

# NARGA

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Mr John Hawkins  
Committee Secretary  
Senate Standing Committee on Economics  
PO Box 6100  
Parliament House  
Canberra ACT 2600  
Australia

Email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Mr Hawkins,

## Competition and consumer Legislation Amendment Bill 2010

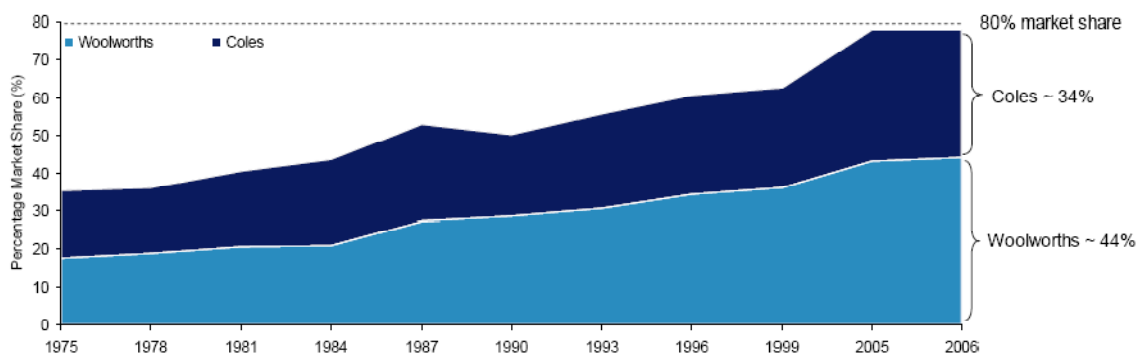
NARGA represents the independent retail grocery sector comprising over 5000 stores employing more than 225,000 people.

The independent grocery sector now comprises 20% of the national grocery market, yet provides essential supplies to thousands of regional and remote communities, particularly those considered too small to be of interest to the major supermarket chains, as well as providing competitive pressure to those chains through larger stores in metropolitan and regional centres.

The ongoing viability of the independent network is ***dependent on their share of the market not shrinking to the stage where the wholesaling and distribution network becomes unviable.***

However, the market share growth of the major chains continues through both new sites and acquisitions of independent stores as is shown by the following graph:

Figure 2.10: Growth in market share of Woolworths and Coles, 1975-2006



Source: Retail World, ACNielsen

It is taken from a report on the retail grocery sector prepared for NARGA by Pricewaterhouse Coopers in 2007, titled: '*The economic contribution of small to medium-sized grocery retailers to the Australian economy, with particular emphasis on Western Australia.*'

The above graph shows how, during the period of the current Trade Practices Act, market share concentration has developed in the Australian retail grocery market to the point where the two major chains now sell close to 80% of all packaged groceries.

The level of market concentration in the Australian retail grocery sector has not changed with the entry of ALDI and Costco into the market in recent years. It contrasts markedly with the grocery market in the USA where the two largest chains – WalMart and Kroger – together make up just 20% of the market.

Whilst the reduction in competition in the retail grocery market over the period is evident, there have been significant impacts on the grocery supply chain – from farm through to processor and wholesaler – which have not been adequately addressed in any merger analysis.

Another measure of retail market concentration in Australia can be gleaned from ABS retail sales data and the annual reports of the two major retailing entities, Woolworths Limited and Wesfarmers Ltd. When the national retail sale turnover of \$230 Billion is compared with the retail sales captured by the two majors in grocery, general merchandise, electronics, hardware, liquor etc., we see ***that these companies take in 40 cents in every retail dollar spent in Australia.***

The importance of national market concentration cannot be overstated, as the non-majors have to survive and compete in the remaining space. Any further shrinkage of that space has major ramifications for the independent sector at both wholesale and retail levels.

The level of concentration in the national grocery market is highlighted by the following examples taken from the ACCC report on their recent inquiry into the sector.

The report says that chains have 87% of stores over 2000 sq metres in size and 96% of stores over 3000 sq metres in size (which have the highest turnover). The ACCC also suggests that the sector has a high HHI<sup>1</sup> - even with the ACCC's reduced estimate of the majors' combined market share:

**The HHI for the retailing of packaged groceries based on this assessment of sales shares is between 2750 and 3000. Although these figures show a high level of concentration in this segment of the retail grocery industry, other factors including barriers to entry and expansion must be considered before any conclusions are drawn on the effectiveness of competition.**

The question that now must be asked is whether further concentration in the sector is desirable and, if not, what can be done to address the issue?

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<sup>1</sup> The **Herfindahl index**, also known as **Herfindahl-Hirschman Index** or **HHI**, is a measure of the size of firms in relationship to the industry and an indicator of the amount of competition among them. Named after economists Orris C. Herfindahl and Albert O. Hirschman, it is an economic concept but widely applied in competition law and antitrust. It is defined as the sum of the squares of the market shares of each individual firm: ie the average market share, weighted by market share. As such, it can range from 0 to 10,000 moving from a very large amount of very small firms to a single monopolistic producer. Decreases in the Herfindahl index generally indicate a loss of market power and an increase in competition, whereas increases imply the opposite.

