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

Dear Mr Hawkins,

Creeping Acquisitions – The Richmond Amendment

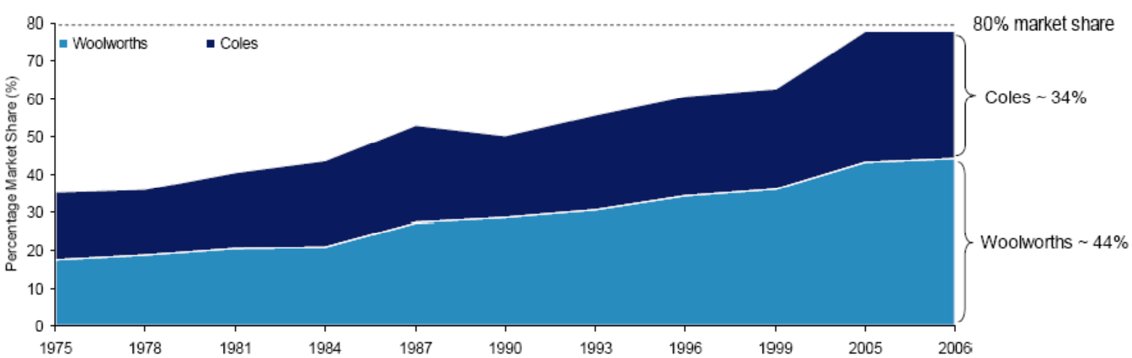
NARGA represents the independent retail grocery sector comprising over 5000 stores employing more than 225,000 people.

The independent grocery sector now comprises less than 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. This figure was confirmed by the data contained in Dr Craig Emerson's recent policy statement[1] which quotes the latest available Neilsen market share data confirming that Woolworths share of the packaged grocery market was 44% and Coles share 34%. A detailed summary is given by the chart below taken from the same PwC study:

Characteristics associated with market participants in the grocery industry

Market Participants	% Turnover	Stores	Turnover	FTEs	FTEs per store
Top 2 – Woolworths & Coles	78-79%	1,493 (24%)	$59 billion	108,833 (43%)	65
Top 4 – Woolworths, Coles, ALDI & Pick 'n Pay (Franklins)	80%	1,683 (27%)			
Independent grocery banner groups – IGA, FoodWorks, Ritchies	18.9%	2,140 (35%)	$15 billion	144,267 (57%)	32
Other independent grocery retailers	1.1%	3,291 (53%)			
TOTAL	**100%**	**6,183**	**$74 billion**	**253,100**	

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.

It shows that these companies take in 40 cents in every retail dollar spent in Australia.

Their dominance is evident in their presence in every major shopping centre, often in several formats, and their growth in markets outside of groceries including general merchandise, electronics, liquor, hardware, petrol and gambling. This high level of retail concentration is unprecedented and underscores the need to address the question of creeping acquisitions that, little by little, augment the retail dominance of the two chains.

The fact that these two entities continue to expand is illustrated by the recent 1st quarter financial report issued by Woolworths[2] which shows that additional 46 new stores were opened during the quarter to September 30 2009.

The size of these entities is important because:

- Retailing is a major component of the economy, both on dollar and employment terms.

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[1] *Competition barriers to major supermarkets being torn down*; Dr Craig Emerson, Minister for Competition Policy and Consumer Affairs, Minister for Small Business, Independent Contractors and the Service Economy, Minister Assisting the Finance Minister on Deregulation, 18 September 2009

[2] Press release Woolworths Limited 20 October 2009

- Prices set by Woolworths and Wesfarmers therefore feed directly into inflation.
- Inflation then affects interest rates set by the RBA

The fact that companies such as Woolworths contribute to food price inflation is demonstrated by the results reported in their most recent annual report[3] which shows sales increasing by 7.5% and profits after tax going up by 12.8%, with the major contribution coming from the supermarket sector of the business – i.e. any improvements in trading terms or efficiency are not being translated into lower prices – rather higher prices and margins are being turned into higher proifits.

Can Australia afford to have two entities have such a significant impact on the total economy?

Looking at the problem from a different perspective it is clear that, as retail market concentration increases, not only are smaller retailers squeezed out of the market, the capacity to supply those remaining retailers with goods and services is constrained, their competitive position is damaged and, as a result, Australians pay more for the goods they buy.

An example of the efforts by majors to squeeze out any competition is the recent move by Woolworths to purchase the Macro Wholefoods stores operated by Macro Life Pty Ltd, a group that provided a degree of innovation and competition in the retail grocery market. Further purchases have occurred in the hardware sector with Woolworths buying the Danks hardware wholesaling business and the continuing acquisition of independently owned hotels.

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[4] - 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.

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[3] Annual Report, Woolworths Limited 2008-09

[4] 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 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?

The Martin Report[5] 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.

Preventing further concentration in the sector

The proposed amendment to the Trade Practices Act – the Richmond amendment – strengthens the competition test to be applied under Section 50 of the Act to one of 'materially lessening competition' in the general case and, in the case of a corporation that has a substantial share of the market, one of 'lessening competition'.

In the case of competition in local markets we suggest that the a practical test of 'substantial share' in a local market would be a measure suggested during the UK Competition Commission 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. (Note that here a clear distinction was made by the UK commission between supermarkets as opposed to non supermarket grocery outlets – e.g. convenience stores and other food retailers.)

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

[5] Review of ACT Supermarket Competition Policy, John Martin, Martin Stone Pty Ltd, September 2009.

divest themselves of sufficient space so as to reduce their share to 60% or less. Such a reduction would occur only if the freed retail space was made available to a competitor, i.e. not simply transferred to another entity within the conglomerate where, as an example, a space vacated by a Woolworths of Wesfarmers related entity is simply transferred to a related entity and thereby denied to a competitor.

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 regional market share expressed in terms of the HHI and /or in terms of share of retail space.

Given the lack of compliance with notification requirements under the current voluntary code, we would also support a system of compulsory notification. Such a notification requirement should apply to entities which have substantial market share and to acquisitions of sites, leases and stores.

Please contact us should you require further details.

Yours sincerely

Ken Henrick
Chief Executive Officer