

NARGA

**National Association of Retail
Grocers of Australia**

S U B M I S S I O N

to the

Senate Economic References Committee

Inquiry into the ACCC's Franklins decision

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Introduction

The proposed acquisition of the Franklins business by Metcash, followed by resale of the 80 Franklins corporate stores to independents, would increase the independents' market share from 11 per cent to 18 per cent in New South Wales.

That would result in increased marketing spend, a stronger negotiating position with suppliers and the ability to do better and more frequent deals for promotions which would benefit consumers.

At present, independent grocery retailers in New South Wales lag behind their peers in other states, particularly Western Australia and South Australia, where independents' market share is strongest, but also behind Victoria and Queensland. There is no significant second wholesaler in any of those markets.

Foodland Associated Limited acquired some of the then Franklins stores in Queensland and operated them as corporate stores under the Action banner. When Metcash later acquired FAL's Action stores in Queensland, those stores were sold to independents. That was a market share boost which has benefited the independent sector in Queensland ever since.

Nor are there any apparent competition "benefits" for independents from the presence of the Franklins "wholesaling" business. Only two operating independents have regarded the Franklins supply option as attractive.

The worst possible outcome for competition in the Australian retail grocery market and for consumers would be that *any* of the existing Franklins stores fall into the hands of the major chains in an already hyper-concentrated market in which they have a combined market share of about 80 per cent - the most concentrated in the world.

New entrant

Pick n Pay has acknowledged Metcash as a credible bidder for the Franklins business. While it is theoretically possible that another credible bidder might emerge, we think it is highly unlikely, for a number of reasons.

There are two parts to the ACCC's claims: that the loss of the "wholesale" supply to eight franchised stores would amount to a substantial lessening of competition and that it wants to preserve the 80 corporate stores as an incentive to a possible new "wholesaler" entrant.

The more likely outcome, if the proposed acquisition does not occur, is that Pick n Pay will close the "wholesale" business and sell their 80 corporate stores by tender, with Woolworths and Coles cherry-picking the best of them.

The 2008 *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* did not list Franklins as a wholesaler¹, even though Franklins was supplying at least four franchised stores at that time.

The *Statement of Issues* for the proposed acquisition now claims Franklins *is* a wholesaler, on the basis of only eight franchised stores.

Announcing its decision to oppose the proposed acquisition, the ACCC said²:

Central to the ACCC's concerns is that the proposed acquisition is likely to result in a substantial lessening of competition through the removal of Metcash's closest and only genuine competitor for the wholesale supply of packaged groceries in NSW.

In the ACCC's view, acquisition of a "wholesaler" supplying only eight stores would amount to a substantial lessening of competition.

In relation to the preservation of the 80 corporate stores (and the wholesale supply to eight franchised stores) as an incentive to a new entrant wholesaler, the ACCC explained its position thus³:

"Barriers to entry in this market are already high, making timely new entry of a competitor to Metcash unlikely if this transaction proceeds.

"Because of high fixed costs, potential entrants need a large number of supermarkets as customers to give them the scale to operate a wholesale network profitably. The proposed acquisition would have resulted in the removal of a large pool of 88 supermarkets, including many medium and large supermarkets, which would otherwise be contestable, either partly or wholly, by a new wholesale competitor," Mr Samuel said.

Yet the ACCC also argued in its 2008 grocery inquiry report that⁴:

The implications of another large-scale wholesaler entering the market are unclear. As the only national wholesaler to the independent sector, Metcash can take advantage of significant economies of scale. If there were two large-scale wholesalers, it is possible that neither would achieve the same economies of scale that Metcash has achieved.

The net result would thus be a weakening of the competitive position of independent retailers in New South Wales.

The commission says⁵:

The ACCC is aware that other parties, whose bids would not raise the same competition concerns as Metcash's bid and indeed may enhance competition, have expressed strong interest in acquiring the entire Franklins business.

¹ op. cit., p. 131

² ACCC to oppose Metcash proposed acquisition of Franklins supermarkets, 17 November 2010

³ Ibid.

⁴ ACCC grocery inquiry report, p. 153. The point was repeated on p. 155

⁵ ACCC media release, 17 November 2010

Pick n Pay has said that no other “credible” bid has been received.

The facts of this particular matter are that two major chains have 80 per cent of the Australian retail grocery market and *all other competitors share the remaining 20 per cent.*

The Metcash purchase of the Franklins business would not change that and nor would the entry of a new wholesaler to the NSW market.

There are only three possible paths forward:

- A new potential purchaser will emerge, as the ACCC claims (although Pick n Pay says it has received no “credible” bid) and acquire Franklins in whole or in part.
- The acquisition is blocked and Pick n Pay closes its wholesale business and sells its corporate stores by tender, as it has indicated it would. This would see Woolworths⁶ and Coles cherry-pick the best of the stores and increase their market dominance in the world’s most concentrated retail grocery market.
- The acquisition, as proposed, goes ahead, giving the independent sector greater market strength, better terms of trade, a bigger marketing spend and delivering consumer benefits

In the first option, a new buyer of the “whole” would be acquiring a business which has already proven unsustainable, even with the expertise, experience and substantial resources of Pick n Pay behind it. Franklins made a profit in only one year since it began operating as a Pick n Pay subsidiary.

Any purchase “in part” would be likely merely to compound the problems such a buyer would face.

Conclusion

We consider the proposed acquisition of the Franklins business by Metcash would bring strong and sustainable benefits to independent retailers and consumers in New South Wales.

We see the failure of the current Franklins business as a strong deterrent to any investment by a new entrant, which would almost certainly lack competitive scale.

⁶ <http://www.brisbanetimes.com.au/business/woolies-eyes-franklins-stores-20101118-17yxq.html>