The Martin Report<sup>2</sup> on the ACT supermarket sector has some illustrative comments on the workings of the current system:

- '...ACCC clearance of a proposal by a major supermarket chain for a particular site acquisition means that it is unlikely to substantially lessen competition and therefore is not illegal. A decision by the ACCC not to intervene does not imply there is no alternative outcomes (sic) that would increase competition, nor that the acquisition would not result in some lessening of competition, albeit a lessening that falls short of being substantial.' P.16
- 'Until 1996 there were four additional independent Cannon group supermarkets ..... These were acquired by Woolworths in 1996 when Woolworths took over the Cannons group in a deal approved at that time by the ACCC. Included in that deal acquisition was the Cannons wholesale distribution centre in Hume that Woolworths subsequently closed cutting off an important alternative source of wholesale supply to Canberra independent retailers.' P.11
- 'In addition, in July 2004 the ACCC did not oppose Woolworth's acquisition of the IGA Charnwood, a group centre supermarket in West Belconnen although Woolworths had two large format supermarkets at Belconnen town centre and Kippax group centre...' p.47
- 'The Review has been informed that on 17 July the ACCC gave informal clearance to Woolworth's acquisition of the Giralang supermarket site.' P.44
- 'The combined 90% share of this sector\* in the ACT held by the two majors is slightly above the national average of 87% identified in the 2008 ACCC Grocery Report.' P.50 (\*large format stores)
- 'An implication for ACT regional supermarket competition is that two earlier ACCC clearances – where Woolworths acquired, firstly four group centre independent Cannons store sites in 1996 (three in Tuggeranong and one in Kippax) and, secondly an IGA store site at Charnwood group centre in 2004 – are likely with the benefit of hindsight to have been rejected under current intensive analysis.' P.72

These comments suggest that the current regulatory and policy framework is not working – it is not preventing a substantial dilution of competition in the sector.

### ***Understanding competition***

As is evident by the quote taken from the ACCC's grocery report re the HHI for the sector, the ACCC is aware that the sector is highly concentrated but suggests that '*other factors.....must be considered before any conclusions are drawn on the effectiveness of competition.*'

This begs the question 'what definition of *competition* is the ACCC using?'

We note here that the Trade Practices Act 1974 (the Act) does not define *competition*. It simply assumes that everyone knows what it is – and in knowing what it is also knows when it is being affected by anti-competitive practices.

However, the concept of competition is central to competition law and competition theory. According to the Productivity Commission this is what a competitive market looks like:

A perfectly competitive market for a good or service will deliver optimal outcomes for society as a whole without government intervention if it has the following characteristics:

- many buyers and sellers, each with an insignificant share of the market
- the goods or services offered by the various sellers (and demanded by the various buyers) are largely the same

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<sup>2</sup> Review of ACT Supermarket Competition Policy, John Martin, Martin Stone Pty Ltd, September 2009.

- buyers and users have complete information about quality and prices charged in the market and can move freely between suppliers
- all traders have equal access to resources and improvements in technology and can freely enter or exit the market in the long run
- there are no externalities in the sale and use of the goods or services (no divergence between private and social costs and benefits).<sup>3</sup>

Obviously it would be impossible to achieve a perfectly competitive market, but key characteristics of a competitive market – one which has optimal outcomes for society – would include:

- a multiplicity of participants
- each with a relatively small market share
- each with unrestricted access to a range of goods and relevant technology
- the absence of mechanisms aimed at capturing customers or suppliers

The necessity of encouraging these attributes has been recognised in other jurisdiction, particularly the USA which has for more than a century recognised the need for government intervention to ensure that markets remain competitive.

This contrasts with the Australian approach where we are repeatedly reminded by the regulator that it is there to protect ‘competition’ and not ‘competitors’ even though it is clear that we need competitors in order to have competition.

The relaxed attitude to mergers and acquisitions is demonstrated by comparing the ACCC use of the HHI as a measure of concentration with the approach taken by the US Department of Justice. The ACCC approach is described as follows:

As part of its overall assessment of a merger, the ACCC will take into account the HHI, as a preliminary indicator of the likelihood that the merger will raise competition concerns requiring more extensive analysis. The ACCC will generally be less likely to identify horizontal competition concerns when the post-merger HHI is:

- less than 2000, or
- greater than 2000 with a delta less than 100.<sup>4</sup>

In the USA a post merger market with a HHI of less than 100 is defined as ‘unconcentrated’, between 1000 and 1800 as ‘moderately concentrated’ and above 1800 as ‘highly concentrated’. A merger potentially raises ‘significantly competitive concerns’ if it produces an increase in the HHI of more than 100 points in a moderately concentrated market or more than 50 points in a highly concentrated market. A merger is presumed ‘likely to create or enhance market power or facilitate its exercise’ if it produces an increase in the HHI of more than 100 in a highly concentrated market.<sup>5</sup>

Even though our markets have a greater problem with market concentration than does the USA, the ACCC would appear to be applying less stringent criteria to the evaluation of merger outcomes. Note that US regulators would regard Australia’s retail grocery market (and other key markets) as ‘highly concentrated’.

