Coles Myer Ltd.
ABN 11 004 089 936

Coles Myer Ltd

submission to the

Senate Economic References Committee inquiry into the effectiveness of the *Trade Practices Act 1974* in protecting small business.

5 September 2003

Index

1. Summary:

Coles Myer understands that this inquiry is not specifically about supermarkets. However, we are contributing some commentary about our industry because the main advocate for this and four previous inquiries, is a group called NARGA whose aim is to achieve protection through legislative assistance.[1]

Over the past five years the grocery industry has been carefully reviewed by:

- A Joint Select Committee Inquiry on the Retailing Sector (1999)
- ACCC review of supplier trading terms (2002)
- Senate Committee review to consider the reverse onus of proof (2002)
- Dawson Review of the Trade Practices Act (2003)

From the perspective of the food and liquor sector, allegations have been presented to these inquiries but there has been no compelling evidence provided which suggests that s46 of the Trade Practices Act should be changed in favour of small business.

That there is no requirement for change in the food industry in further evidenced by:

- The significant growth and success being celebrated by the independents who have

[1]"We demand, absolutely insist on a level playing field. We want laws that are more easily enforceable and protection, not for us, but for consumers against the slide to the two players," Andrew Reitzer, CEO Metcash, Retail World, Aug 4 – Aug 5 2003. Metcash is the wholesaler to the Independents. Metcash contributes the majority of NARGA's funding. (Peter Switzer, Small Business writer, The Aust, 15 July, 2003.)

grown market share by approximately 30% from 11.8% in 2000 to 16.3% this year[2] with comparable stores sales growing at 7% over the previous year – the greatest in the industry
- The entry into Australia of two major international supermarket operators, Aldi and Pick n Pay

Coles Myer suggests that the changes arising from the previous inquiries should be given time to operate before further changes are contemplated.

As part of this submission, Coles Myer has commissioned Access Economics to update the economic assessment of the competitiveness of the retail grocery market in Australia. References to the Access report appear in the right hand margin.

We also append the Coles Myer submission made to the Joint Select Committee Inquiry in 1999 as the arguments and discussion points remain the same.

[2] Metcash market share has grown from 11.8% in 200 to 16.3% in 2003 – Retail World, Aug 4-Aug 15 2003; Foodweek, July 28, 2003

2. Coles Myer's view

Broadly, Coles Myer suggests that the range of changes to the TPA arising from the previous inquiries, should be given time to operate before the parliament considers further changes.

Initiatives emanating from the Joint Select Committee Inquiry and the Dawson Review include:

Access p 30-34

- The establishment of a Retail Grocery Code of Conduct and Ombudsman scheme (currently being reviewed)
- Regional markets test for mergers and acquisitions in the TPA
- An increase in the transactional limit for unconscionable conduct,
- Representative actions on behalf of businesses by the ACCC
- A proposal to facilitate collective bargaining by small business.

Coles Myer's response to the specific terms of reference as they relate to the supermarket sector is:

a) S46

No compelling evidence has been presented to these inquires which suggests that s46 needs to be amended because of problems identified in the food and liquor industry.

The food and liquor industry is highly competitive with firms competing on price, range, quality, convenience and service. Australia is considered to have amongst the best retail food offers in the world.

Access p i

Australian supermarket margins are significantly lower than the EBITDA margins of international supermarkets[3]:

Access p 37

Australia	average 4.4%, CML 4.1%
US	average 7.4%, Walmart 7.4%
Europe	average 6.1%, Carrefour 6.9%
UK	average 7.2%, Tesco 7.85%

Australian consumers have benefited from the intensity of this competition with food prices amongst the lowest in the OECD.

Coles Myer fears that changes to s46 such as an effects test, reverse onus of proof and banning below cost pricing, could result in the following negative consequences for both our business and consumers. They would:

- Restrain competitive pricing

[3] Deutsche Bank, Global Food Retailing Report, March 2003, Eat Cheese or Surrender – EBITDA for the international operators. Note, the property ownership model and high property costs in the UK require higher margins. The Australian average is an estimate based on published FY 2002 EBITDA of listed retail food companies.

- Restrict innovation and expansion of product ranges
- Limit opening new stores in new markets especially in regional areas where the geographic boundaries are more clearly defined.

Access p 36, 37

Banning loss leaders or below cost pricing would restrict competitive discounting and disadvantage consumers. Significantly, it would advantage the lowest cost operators and enhance their profitability, as has occurred in France where such a ban exists[4].

b) Unconscionable conduct

The unconscionable conduct provisions of the Trade Practices Act are a key feature of Coles Myer's comprehensive Trade Practices compliance program (the program also deals with fair trading and misuse of market power). The provisions have both an educative and preventative impact.

c) Codes

Coles Myer is a signatory and active participant in the Retail Grocery Code of Conduct and Ombudsman scheme. The Code has been in operation for three years and Coles has participated in one mediation, which was resolved to the satisfaction of both parties.

There is an opportunity to improve the Code which is currently being reviewed to:

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[4] Deutsche Bank, Global Food Retailing Report, March 2003, Eat Cheese or Surrender pp. 101-103

- Accommodate requests by growers for greater transparency, and

- with the support of NARGA, to encourage awareness of the Code amongst individual independent supermarket operators in respect of their relationship with their wholesalers – monopoly operators in most areas of Australia.

d) Observations on assistance to small business

- NARGA has created a mistaken impression that normal price competition is "unfair" which is resulting in unrealistic expectations for change and what any change is likely to achieve

- Some sections of the retailing sector have benefited commercially from protective legislation such as shop trading hour laws, pharmacy rules, liquor licensing rules and newsagency laws. However, in order to achieve fair competition, these largely state based restrictions have been challenged by the National Competition Council and have been repealed or are under consumer pressure to be repealed. *Access p 28, 31*

  For these protections to be reinstated through broad competition law like the Trade Practices Act, or other less transparent means, would be a retrograde step for competition. *Access p 25-29*

- Suggestions such as a 25% cap on market share, preventing "creeping acquisitions" and the reintroduction of price discrimination have all been carefully considered and rejected by the various inquiries.

e) International approaches

France has two laws designed to protect small business: *Access p 36*

- a ban on below cost selling, or loss leading, called the Gallard Law, and
- the 1995 Raffarin Law which limits the expansion or development of new retail sites

However, the ban on below cost selling is currently under review as it is too restrictive for all participants including consumers, is problematic to manage and favours the biggest chains and lowest cost operators, Carrefour and Leclerc.

According to a comprehensive Deutsche Bank report[5], the Raffarin Law has been responsible for the *"structurally surplus profitability"* of retailers. New floorspace growth in France has fallen well below floor space growth in other countries and significantly below demand of 2% per year. Therefore the Raffarin law gives a significant advantage to existing large retailers because new competition is severely restricted.

France has a tradition of protecting its industries be they state owned enterprises or sectors like agriculture.

[5] Deutsche Bank, Global Food Retailing Report, March 2003, Eat Cheese or Surrender

Several countries have town planning laws to restrict large scale developments occurring outside the existing town centres. These rules typically apply in countries that have limited space for such developments, like Britain, or wish to preserve heritage areas. If such restrictions were to be implemented in Australia they would only further enhance the advantage of existing operators in Australia by restricting new developments.

3. Background – The Australian Supermarket Sector

3.1 Consumers throughout Australia are benefiting from the intensity of the competition in the retail sector. Prices in Australia are amongst the lowest in the OECD and profit margins of the major chains are much lower than those of US and UK supermarket chains. *Access p 37*

3.3 Supermarket retailing in Australia has evolved in much the same manner as other developed nations. Firms such as Coles Myer have grown larger and are utilising the efficiencies of technology to extract economies of scale and passing on cost savings to consumers in the form of lower prices. *Access p i, 35*

3.4 The industry in Australia is dynamic. It has seen the exit of a major international operator and the entry of two new major international operators during the past five years. The independent chains have seen substantial market growth of more than 30%, an increase from 11.8% in 2000 to 16.3% this year. The growth in convenience stores or mini marts continues at nearly double-digit levels. *Access p 10-22 Extent of grocery market concentration* *Access p 16*

3.5 That there are two major Australian chains in addition to thousands of independents, as well as a major international discount supermarket operating, indicates a dynamic, evolving and highly competitive industry. Aldi already has 50 supermarkets in two *Access p 2* states – 41 in NSW in the first two years of operation and nine in Victoria opened in only three months. Aldi has signalled its intention to open in Queensland next year. Aldi has international sales of A$38 billion compared with Coles Myer Food and Liquor group's $16 billion and Woolworths' $21 billion. *Access p 16*

3.6 Many of the international companies supplying Coles Myer are significantly larger than Coles as are some of the shopping centre owners, both of which provide appropriate countervailing power. *Access p 22-24*

3.7 Concentration in the industry is similar to the market concentration occurring internationally in areas with similar geographic and population characteristics. *Access p 38-40*

The level of consolidation in the US appears very fragmented. However when viewed regionally, the US market is much more concentrated than it appears.

