was observed);*
- *High costs incurred by wholesalers and retailers; and*
- *Possible movements in the factory gate price between March, 2009 and May, 2009 (when the prices were observed).*

The observed data suggests that in several instances the final retail prices charged for flour and sugar implied that allowable margins were not being observed by wholesalers and retailers. Given that price data was observed from only a few stores (at most) the Commission does not believe that this survey provides evidence of a lack of competition in wholesale and retail markets. The Commission accepts the evidence that in urban centres consumers are presented with a variety of choice as to where they can purchase household products."⁴⁷

The Commission ceased regulation of wholesale and retail margins on the sale of flour, sugar and rice as a result of the 2009 review.

9.2 Estimated Retail Margins

For the purposes of this review, the Commission has used information it had available to estimate retail margins. Gross retail margins appeared to be in the 20% to 40% range, depending upon location and transport costs.

9.3 Proposed Retail Margin Review

The 2009 PNG Wholesale and Retail Industry Review that removed retail margin regulation was much wider in scope than just flour. If a review of the retail margin is to be conducted now, it should also take a wider perspective than just the flour retail margin. A retail groceries margin review is outside the scope of the current 2015 Flour Industry Pricing Review, which is concerned only with flour prices.

⁴⁷ Final Report PNG Wholesale and Retail Industry Review, 12 October, 2009, p.61.

The Commission believes that a broader review of retail price margins for groceries is appropriate, and that this will inform the Commission about the need for regulation of retail flour prices.

The proposed approach to investigating retail margins is to do some initial research on the issue of retail grocery margins in order to identify whether a more significant review is necessary. Alternatively this initial investigation may confirm that current margins are within an acceptable range and no further work in this area of retail margins is necessary.

The proposed retail grocery margin review will include retail and wholesale businesses which generally sell groceries. Freight companies or margins on freight will not be evaluated. The proposed method is to survey a selected sample of retail outlets in various parts of PNG to collect specific data on their costs and revenues. This will allow an assessment of their margins.

Conceptually,

$$[\text{Retail Margin}] = [\text{Revenue}] - [\text{Stock purchase costs}]$$

Margin must equal or exceed operating costs if a retail business is going to survive. The Commission wants to quantify how much margin does exceed operating costs in practice.

The Commission has not yet carried out this work but wants to complete the flour review in a timely manner. Therefore, the Commission has decided not to wait until this work is done. The Commission notes that if retail margins were found to be high, then the Commission would want to take steps to protect consumers. This could possibly include price control of retail prices for selected products including flour.

The Commission has not found any evidence of the need to control flour prices as part of this review. Therefore the Commission has made the determination as described in section 0. However, in the event that the retail margin review did conclude that there was a requirement to control prices of some products in order to protect consumers, then the Commission reserves the right to modify the determination made in the Flour Price Review.

10 SEA AND ROAD FREIGHT COSTS

10.1 Background

In addition to monitoring the ex-factory gate price of flour, the Commission's 2005 review initiated a monitoring arrangement for domestic sea and road freight charges for the transport of flour products. The intention of this monitoring arrangement was to protect consumers from being disadvantaged by market power of transport companies. In this monitoring arrangement, the Commission monitored the freight charges for flour transported from both AML and NGTB's mills. While the millers collated and reported the information to the Commission, they themselves did not set freight charges. Rather, customers generally arranged their own transport.

While this review is focused upon flour, freight can have a major impact upon the availability and cost of distributing products around PNG. Naturally this can have a major effect upon the prices consumers pay for flour.

10.2 The 2010 Final Report

In the 2010 Final Report, the Commission noted its 2007 *Review of the PNG Coastal Shipping Industry* which found that there are limited barriers to entry in the coastal shipping market and that there is competition in the sea freight market. The Commission also analysed the data obtained via the price monitoring arrangements and discussed this with reference to examples from both the sea and road freight markets.

With respect to sea freight, the Commission noted that NGTB and AML faced different prices for transport to Rabaul and Kimbe and concluded this indicated competition between transport suppliers. For road freight, the Commission discussed the difference between freight charges to Goroka, where reported prices for the two mills varied by over 70 per cent. The Commission noted that the divergence was quickly reduced indicating that competitive forces in the market meant the higher freight prices were unsustainable.