### ***Proposed changes to the Act***

NARGA supports the proposed changes to the Act which make it clear that the ACCC is to address acquisitions in local markets. This is achieved by removing the word ‘substantial’ before ‘market’ in

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<sup>3</sup> Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments, Issues Paper, May 2010, Productivity Commission, p.17

<sup>4</sup> ACCC Merger Guidelines 2008 p.37

<sup>5</sup> Summarised from the DOJ-FTC 1992 Horizontal Merger Guidelines

subsection 50(6) and adding the word 'any' before the word 'market' in section 50 – making the test a substantial lessening of competition in any market.

Whilst the changes are welcome, they will not work unless there is an early resolution of some of the resulting definitional issues. Note that the current approach to such issues has been to wait until the courts decide what each term means. Often this takes many years because there appears to be a reluctance to take cases to court. An example is the previous section 49 of the Act referring to price discrimination. During its currency, neither the ACCC nor its predecessor, took a case to court.

A more recent example is the Birdsville Amendment on predatory pricing. In spite of the fact that there have been many complaints and there are a number of terms that need definition, no case has been taken to court nor has the ACCC issued a guidance note to indicate what its view is on key terms within the amendment.

So let us make a start in relation to the proposed amendments.

It is clear that the removal of the word 'substantial' from subsection 50(6) makes it clear that the ACCC can now review acquisitions in local markets – including markets that may be relatively small geographically - and can look at 'any market' in those local markets.

So what could 'any market' mean?

Coming back to the retail grocery example, it is clear that the market is made up of a number of sets and subsets. These include:

- The full range of grocery products supplied through a large supermarket
- The subsets within it including packaged groceries, fruit and vegetables, meat, delicatessen goods, milk, bread etc. each of which could be differentially impacted by an acquisition in a local market.
- The type of store – large full scale supermarkets, medium range supermarkets, smaller stores could be seen a separate 'markets' although they interact.<sup>6</sup>
- The retail sector as a whole
- Grocery retail space
- Retail space
- Geographic markets
- Impact on suppliers?

Guidelines are needed to explain how the ACCC will interpret the 'any market' definition.

### ***Preventing further concentration in the sector***

In the case of competition in local markets we suggest that the test of market share for the purposes of assessing post acquisition market concentration should be a measure suggested during the UK Competition Commission (UKCC) inquiry into their grocery industry, where it was suggested that an entity's share of the local market could be related to the relative size of its retail space in relation to the total retail space taken up by that sector in the area.

The UK CC suggestion is that should a particular retailer have a share of that retail space of 60% or larger that they would only be allowed to occupy additional space in that locality if they were to divest themselves of sufficient space so as to reduce their share to 60% or less. Such a reduction in

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<sup>6</sup> The UK groceries inquiry found that large stores provide downward pressure on smaller stores whilst smaller stores did not put pressure on larger stores.

relative retail space would only occur if the freed retail space ***had to be made available to a competitor***, i.e. not simply transferred to another entity within the conglomerate<sup>7</sup>.

Guidelines could be issued in relation to the acquisition of other businesses, leases or development sites that make it clear what the limits are in terms of local or regional market share expressed in terms of the share of retail space applicable to the sector in question.

### ***Notification***

Given the lack of compliance with current ***notification*** requirements under the voluntary code, we would also support a system of compulsory notification of acquisitions by large entities in concentrated markets. Such a notification requirement should apply to acquisitions of sites, leases and stores. Without mandatory notification, the proposed amendments would be difficult to implement.

### ***Land banking***

According to the ACCC groceries inquiry the major supermarket chains have 87% of stores above 2000 square metres in size and 96% of stores above 3000 square metres in size (p.59), suggesting that their share of grocery retail space exceeds 80%. In addition they have extensive holdings of retail space through their activity in other retail sectors including general merchandise (department stores), petrol, liquor, hotels, office supplies and electronics. Their holdings of undeveloped land or sites are unknown.

Retail uses in many of these locations are interchangeable with the result that, if asked to divest a store or site, it is possible to keep out competition by making the vacated space available to another of their trading entities. It is also clear that the expansion of liquor outlets owned by the majors into sites that are suited to smaller supermarkets, has reduced the number of sites available to competitive entries.

This suggests that, in order for the ACCC to be able to properly assess competition within the retail sector, it would be appropriate to require major retail entities to provide details of all of the sites at their disposal.

NARGA supports the proposed 'creeping acquisition' amendments to the Act, but believes more needs to be done to improve competition in Australia's highly concentrated markets.

Please contact us should you require further details.

Yours sincerely

Ken Henrick  
**Chief Executive Officer**

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<sup>7</sup> There have been a number of instances where supermarket space vacated by the majors has simply been transferred to one of their liquor entities, keeping out a potential competitor.