For example, in Florida, population 16.5 million, supermarket groups Publix, Winn-Dixie and Wal-Mart control 73% of the grocery market (2001).[6] *Access p 39*

[6] Deutsche Bank, Global Food Retail, March 2003, Eat Cheese or Surrender, p24, p 27.

Publix	44.3%
Winn-Dixie	21.7%
Wal-Mart	7.3%
Albertsons	7.2%

In the Netherlands, population 16 million, two supermarket groups have 70% of the grocery market.[7]

3.8 World-wide, consolidation and mergers continue to occur and new entrants emerge as the supermarket industry evolves.

For example, in the US in 1990 Wal-Mart had no supermarkets, it was a discount department store. In 1995 its food operations had less than 5% market share. By 2002 its food marketshare had grown to 15% with 1,300 supermarkets. Wal-Mart plans to roll out 200 new supermarkets[8] per year over the next five years. Now, in 2003, it is the largest food retailer in the United States and operates supermarkets in the UK, Germany, Mexico and China. Its annual sales, food only, are A$130 billion[9] (CML food and liquor = A$16 billion).

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7 Deutsche Bank, Global Food Retail, March 2003, Eat Cheese or Surrender, p 111
8 The Wal-Mart supermarket is generally part of a supercentre which is approx 200,000 square feet with food occupying half the store, and the remainder discount general merchandise and apparel
9 Deutsche Bank, Global Food Retail, March 2003, Eat Cheese or Surrender, p 18,19

The expansion of Wal-Mart has seen it take over the ASDA chain in the UK and other major retailers have merged or sought to merge in response. For example, Kroger took over Ralphs, and Safeway took over Vons on the West Coast of the US.

3.9 Despite Australia's small population relative to our landmass, consumers in most parts of Australia have improved access, through the expansion of the supermarket chains, to lower food prices, quality food and increased product ranges.

The Joint Select Committee into the Retailing Sector (1999) reported in its executive summary that:

"*Despite the growth of the major chains, consumers appear to be benefiting from the competitive forces of the current market structure. The evidence revealed that, since 1986, prices have fallen on average for baskets of food and individual foods at supermarkets. Although there are some exceptions, the Committee accepts that economies of scale and scope have driven prices down in major supermarkets across Australia.*"[10]

[10] Fair Market or Market Failure, A review of Australia's retailing sector, Report by the Joint Select Committee on the Retailing Sector, August 1999, p vii

4. Changes and findings of previous inquiries

4.1 The Joint Select Committee Inquiry on the Retailing Sector saw the establishment of a Retail Grocery Code of Conduct and Ombudsman Scheme. *Access p 31*

The Code is currently being reviewed as part of its ongoing operation and to ensure its relevance and effectiveness.

During its first few years of operation, the Ombudsman found that most of the complaints were between primary producers and market agents. Coles Myer has had only one complaint requiring mediation and it was settled to the satisfaction of all parties.

The Review is expected to encompass grower requests for greater transparency in their dealings through the central market system.

It is Coles Myer's observation that the Code could also be made more robust if it were promoted to small grocery store operators as a potential vehicle for greater transparency and fairness in their dealings with monopoly wholesalers.

4.2 Also emanating from the Inquiry was a regional markets definition in the Trade Practices Act in respect of acquisitions. This change was intended to address concerns raised by NARGA about creeping acquisitions. *Access p 32*

Coles Myer voluntarily notifies the ACCC of supermarket acquisitions and will continue to do so.

4.3 Change to allow representative actions by the ACCC on behalf of small business was intended to improve access to the TPA. *Access p 33*

4.4 Increasing the transactional limit to $3m for unconscionable conduct was intended to broaden the provisions sphere to include a far greater number of transactions. *Access p 33*

4.5 The Dawson Review has recommended that collective bargaining authorisations be more easily accessible to small business. It is Coles Myer's observation that the recommendation to facilitate collective bargaining has been generally well received by small business with the exception of NARGA, which has been critical of the proposal.

5. Coles Myer food and liquor operations – overview of relevant behaviours, practices and procedures

Coles Myer's success is dependent upon its customer focus – working with staff and suppliers to provide service, range, price, quality and convenience for customers.

Reputation and behaviour are critical elements of the relationship.

5.1 Employees – quality jobs

Coles Myer is the largest private sector employer in Australia with over 160,000 employees.

There are 82,000 employees in the company's food and liquor operations.

In order to attract and retain staff, it endeavours to treat employees well by providing greater permanency than the industry norm. For example, Coles shifted from having a predominantly casual workforce eight years ago (approx 70%), to having 70% of its workforce now in permanent positions.

Training and careers are provided through the Coles Myer Institute, which was pioneered six years ago in partnership with Deakin University. It provides education and training programs to take a retail trainee through to an MBA qualification.

Coles Myer is investing in excess of $38 million in training staff Australia-wide this year.

5.2 Commercial Conduct

All Coles Myer employees and directors are required to sign a binding Code of Conduct.

Buyers receive training and updates on Trade Practices Compliance and Fair Trading with particular application to their dealings with small suppliers and they are trained in the company's ethical obligations towards suppliers.

Terms and conditions are clearly set out and available to both buyers and suppliers.

Store managers, and management generally, receive training and manuals on their Fair Trading obligations.

5.3 Suppliers

Coles Myer Food and Liquor Group considers the sustainable supply of quality products to be critical in meeting customer expectations. Therefore open and fair relationships with suppliers that provide a return for all parties are very important.

Coles Myer is an active participant in the Retail Grocery Code of Conduct and Ombudsman scheme.

The company has a robust internal dispute resolution process, which enables suppliers to discuss issues without fear. The process is easily accessible on the Coles website (www.coles.com.au under the tab, 'suppliers')

Coles Myer buyers have strict guidelines and standards for their day-to-day dealings with suppliers.

Increasingly Coles Myer tries to buy directly from producers to ensure an ongoing supply of quality products. For example, 70 per cent of beef sold in Coles Supermarkets is grown specifically for Coles Myer. Beef farmers work with the buyers to review specifications regularly ensuring customers' changing expectations in cuts, fat content and quality variations are being adequately addressed.

Direct relationships also ensure greater transparency for the growers in the relation between prices paid to farmers and prices charged by supermarkets.

5.4 Pricing policy

Coles Myer supermarkets pricing strategies are designed to maximise the value / price proposition for the customer by combining extensive Every Day Low Prices with genuine promotions.

There are 1,500 quality house brand products and 200 national brands on every day low price in Coles.

Bi-Lo, Coles Myer's discount supermarket, has over 1,250 house brand products also at Every Day Low Prices.

Coles Myer has a standard price structure in each state designed to give a satisfactory return while providing good value for customers.

The state price may vary upwards or downwards according to different structural costs in each location.

Coles Myer may, because of local competition, be obliged to accept lower prices than its standard structure.

All store managers have the discretion to lower prices on key lines to meet (but not undercut) local competition. All local price movements are reported by store managers to a central point. They do not have the authority to raise prices.

7. Conclusion

Since 1998 there have been four inquiries where supermarket issues have been considered.

There are now new provisions in the Trade Practices Act to make it more accessible to small business.

There is a Retail Grocery Code of Conduct and Ombudsman Scheme which is currently being reviewed as part of its evolution.

However, there has been no compelling evidence of unfair behaviour presented to these inquiries such that they could conclude that the Trade Practices Act, s46, required amendment on account of the food and liquor industry.

Coles Myer urges the Committee not to move towards protectionism for small business at the expense of consumers or competition generally.

Intense competition is currently ensuring that Australian consumers are provided with supermarket offerings that are amongst the best in the world and food prices that are amongst the lowest.