The Commission concluded that the evidence of competition in the sea and road freight markets meant it was unlikely that transport companies were significantly exploiting any market power. The Commission noted that it had not received complaints about freight pricing from consumers. Furthermore, the Commission noted that the flour mills have no control over freight charges and that while the mills may arrange for transport on behalf of customers, the mills are not themselves responsible for transport costs.







The Commission therefore, concluded that it was appropriate to cease monitoring the freight costs of flour given that the freight market appears to be competitive and that flour mills are not responsible for determining freight charges.

In this Final Report, the Commission has used the same framework that was used in the 2010 Final Report to assess the competitive nature of the sea and road freight market in the country.

10.3 Analysis of Coastal Shipping

It is the Commission’s view that the competitive nature of the freight market in the country has gone through some significant changes. For example, in the shipping industry Steamships Trading Company now has a controlling interest in Consort Express Lines. As both companies operate similar services directly or indirectly via subsidiary companies, this is likely to have had an impact on competition in markets in the shipping industry.

TABLE 13: COASTAL SHIPPING ASSESSMENT

Barriers to Entry	High 	Requires taking a lease on a ship and taking the risk that you can sell the capacity. Economies of scale are likely to apply, so larger ships with more cargo are likely to be able to offer cheaper services
Substitutes	None. 	Most major centres are not connected by road. Air travel is not an economic substitute for low value goods.
Competition between participants	Limited 	There are only two participants. <ul style="list-style-type: none"> No firm evidence has been provided to the Commission demonstrating any evidence of price competition.
Countervailing Market Power	None for small retailers.  Some for large retailers 	This is likely to be one of many factors that make it more difficult for small retailers to compete. The Commission thinks it is unlikely that even a larger retailer will have countervailing market power because they have little alternative than to use the coastal services available from the Steamships / Consort consortium.
Customer Choice	Limited 	There are only two suppliers so customers have very limited choice. And one supplier is controlled by the other.

Since the 2007 review of the Coastal Shipping Industry, the Commission has not done any recent review of the Coastal Shipping Industry in the country. In the Commission’s consultation, AML said that there is a lack of competition in the coastal shipping market in PNG. It appears that there is some competition on the Port Moresby to Lae route. However for other sea routes there are only two companies.







The conclusion is that competition in coastal shipping is likely to be limited. With only two companies offering service on most routes and one of these companies owning shares in the other, the market is in effect operated by a monopoly.

The Commission is generally concerned about this finding. The PNG economy relies heavily upon coastal shipping. To have an unregulated monopoly operating the coastal shipping

market is not acceptable. It is now 8 years since the last review of Coastal Shipping was carried out by the Commission. Therefore, the Commission’s current position is that it needs to consider carrying out another review of coastal shipping within the next 12 months.

10.4 Analysis of Road Transport

TABLE 14: ROAD TRANSPORT ASSESSMENT

Barriers to Entry	Low 	There is little to stop any individual from purchasing a truck and setting up business to transporting goods. Economies of scale are not likely to be a major issue which will favour existing market operators.
Substitutes	None 	Road Transport is used for inland routes where coastal shipping is not an option. Air travel is not an economic substitute for low value goods.
Competition between participants	Some 	The Commission does not know the number of operators who offer service on any particular route. No firm evidence has been provided to the Commission demonstrating any evidence of price competition.
Countervailing Market Power	None for small retailers.  Some for large retailers 	This is likely to be one of many factors that make it more difficult for small retailers to compete. Large retailers may be able to own their own trucks. But for small operators this is not likely to be an option.
Customer Choice	Some 	The Commission does not know the number of operators who offer service on any particular route. However, the Commission understands that the number of operators on any particular route varies around the country. No firm evidence has been provided to the Commission demonstrating any evidence of price competition.

AML said that there are more players in the road transport industry than in Coastal shipping. However, in their view, the road freight costs for the highlands region of the country are quite high. These high transport costs are attributed to the deteriorating road conditions of the Highlands Highway and security issues along the highway. The Commission does not have any information with which to assess whether or not road freight prices are cost reflective.

It is reasonable to expect road freight to be relatively competitive on most routes because of low entry barriers. However, the Commission has no evidence of whether or not it is, and currently has insufficient evidence to rule out a need for regulation. If the road freight markets are not competitive, this then raises an issue as to how the Commission should respond in terms of the Flour Industry Pricing Review.