UPDATE ON THE STATE OF THE FOOD & GROCERY MARKET

REPORT BY
ACCESS ECONOMICS PTY LIMITED

FOR

COLES MYER LTD

3 SEPTEMBER 2003

TABLE OF CONTENTS

TABLES

FIGURES

EXECUTIVE SUMMARY

Retailing or distribution remains one of the largest sectors of the economy. It covers a diverse range of activities and accounts for around 12 per cent of GDP and 15 percent of total employment. Despite substantial real growth and changes in the types and relative prices of goods on offer, retail spending has not changed significantly in composition or in size in relation to the rest of the economy since 1999.

Consistent with the evidence in previous years, the retail grocery industry continues to exhibit the hallmarks of intense competition:

- Profit margins in retailing are consistently lower than in other industries, both for smaller and larger stores.
- Ease of entry and exit continues, with the exit of Hong Kong based Franklins, and the entry of the German discounter, Aldi and South African chain Pick ‘n’ Pay over the past four years.
- The countervailing power of suppliers to retailers continues to strengthen over the period with the top 20 suppliers supplying 47.6 per cent of Coles’ total packaged dry grocery sales, and further consolidation occurring in the ownership of shopping centres.
- Economies of scale have contributed to the growth in the larger stores but the differentiated nature of the market has also seen growth in the number of smaller specialist food retailers.
- Changes in grocery retailing have occurred in parallel with a consistent trend towards more affordable food and groceries for Australian consumers.

Australian governments have removed a number of distorting mechanisms over the last decade, including the repeal of restrictions such as those on shop trading hours. Governments nevertheless continue to support small business through a range of measures which provide a significant competitive advantage at potential cost to consumers.

Retailing-specific and other regulatory initiatives following the 1999 Joint Select Committee Inquiry into Retailing (Baird Inquiry) have had some direct influence on the behaviour of the large retailers, but it is likely that more substantial indirect effects have occurred within the organisations and in their dealings with suppliers and smaller competitors, to the advantage of these other parties. For example, in some cases, the reforms have directly helped improve the large retailers’ relationships with their suppliers, to the likely ultimate benefit of all parties, including consumers.

In all cases, the recent reforms have probably not been in place long enough to be able to judge whether they have been successful in correcting the perceived problems they were intended to address. In any event, to the extent that proposals for change to the *Trade Practices Act* are driven by perceived need to further protect small retailers, and small business in general, there are more direct and transparent means available to governments that will serve the purpose with less cost to the Australian community.

1. BACKGROUND

In 1999 Access Economics prepared a report for Coles Myer Ltd (CML) that provided economic background to the CML submission to the Joint Select Committee Inquiry into Retailing held that year. We have now been commissioned to revisit the statistical chapters of our 1999 report and to provide commentary on recent changes and trends in the supermarket retailing and associated markets as support for the CML submission to the current Inquiry by the Senate Standing Committee on Economics into the effectiveness of the *Trade Practices Act 1974* (TPA) in protecting small business.

The analytical content of our 1999 report is still valid and is relevant economic background to the current Inquiry. We have included some material drawn from that report where appropriate but, for brevity, this report concentrates on updating the statistical picture of Australian retailing and discussing the effects of changes in the regulatory framework since the 1999 Inquiry. In many cases, however, the delays in release of data and the occasional nature of many of the surveys mean that that picture is only now catching up with the 1999 Inquiry. Nevertheless, the changes evident in the currently available information support the hypotheses we put in our last report regarding trends in the nature of Australian supermarket retailing.

This report is organised as follows:

- Section 2 provides an overview of the state of the retailing industry in Australia, with particular reference to changes since our 1999 report.
- Section 3 examines existing forms of government assistance for small business, including the principles that have guided recent reforms and should be applied in designing any future assistance or considering any further legislated changes to competition.
- Section 4 summarises and briefly assesses recent changes in the regulation of Australian retailing, covering both general changes to the *Trade Practices Act* arising out of the 1999 Joint Parliamentary Inquiry into Retailing and other reforms associated with the implementation of National Competition Policy.
- Section 5 gives an overview of recent changes in retail markets overseas, including updates of the comparisons of the characteristics of Australian and foreign retail markets made in our 1999 report.
- Section 6 summarises our conclusions.

2. CURRENT STRUCTURE OF AUSTRALIAN RETAILING

Retailing or distribution remains one of the largest sectors of the economy. It covers a diverse range of activities and accounts for around 12 per cent of GDP and 15 percent of total employment.

Despite substantial real growth and changes in the types and relative prices of goods on offer, retail spending has not changed significantly in composition or in size in relation to the rest of the economy since 1999.

Consistent with the evidence in previous years, **profit margins in retailing are consistently lower than in other industries, both for smaller and larger stores.**

The present report deals mainly with food and grocery retailing. On the broad definition of where food and groceries are bought - the so-called "share of stomach" measure - expenditure in the sector still accounts for around 55 per cent of retail trade turnover. In turn, supermarkets and grocery stores account for about 53 per cent of this measure, their share having increased marginally from 1998 but has been relatively stable for the last three years (see Table 2-8).

There have been substantial changes in the distribution of market shares within the supermarkets and grocery market following the collapse and sale of the Franklins chain. On the narrower definition, the two largest supermarkets account for 77 per cent (of the dry packaged goods market) though broader measures used by the ACCC suggest market share is around 61 per cent.

There is no clearly defined third-ranked chain, but the Metcash/IGA group, a distributor and its affiliated "independent" retailers, is rapidly rebuilding the market niche left by Franklins, increasing their market share to 16.3 per cent in 2003. This is in addition to strong competition from new international entrants such as Aldi and Pick 'n' Pay. These new competitors already have 4 and 8 per cent, respectively, of the dry packaged goods market in NSW.

Substantial structural changes in supply industries are also working through into retail markets.

The larger stores operate on narrower margins, suggesting that any forced transfer of sales from large to small would come at the cost of higher prices for consumers.

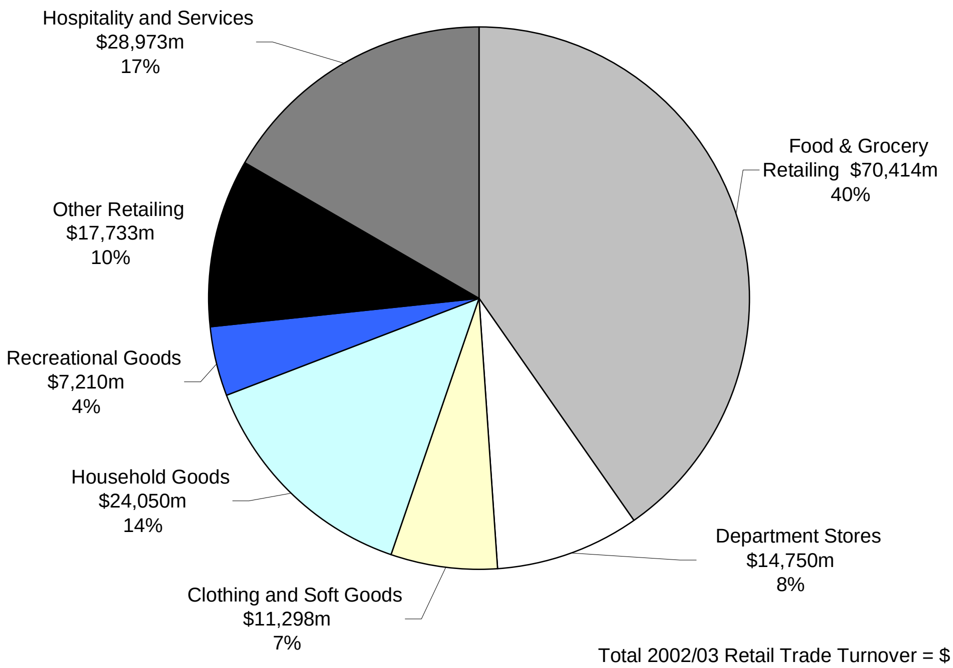
The countervailing power of suppliers to retailers continues to strengthen over the period with the top 20 suppliers now supplying 47.6 per cent of Coles' total packaged dry grocery sales, and further consolidation occurring in the ownership of shopping centres.

This Section provides an overview of the retailing industry in Australia, with particular reference to changes since our 1999 report. Wherever possible, data are analysed separately for different categories of food retailers.

2.1 OVERVIEW

The retail industry remains important in national output. Retail and wholesale trade accounts for about 12 per cent of Australia's Gross Domestic Product (GDP), slightly more than the 11 per cent share in 1999. The retail industry nevertheless still accounts for 44 per cent of total private final consumption expenditure (increased only marginally since 1999), and 15 per cent of total employment. A breakdown of retailing by type of activity in 2002-03 is given in Figure 2-1 below. This breakdown is largely unchanged since 1999, with the exception of the gradual shift since then of about 3 per cent of the total from the Recreational goods category to the Household goods category. That is, despite substantial changes in the types of goods on offer and in relative prices of many goods, retail spending has not changed significantly in composition or in relation to the rest of the economy since our last report.

FIGURE 2-1: RETAIL TRADE TURNOVER, AUSTRALIA 2002-03



Total 2002/03 Retail Trade Turnover = $ 174.4 billion
(note that this excludes motor vehicles and assoc. goods)

Source: ABS 8501.0, Table 3

Of the 1,164,100 businesses in Australia in 2000-01, 168,700 were in the retail trade sector. These numbers were, respectively, 10.7 per cent and 3.5 per cent higher than in 1996-97 Small retailers still account for almost 97 per cent of all retailers, up 2.4 per cent on 1996-97, with close to 43 per cent of small retailers classified as non-employing businesses[1]. This suggests a continuation of the higher than average proportion of family businesses in retail

1 Australian Bureau of Statistics (ABS), Cat. No. 1321.0, Table 1.3.

trade noted in the 1996 Business Longitudinal Survey[2], in which 63 per cent of retail trade firms considered themselves to be family businesses.

As shown in Table 2-1 and illustrated in Figure 2-2, real retail trade turnover increased by 36 per cent in the eleven years to 2002-03, and has shown renewed growth in the three years since our last report. Strong growth has mainly occurred in the retailing of food, recreational goods, and hospitality and services. Within food retailing nominal turnover was close to $70 billion in 2002-03, with supermarkets and grocery stores accounting for 73 per cent of the total[3], an increase on the 68 per cent share in 1998-99. Many factors will have influenced these figures. For example, the notable decrease in the Takeaway food category in 2000-01 most likely reflects an adjustment following the introduction of the GST.

TABLE 2-1: REAL RETAIL TRADE TURNOVER SUMMARY ($M)

	1985-86	1991-92	1994-95	1997-98	2000-01	2002-03
Total Retail	**125,175**	**128,239**	**139,801**	**149,993**	**160,908**	**174,428**
Food	44,965	49,728	54,535	62,015	65,068	70,414
Supermarkets / grocery	30,588	34,502	38,312	43,520	47,586	51,274
Takeaway	5,969	6,894	7,151	7,504	6,806	7,197
Specialty Food Retailing	8,409	8,332	9,072	10,991	10,676	11,943
Department Stores	14,813	13,533	13,797	13,947	13,938	14,750
Clothing and Soft Good	11,233	10,534	9,897	9,755	10,526	11,298
Household Goods	16,683	15,836	18,476	19,142	20,829	24,050
Recreational Goods	6,476	6,464	7,134	7,380	7,128	7,210
Other Retailing	9,205	10,958	12,658	14,581	16,096	17,733
Hospitality and Services	34,513	23,715	22,492	23,172	27,324	28,973
Hotels and clubs	15,088	12,712	13,644	13,592	15,001	16,287
Cafes / restaurants	4,887	6,684	7,537	7,477	9,962	9,966
Selected services	1,825	1,790	2,123	2,104	2,361	2,719

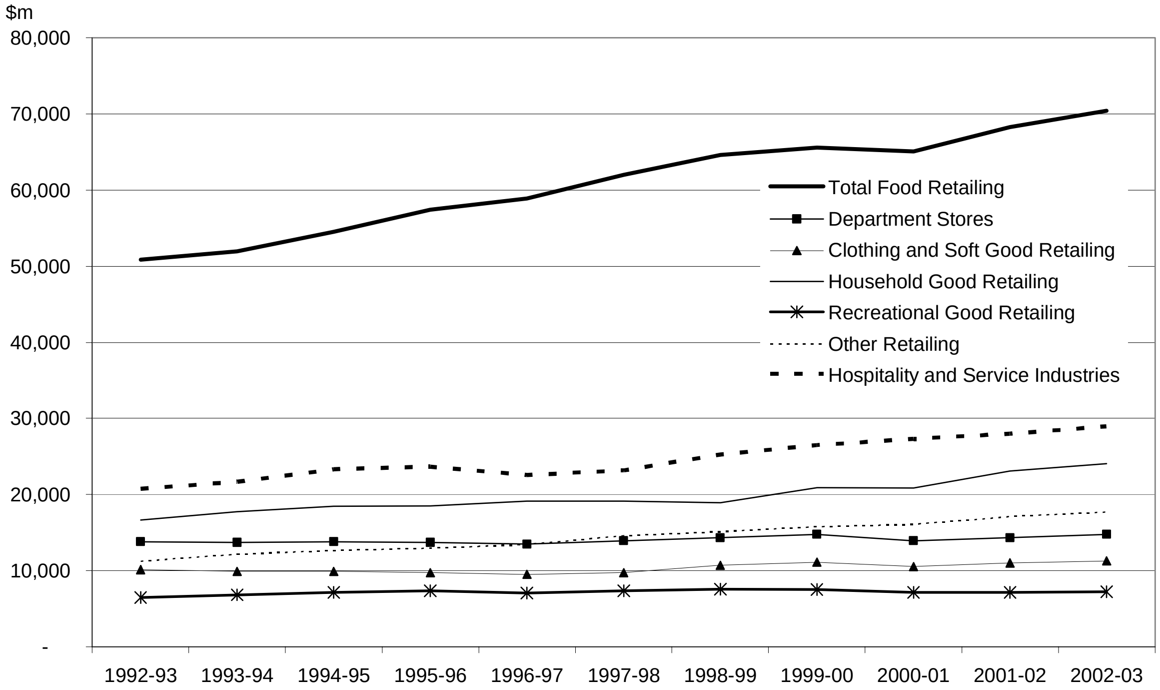
Source: ABS 8501.0, Table 1; Access Economics

Note: Prices are in real terms, adjusted by headline CPI to 2002-03 prices.

2 Department of Employment, Workplace Relations and Small Business, *A Portrait of Australian Business: Results of the 1996 Business Longitudinal Survey*, AusInfo, Canberra, 1998.

3 This excludes food sales from the hospitality and services sector.

FIGURE 2-2: REAL RETAIL TRADE TURNOVER (2002-03 PRICES)



Source: ABS 8501.0, Table 1; Access Economics

The retail industry employed 1,353,500 persons in May 2001 an increase of 11 per cent over the number in 1996-97, compared with economy wide employment growth of 8.8 per cent over the same period. Of that retail employment, the proportion in small businesses was about 44 per cent in 2000-01, a decrease from the just over 51 per cent in 1996-97 (ABS, 1321.0, Table 2.2.

As shown in Table 2-2, the employment in the Coles Myer food and liquor division has continued to grow from 13,000 in 1970, to almost 82,000 in 2002-03. Coles' program of permanency has seen the proportion of casuals employed in the business reduced from 70 per cent to just over 30 per cent.