Overall the Commission has concluded that while road freight costs in PNG may be high compared to other countries this is most likely to be driven by road conditions rather than by a lack of competition.

10.5 Findings on Freight

The Commissions' consideration of the framework factors above indicates that;

- Effective competition is unlikely on most coastal shipping routes.
- Low barriers to entry for road transport services should encourage competition.

Commission's Findings: A further review of the coastal shipping industry should be undertaken within the next 12 months, with a view to assessing the competitive nature of this industry and regulating it if necessary.

11 FORM OF REGULATION

11.1 Draft Report

In the draft report the Commission proposed to increase the level of monitoring. This was done in part in order to elicit a more engaged response from the industry. Since the draft report, the Commission has received further information and from this has drawn its final conclusions in this report.

11.2 Submissions on monitoring

The Commission received the following submissions in support of the removal of price monitoring.

AML stated;

“Given the market structure and the degree of competition in the PNG flour market..., there are strong grounds to support the removal of the current price regulation of flour in PNG (in the form of price monitoring). Goodman Fielder would support a decision by the ICCC to remove price monitoring of flour in PNG for those reasons.”⁴⁸

NGTB submitted;

“The level of competition has now reached a point where I believe that there is no further need for price monitoring in this category, but rather a need to protect the two manufacturers from the high levels of competition coming from Australia and Fiji.”⁴⁹

Punjas submitted;

“We reiterate our stance that there is no need for price monitoring by the commission as there is stiff competition among the players but if price monitoring is implemented and is unbiased between Importers and local manufacturers, Punjas will adhere to it.”⁵⁰

11.3 Benefits of Monitoring

The Commission carries out an important role in PNG protecting the interests of consumers. Food items such as flour and rice are critical items for the health and well-being of the general population. This is particularly true for families with low incomes.

The importance of having access to food at affordable prices is currently being emphasised in PNG by two things.

- The current drought and frosts in parts of PNG which have severely damaged local crops.

⁴⁸ AML submission on the Public Notice, January, 2015, p.8.

⁴⁹ NGTB submission on the Public Notice, January, 2015, p5.

⁵⁰ Punjas submission 15th July, 2015

- The Governments development of its policy in relation to rice and other food groups.

To fulfil its role, the Commission must collect the information it needs to assess the level of competition in the market. Monitoring is a mechanism which enables the Commission to collect this information and to exercise its powers under the PR Act.

The Commission also considers that Monitoring is a relatively light and cheap form of regulation. This is true provided that the information collected by the Commission is not onerous to collect.

For these reasons the Commission is of the view that continued monitoring is both important and necessary in order for the Commission to continue to carry out its duties. Upon, that the Commission has therefore, decided to continue to monitor flour prices even though most parts of the industry appear to have effective competition.

The Commission did consider reducing the number of items it currently monitored in retail outlets. However, it was decided that having begun to collect this information in 2011, there is value in maintaining a continuous data set for future analysis. The additional cost of continuing to collect this data is relatively low. Most of the time consumed collecting this information is taken up travelling to and from a particular retail outlet. Once the Commission staffs are present in the retail outlet, it takes very little additional time to record prices on additional items.

11.4 Determination on monitoring

The Commission has determined that it will continue to monitor flour prices. However, it has made some changes to the actual information it will collect for monitoring purposes.

The following tables outline the information the Commission has decided to collect as part of its monitoring of flour prices.

TABLE 15: REPORTING REQUIREMENTS FROM MILLERS AND IMPORTERS

Type of Flour	Package Size	Brand Names	Quantity	Net Billed Revenue (net of discounts)
Plain Flour	1 Kg	Brand name sold under	Tonnes	Kina
	2 Kg	Brand name sold under	Tonnes	Kina
	5kg	Brand name sold under	Tonnes	Kina
Wholemeal Flour	1Kg	Brand name sold under	Tonnes	Kina

Information must be provided for each separate brand sold by the local millers (AML and NGTB) plus any major importer or wholesaler. A major importer or wholesaler is one that imports more than 10,000 tonnes of flour per year and supplies flour in the specified package sizes.