TABLE 2-2: COLES MYER FOOD AND LIQUOR EMPLOYMENT 1970 TO 2003

	Total Employees
1970	13,000
1977	20,000
1985	44,200
1990	60,186
1998	72,738
2003	82,000

Source: CML

TABLE 2-3: SHOPFRONT RETAILING IN AUSTRALIA

	Locations	Persons Employed	Turnover ($m)	Floor space ('000 sq m)	Turnover/ Employee ($/person)	Turnover / Floorspace ($/sq m)
CML Food & Liquor						
2001-02	**1,179**	**84,834**	**15,711**	**1,416**	**185,197**	**11,095**
1997-98	**1,188**	**72,738**	**10,829**	**1,188**	**148,878**	**9,117**
1998-99						
Total Food Retailing	**34,003**	**478,717**	**54,739**	**7,824**	**114,346**	**6,996**
Supermarket and Grocery Stores	5,631	234,960	38,329	5,000	163,129	7,666
Specialised Food Retailing	28,372	243,757	16,410	2,824	67,323	5,811
Fresh meat, fish, poultry	3,924	18,627	2,122	344	113,926	6,178
Fruit and vegetable	1,611	12,103	1,735	341	143,336	5,086
Liquor	1,388	8,452	2,628	259	310,968	10,136
Bread and cake	3,579	27,084	1,141	311	42,132	3,675
Takeaway	15,357	166,612	6,948	1,371	41,704	5,070
Specialised	2,513	10,879	1,836	195	168,738	9,424
Department Stores	631	103,078	11,885	4,652	115,301	2,555
Clothing and Soft Good Retailing	14,175	79,256	8,996	2,496	113,509	3,605
Furniture, Houseware, Appliance Retailing	9,542	76,043	16,266	3,281	213,911	4,958
Recreational Goods	8,698	57,749	7,493	1,694	129,753	4,424
Other Personal & Household Goods	19,163	116,574	14,896	6,066	127,779	2,456
Household Equipment Repair Services	2,828	9,090	96	250	10,517	383
Selected Personal Services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total	**89,040**	**920,507**	**114,371**	**26,262**	**124,248**	**4,355**
1991-92						
Total Food Retailing	**53,166**	**406,299**	**40,811**	**9,963**	**100,445**	**4,096**
Supermarket and Grocery Stores	9,486	180,826	26,102	5,290	144,348	4,934
Specialised Food Retailing	43,680	225,473	14,709	4,672	65,235	3,148
Fresh meat, fish, poultry	7,349	28,459	2,787	744	97,930	3,746
Fruit and vegetable	3,670	18,189	1,893	630	104,074	3,005
Liquor	1,847	8,593	2,094	397	243,687	5,275
Bread and cake	4,771	30,066	1,174	536	39,047	2,190
Takeaway	20,324	118,212	4,885	1,894	41,324	2,579
Specialised	5,719	21,954	1,876	471	85,451	3,983
Department Stores	459	87,148	9,880	3,962	113,372	2,493
Clothing and Soft Good Retailing	21,688	91,138	8,495	3,499	93,215	2,428
Furniture, Houseware, Appliance Retailing	14,268	75,355	12,012	5,971	159,407	2,012
Recreational Goods	12,913	60,071	6,678	2,224	111,176	3,003
Other Personal & Household Goods	28,164	116,986	9,501	5,186	81,216	1,832
Household Equipment Repair Services	3,238	9,654	522	315	54,094	1,656
Selected Personal Services	38,708	223,431	8,275	5,398	37,035	1,533
Total	**172,604**	**1,070,082**	**96,175**	**36,519**	**89,876**	**2,634**

Sources: ABS 8613.0 (1991-92) Table 3, ABS 8622.0 (1998-99) Table 1, CML and CML *Annual Review and Financial Report, 2002*
n.a. not available

Table 2-3 also shows the extent of Coles Food and Liquor group in 1997-98 and 2001-02. This covers Coles and Bi-Lo supermarkets, as well as the Liquorland stores. Note that these figures are not directly comparable with the 1998-99 data for other retailing. Clearly, however, even after allowing for real and nominal growth of total Food Retailing since 1998-99, the Coles food and liquor group represents an important part of the industry. Coles food and liquor store locations reduced slightly between 1997-98 and 2001-02, with growth in supermarket and liquor stores numbers offsetting the sale of Red Rooster locations. Total floorspace and employee numbers have consequently also grown and Coles has significantly increased both its turnover per square metre and turnover per employee (by 10.0 per cent and 7.6 per cent, respectively, in real terms).

One measure of the degree of competition in an industry is the level of profitability, the simplest measure of which is the profit margin conceived as the ratio of operating profit before tax to total turnover.

Over the 1990s profit margins have decreased marginally in retailing. The retail trade industry had the lowest net profit margin (2.7 per cent, matched only by Wholesale trade) of all industries in Australia in 2000-01 (see Table 2-4 below). This is entirely consistent with previous years, in which the retail industry net profit margin has always been at or near the lowest of all industry groups. According to published ABS data (ABS, 8140.0, Tables 33 and 34), large retail businesses achieved a net profit margin of 2.1 per cent in 2000-01 compared with 3.1 per cent for the small and medium sized firms (down from 2.7 per cent and 3.9 per cent, respectively, in 1994-95). Both figures remain well below the all-industries average.

TABLE 2-4: AUSTRALIAN BUSINESS NET PROFIT MARGINS (%)

	1996-97	1997-98	1998-99	1999-00	2000-01
Agriculture, forestry, fishing	11.8	14.1	13.3	16.3	na
Mining	17.9	15.3	16.5	18.4	27.8
Manufacturing	6.0	6.1	5.6	6.6	6.1
Electricity, gas and water	13.9	15.1	14.1	13.9	12.0
Construction	5.1	4.5	5.6	4.8	4.8
Wholesale trade	3.2	2.9	3.7	3.8	2.7
Retail trade	***2.9***	***3.2***	***3.4***	***3.4***	***2.7***
Accommodation, cafes & restaurants	6.8	6.8	5.0	5.4	4.0
Transport and Storage	6.6	6.6	7.1	5.1	3.7
Finance and Insurance	24.2	26.3	27.7	22.8	28.4
Communication services	8.3	18.5	20.6	18.1	18.0
Property and business services	11.7	11.4	10.7	10.5	9.5
Private community services	10.7	11.2	10.9	8.6	9.8
Cultural and recreational services	5.0	9.3	12.1	13.6	9.7
Personal and Other services	8.1	11.8	7.5	9.5	8.0
All industries	**8.4**	**8.9**	**9.3**	**8.8**	**9.2**

Source: ABS 8140.0

Details of the components of these performance indicators for 1994-95 and 2000-01 are shown in Table 2-5, divided between large and small and medium-size enterprises.

TABLE 2-5: RETAIL TRADE SUMMARY OF PERFORMANCE, 1994-95 AND 2000-01

	1994-95			2000-01		
	Small & Medium Enterprises	Large Businesses	Total	Small & Medium Enterprises	Large Businesses	Total
Total Retail Trade						
Sales of goods and services ($m)	87,146	50,726	137,872	121,250	77,602	198,852
Cost of sales ($m)	73,257	42,735	115,992	100,278	65,090	165,368
Cost:Sales ratio	0.84	0.84	0.84	0.83	0.84	0.83
Gross/trading profit ($m)	13,889	7,991	21,880	20,972	12,512	33,484
Gross profit margin (%)	15.9	15.8	15.9	17.3	16.1	16.8
EBIT ($m)	4,198	1,921	6,119	4,698	5,724	10,422
EBIT margin (%)	4.8	3.8	4.4	3.9	7.4	5.2
OPBT ($m)	3,402	1,420	4,822	3,808	1,703	5,511
Net profit margin (%)	3.9	2.7	3.5	3.1	2.1	2.7

Source: ABS 8140.0, Tables 32-34.

In 1994-95, gross profit margins in retail trade were similar for businesses of all sizes. However, margins calculated on earnings before interest and tax (EBIT) were lower for large businesses than for small and medium enterprises. By 2000-01, however, this latter pattern had been reversed (returning to the order evident in the early 1990s) and there was greater disparity between the gross profit and EBIT margins of the two classes of businesses. Note however, that net profit margins (comparable with those in Table 2-4) preserve the original rankings and show large retail businesses operating on much smaller margins (2.1 per cent in 2000-01).

TABLE 2-6: FOOD RETAILING SUMMARY OF PERFORMANCE, 1991-92 AND 1998-99

	1991-92			1998-99		
	Supermarkets & grocery stores	Specialised Food Retailing	Total Food Retailing	Supermarkets & grocery stores	Specialised Food Retailing	Total Food Retailing
Sales of goods and services ($m)	25,280	11,536	36,816	38,329	16,410	54,739
Cost of sales ($m)	19,941	7,083	27,023	29,541	10,508	40,050
Cost:Sales ratio	0.79	0.61	0.73	0.77	0.64	0.73
Gross/trading profit ($m)	5,339	4,453	9,792	8,788	5,902	14,690
Gross profit margin (%)	21.1	38.6	26.6	22.9	36.0	26.8
EBIT ($m)	765	685	1,450	1,371	1,126	2,497
EBIT margin (%)	3.0	5.9	3.9	3.6	6.9	4.6
OPBT ($m)	522	396	918	1,130	875	2,005
Net profit margin (%)	2.1	3.4	2.5	2.9	5.3	3.7

Source: ABS 8622.0, Tables 1 and 2.