TABLE 16: LIST OF MONITORED ITEMS FOR WHOLESALE OUTLETS

Type of Flour	Package Size	Brand Names
Plain Flour	Multiple packages of 1kg bags	Flame, Roses, or other miller brands plus any importers brands where the importer imports a total of more than 10,000 tonnes per annum.
	Multiple Packages of 2 kg bags	
	Multiple packages of 5 kg bags	
Wholemeal Flour	Multiple package of 1 kg bags	

TABLE 17: LIST OF MONITORED ITEMS IN RETAIL OUTLETS

Type of Flour	Package Size	Brand Names
Plain Flour	2kg	Lowest price available (not brand specific)
Plain Flour	1 Kg	Flame, Roses, or other miller brands plus any importers brands where the importer imports a total of more than 10,000 tonnes per annum.
	2 Kg	
	5kg	
Wholemeal Flour	1Kg	

11.5 List of parties to monitor

The ICCC currently monitors retail and prices from the following parties and will continue to do so.

TABLE 18: MONITORED RETAIL OUTLETS

Momase Region - Lae	Niugini islands Region - Kokopo	Highlands region - goroka	Southern region - NCD
8-6 Shop	Papindo	Bintangor	RH Vision City
Food Mart	Tropicana Kokopo	New Century/Goroka FoodMart	SVS Koni
Andersons Foodland	K-Central	Daewon/Papindo	J Mart-Erima
Papindo	John J & H Seeto Kokopo	Istana	SNS-North Waigani
Zero City	A & J Zero Trading - Rabaul	Seng Da	TST-Gerehu

The Commission will no longer monitor prices from wholesalers.

11.6 Length of the Regulatory Period

It is the Commission's current practice to generally carry out reviews of regulated industries every five years.

In the draft report the Commission proposed to carry out its next review in 2020. While it received several submissions saying that further monitoring or regulation was not necessary, no submissions were made about when the next review should be carried out. Therefore, the Commission has determined that the next review of flour prices will be carried out in 2020.

12 APPENDIX

12.1 APPENDIX 1 – SECTION 21 (2A) PR ACT

When making an order under subsection (1) of the PR Act, the Commission shall have regards to:

- A. the need to protect consumers and users of the declared goods or services from misuse of market power in terms of prices, pricing policies (including policies relating to the level or structure of prices) and the standard of the declared goods or services;
- B. the cost of making, producing or supplying the declared goods or services;
- C. the desirability of encouraging greater efficiency in relation to making, producing or supplying the declared goods or services;
- D. the need to ensure an appropriate rate of return on any investment in relation to the declared goods or services;
- E. the borrowing, capital and cash flow requirements of persons making, producing or supplying the declared goods or services;
- F. considerations of demand management and least- cost planning;
- G. existing standards of quality, reliability and safety of the declared goods or services, and the desirability of encouraging improvements in those standards;
- H. the effect any proposed order on general price inflation over the medium term; the economic and social impact of any proposed order; and
- I. any other matters the Commission considers relevant.

12.2 APPENDIX 2 – LIST OF SUBMISSIONS

Submissions on the Public Notice were received from:

AML;

NGTB; and

Punjas Ltd

In addition to the formal submissions, the Commission undertook some interviews of wholesalers/retailers and bakers.

12.3 APPENDIX 3 - Price Monitoring Arrangements 2010 to 2014

In the 2010 to 2014 review period, the Commission monitored the ex-factory gate price of flour based on a Statistics New Zealand Food Price Index Data “Flour – white (supermarket only)” SAP0125 for 1.5kg of flour. The flour products the Commission monitored were:

Product	Pack Size (kg)	Pack
Bakers flour	50	Polypropylene
Biscuit flour	50	Polypropylene
Soft flour	50	Polypropylene
Plain flour	25	Polypropylene
Plain flour	10	Polypropylene
Plain flour	5	Polypropylene
Plain flour	2.5	Polypropylene
Plain flour	2	Paper
Plain flour	1	Paper
Wholemeal flour	50	Polypropylene
Wholemeal flour	25	Polypropylene
Wholemeal flour	10	Polypropylene
Wholemeal flour	5	Polypropylene
Wholemeal flour	2.5	Polypropylene
Wholemeal flour	1	Paper
Self-raising flour	50	Polypropylene
Self-raising flour	5	Polypropylene
Self-raising flour	2	Paper
Self-raising flour	1	Paper
Source: ICCC (2010) Flour Pricing Review, Final Report.		

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