Within the food retailing sector, gross profit margins had tended to be slightly higher in 1991-92 than the average for the retailing industry. Supermarkets and grocery stores had smaller EBIT margins than specialised food retailers, as can be seen from Table 2-6. These relatively lower profit margins were still evident in 1998-99. Comparable, and more recent, figures for the CML Food and Liquor division are presented in Table 2-7.

TABLE 2-7: SUMMARY OF COLES' PERFORMANCE

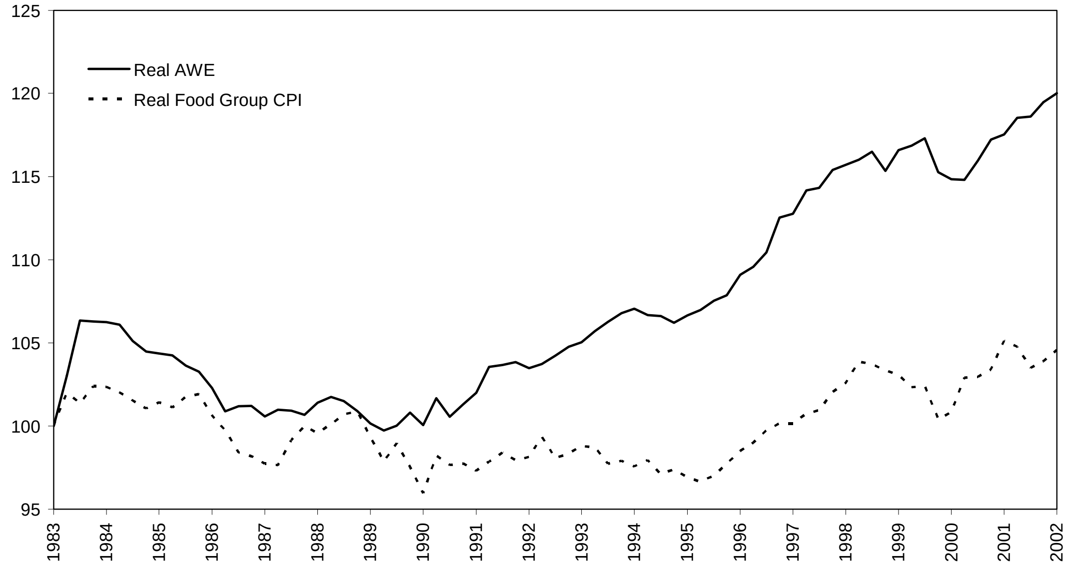
	1997-98	1999-00	2001-02
CML Food and Liquor			
Sales ($m)	11,559	14,221	15,892
EBIT ($m)	387	471	547
EBIT margin (%)	3.5	3.5	3.4

Source: CML *Financial Report, 1998, 2000, 2002*

We previously concluded (1999 report, paragraphs 69 and 70) that the higher mark-up on goods purchased from the specialised food retailers suggested that any artificial shifting of retail trade out of supermarkets and grocery chains, into smaller stores unable to take advantage of the large firms' economies of scale and scope, might lead to higher final retail prices. The figures in Table 2-6 still support this proposition. Note, however, that despite their higher mark-ups on cost of goods the small speciality stores have done so without losing substantial market share to supermarkets and grocery stores. One possible explanation is that these businesses are serving niche markets (defined, for instance, by product offer, convenience, trading hours or customer service) that larger businesses do not, allowing them to have different cost structures.

The changes in grocery retailing have occurred in parallel with a consistent trend towards more affordable food and groceries in Australia. Figure 2-3 shows the movements in real Average Weekly Earnings and Food Prices over the last twenty years. While there are many factors that influence the relative level of food and grocery prices over time, including seasonal factors such as drought, food prices for consumers continue to fall as of proportion of weekly earnings.

FIGURE 2-3: MOVEMENTS IN REAL AVERAGE WEEKLY EARNINGS AND FOOD PRICES, 1983-2002



Sources: ABS 6302.0 Average Weekly Earnings Australia, ABS 6401.0 Consumer Price Index Australia

2.2 EXTENT OF GROCERY MARKET CONCENTRATION

We noted in our 1999 report that the extent of retail concentration depends crucially on the market definition chosen. As shown in Figure 2-1 above, food and grocery retailing still makes up 40 per cent of total retail trade turnover. Sales by the Coles Myer Group (encompassing Supermarkets, Department stores and discount and specialty stores) were about 15.7 per cent of total retail trade turnover in 2001-02, slightly higher than the 15 per cent previously reported for 1997-98.

The following pie charts (Figure 2-4 to Figure 2-7) and accompanying tables illustrate three measures used to describe the food and grocery market:

- Retail industry's "share of stomach" measure;
- ABS Measure 2 used by the ACCC; and
- Retail industry AC Nielsen Brandscan measure.

While there is a degree of overlap between the three measures, each is useful in understanding the dynamics in the food and grocery market. The most notable changes since 1999 arise from the exit of Franklins, the consequent growth in market share of the largest chains, particularly the Metcash group, and the growth or entry of other independent chains such as Action, Pick 'n; Pay and Aldi.

At the broadest level, supermarkets and grocery stores compete with other retail outlets in food and grocery supplies, including ready to eat meals from takeaway outlets, hotels, cafes and restaurants. As evident from Table 2-8, takeaway foods share of this market declined by almost 20 per cent since calendar 1998. Supermarkets and grocery stores increased their share of this broad food retailing market by 5.5 per cent since calendar 1998. Cafes and Restaurants increased their market share by 12.2 per cent and at nearly twice the rate of total food sales in the four years to 2002, while other food retailing and hotels and clubs declined by 6 per cent and 8 per cent, respectively.

TABLE 2-8: ANNUAL FOOD SALES BY SECTOR

	1998		2000		2001		2002	
	$m	% share	$m	% share	$m	% share	$m	% share
Supermarkets / Grocery	38,763	50.2%	43,217	53.0%	46,727	53.0%	49,732	52.9%
Takeaway	7,184	9.3%	6,018	7.4%	6,605	7.5%	6,978	7.4%
Other Food Retailing	10,187	13.2%	9,893	12.1%	10,501	11.9%	11,894	12.7%
Hotels & Clubs	14,130	18.3%	13,575	16.6%	14,793	16.8%	15,807	16.8%
Cafes & Restaurants	6,996	9.1%	8,867	10.9%	9,618	10.9%	9,549	10.2%
TOTAL	**77,260**		**81,569**		**88,243**		**93,961**	

Source: ABS 8501.0, Table 3.

As previously reported, retail industry's "share of stomach" measure for 2002-03 still accounts for about 55.4 per cent of total retail trade turnover (40.4 per cent from food and grocery retailing and the other 15.0 per cent from the hospitality and services sector). Total turnover covered by the share of stomach definition grew by 36 per cent from $71,259 million in 1997-98 to $96,667 million in 2002-03 (an increase of 16.3 per cent in real terms).

The distribution of share of stomach sales across different categories of retailers between 1991-92 and 2002-03 is shown in Table 2-9 below. These financial year shares are comparable with the calendar year figures presented in Table 2-8. Figure 2-4 and Figure 2-5 illustrate, respectively, the share of stomach distributions in 1997-98 and 2002-03. Note that the 1997-98 figures have been revised by the ABS since our last report.

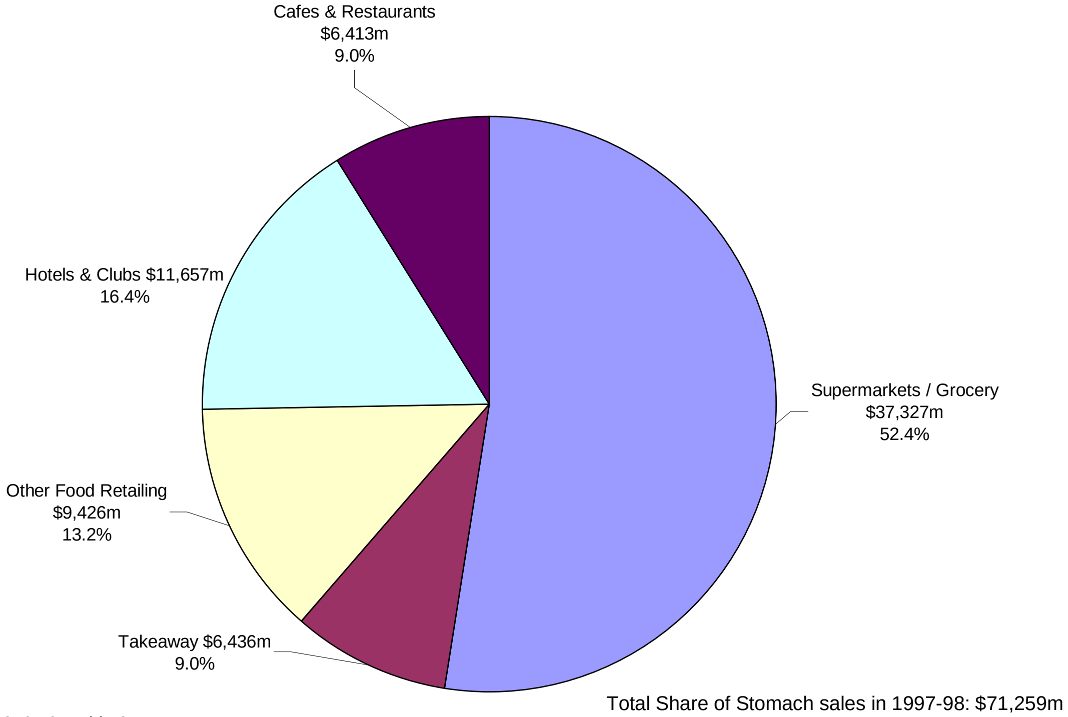
As might be expected from the broader nature of the share of stomach measure, and the observation earlier about the stability of the distribution of retail trade turnover, the shares of stomach sales have also remained almost unchanged since 1997-98. There has been a shift from the Takeaway and Other Food Retailing categories to Hotels & Clubs and Cafés & Restaurants. The Supermarkets and Grocery share has also increased slightly, from 52.4 per cent to 53.0 per cent.

TABLE 2-9: SHARE OF STOMACH MEASURE

	1991-92	1994-95	1997-98	2001-02	2002-03
Supermarkets / Grocery	48.5%	48.5%	52.4%	53.0%	53.0%
Takeaway	10.4%	10.0%	9.0%	7.4%	7.4%
Other Food Retailing	12.3%	12.2%	13.2%	12.3%	12.4%
Hotels & Clubs	19.4%	19.5%	16.4%	16.8%	16.8%
Cafes & Restaurants	9.5%	9.8%	9.0%	10.4%	10.3%

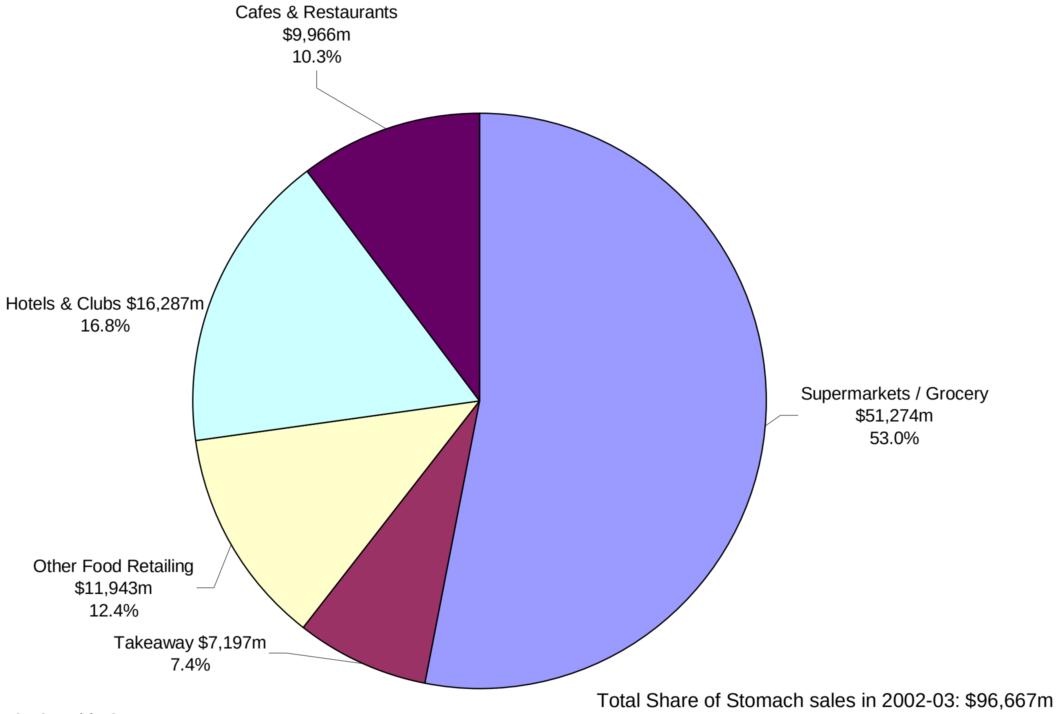
Source: ABS 8501.0, Table 3.

FIGURE 2-4: DISTRIBUTION OF SHARE OF STOMACH SALES, 1997-98



Source: ABS 8501.0, Table 3

FIGURE 2-5: DISTRIBUTION OF SHARE OF STOMACH SALES, 2002-03



Source: ABS 8501.0, Table 3

As mentioned above, the food and grocery component of the retail trade industry is a subset of the share of stomach measure, and was worth just over $70 billion in 2002-03 (ABS, 8501.0, Table 1), an nominal increase of about one-third since 1997-98. It includes total sales from supermarkets and grocery stores, takeaway outlets and other specialised food retailers, but excludes sales from clubs, pubs & taverns, and cafes & restaurants. Within the food and grocery component of the retail trade industry, there is a large number of sub-categories of food (and non-food) items.

The Baird Inquiry report discussed[4] a number of measures of the food and grocery market and associated market shares suggested by the ABS. ABS Measure 2 comprised sales of the supermarket and grocery stores, including non-petrol sales of convenience stores of petrol stations (ABS Measure 1), together with sales by liquor retailing stores, other food retailing, bread and cake retailing stores and other specialised food retailing stores. **The ABS advised the Inquiry that this broader measure was the most realistic, and it has subsequently been used by the ACCC.**

Figure 2-6 and Figure 2-7 below show the distribution of ABS Measure 2 sales for the years to July 1998 and 2002, respectively, divided across major supermarkets groups, specialty food and liquor retailers. Franklins' demise saw their market share split largely between

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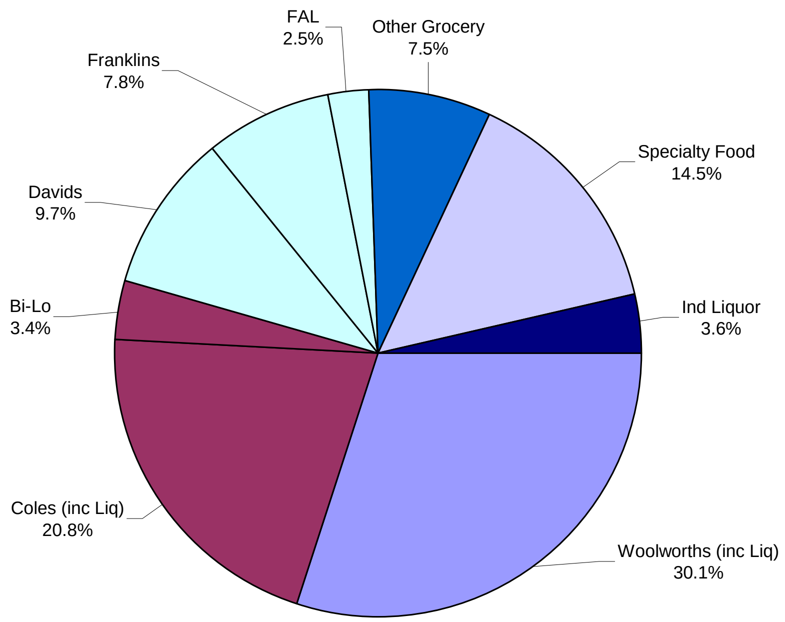
[4] *Fair Market or Market Failure? A review of Australia's retailing sector*, Report by the Joint Select Committee on the Retailing Sector, August 1999, Senate Printing Unit, Parliament House Canberra, page 42.

Woolworths and the independents. Coles and Woolworths accounted for 61.6 per cent of ABS Measure 2 in 2002[5].

Figure 2-6: ABS Measure 2, year to July 1998

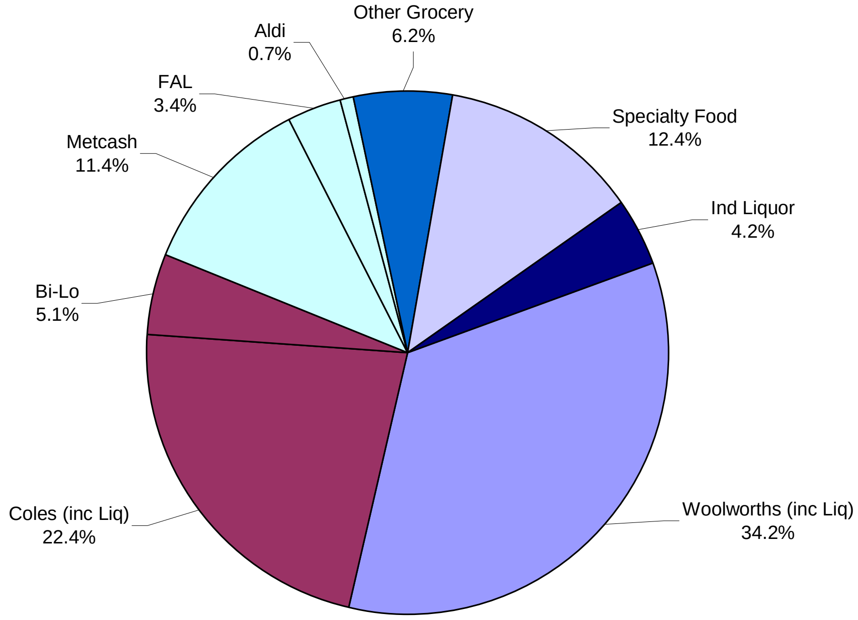


Source: ABS Retail Trade Turnover Cat No 8501.0 & Annual Reports

Total Measure 2 sales: $47.1 billion

5 In addition to Coles and Woolworths share one needs to add the other corporate players chains, namely FAL's Action (75 stores), Aldi (50 stores) and Pick N Pay (80 stores).

FIGURE 2-7: ABS MEASURE 2, YEAR TO JULY 2002



Source: ABS Retail Trade Turnover Cat No 8501.0 & Annual Reports

Total Measure 2 sales: $59.9 billion

Another distinction relevant to an assessment of retail concentration is the split between fresh foods and packaged or dry groceries. The market research group AC Nielsen collects data on dry packaged branded groceries in its Brandscan[6] surveys. The dry packaged groceries market definition is the narrowest of the market concentration measures used, although it gives some insight into the changes occurring within the broader measures. Dry packaged groceries comprises of food and grocery items within the food and grocery retailing sector but *excludes* fresh foods and takeaway foods. It accounts for 70 per cent of the total food and grocery retail trade in Australia.

State-by-State market shares of the major supermarket retailers for the *year to* March 2002 are shown in Table 2-10 below, together with all Australia shares in the March 2002 and December 1998 *quarters*. In December 1998 Coles, Woolworths and Franklins supermarkets accounted for 80 per cent of the Australian dry packaged goods market. Since then, the Franklins chain has been substantially redistributed (effective at the end of 2001) to Woolworths, Action, Pick 'n' Pay and independent operators with strong ties to the Metcash wholesale distributors. Coles was specifically precluded from acquiring any Franklins stores at the initial break up of the chain. However, it later acquired 37 stores that had not been able to be taken up by the independents in the carve up deal negotiated by Franklins with Woolworths and Metcash.

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6 Brandscan excludes fresh food, specialty food retailers and many independents. AC Nielsen's research is undertaken in order to track sales and monitor market shares for major brand items, and the shares of their sales across the major retail chains.

The State-by-State data in Table 2-10 below consequently still includes about three-quarters of the previous Franklins annual share. A better picture of the effect of the redistribution due to the sale of Franklins stores is given in the all Australia data for the March quarter 2002, in which Woolworths held 41.6 percent of dry grocery sales. Note that, compared with the end of 1998, although the market share held by the top two firms increased, other, mainly independent stores and smaller chains, also increased their dry grocery share.

TABLE 2-10: MARKET SHARE OF PACKAGED DRY GROCERIES SALES

	Coles / Bi-Lo	Woolworths	Franklins	Other
Year to March quarter 2002				
NSW/ACT	31.1	43.1	9.7	16.1
VIC	37.7	39.4	3.6	19.3
QLD	32.9	41.6	7.0	18.5
WA	29.1	27.6	0.0	43.3
SA/NT	41.4	31.1	2.4	25.1
TAS	29.2	57.9	0.0	12.9
All Australia				
March quarter 2002	**35.6**	**41.6**	**0.0**	**22.8**
December quarter 1998	**30.3**	**35.9**	**14.2**	**19.6**

Source: AC Nielsen, Retail World, December 14, 1998 and 2002
Notes:
1. In Victoria, Woolworths trades as Safeway
2. Purity/Vos is the retailing arm of Woolworths in Tasmania
3. WA's almalgamated independents are serviced by one distributor
4. All Australia based on Q1 2002 (Franklins sold Oct/Nov 2001)

As with all the definitions discussed, there is some degree of overlap between the definitions and there are some grey areas concerning what is included in each definition. For example, the ABS definition of total food and grocery retailing does not include other retailing items such as personal healthcare products like cosmetics and toiletry retailing, which many supermarkets provide. Similarly, the ABS definition does not separate out food and grocery items sold through discount department stores, pharmacies, hardware stores and the like – which account for an estimated 5 per cent of food sales. **The market share of the top 3 retailers in the packaged goods category is therefore likely to be overstated.**

The aggregated data also fail to show the growth of specific chains (eg the new Franklins) and the shares of independent supermarket and grocery stores with close ties to their distributor – eg Action. In particular, Metcash has effectively built a substantial market share in the eastern States (and consequently in Australia as a whole). In a recent speech[7], the CEO of Metcash Trading stated that:

[7] ' "It's been a tough 12 months" says Metcash chief', *Foodweek,* 28 July 2003, pages 11-12.

As at June (2003), Metcash/IGA's market share, state-by-state was 25.2% in South Australia, 18.1% in NSW, 19.6% in Victoria, and 14.8% in Queensland. To April this year, the IGA network had an annualised market share of 16.3% - up from 11.8%.

These figures are consistent with a more than seven per cent increase in comparable stores sales by Metcash in the last reporting year and are notable both for their size and for the explicit aggregation of the retail market shares of the IGA chain and other stores and chains to which Metcash distributes. Metcash is the monopoly distributor on Australia's eastern seaboard. Independent retailers who do not purchase from it have no other recourse except to deal directly with manufacturers, most likely at a cost disadvantage reflecting their relatively small size and higher distribution costs. Assuming the market share is based on dry packaged groceries sales, the Metcash/IGA group clearly has a substantial presence in a number of States that would make it third behind Coles and Woolworths.

Other chains have also begun to expand. The Western Australia based FAL, which dominates the independent sector in that State, has established its Action supermarkets in Queensland. FAL is the monopoly wholesaler to the independent sector in WA while simultaneously competing with these retailers with its Action chain.

The German discount supermarket retailer Aldi has also established a substantial presence in New South Wales and has begun its expansion into other States. While its sales are not included in the various retail trade measures of market share, and it is generally very reserved about revealing details of its business, Aldi is reported[8] to have captured around 4 per cent of the grocery market in NSW in the last three years. Even with only a few stores outside that State, this is enough to give it around 1 per cent of the market in Australia. While not providing details, Aldi has made it clear that it intends to continue to establish stores in both Victoria and Queensland. There is no reason to expect that Aldi could not build the same level of market share in those States in the next three years, pending the availability of suitable sites for its small stand-alone store format.

Similarly, Pick 'n' Pay from South Africa has purchased 80 stores in NSW and has plans to double the number of "new" Franklins stores in Australia.

As noted in our previous report, supermarkets compete with a wide variety of other specialty retailers in individual product markets, including pharmacies, discount department stores, convenience stores, petrol stations, newsagents, butchers, bakers and home delivery vendors. The market shares discussed above are aggregates, and it is worth noting the major supermarkets' shares of sales in individual categories. The following pie charts (Figure 2-9 to Figure 2-11) illustrate updated market shares for bakery products, fresh produce, delicatessen and meat using Roy Morgan BrandPlanner data. In 1999 and 2002, supermarkets' sales in each of these categories was roughly in proportion to their shares of food and grocery retailing.

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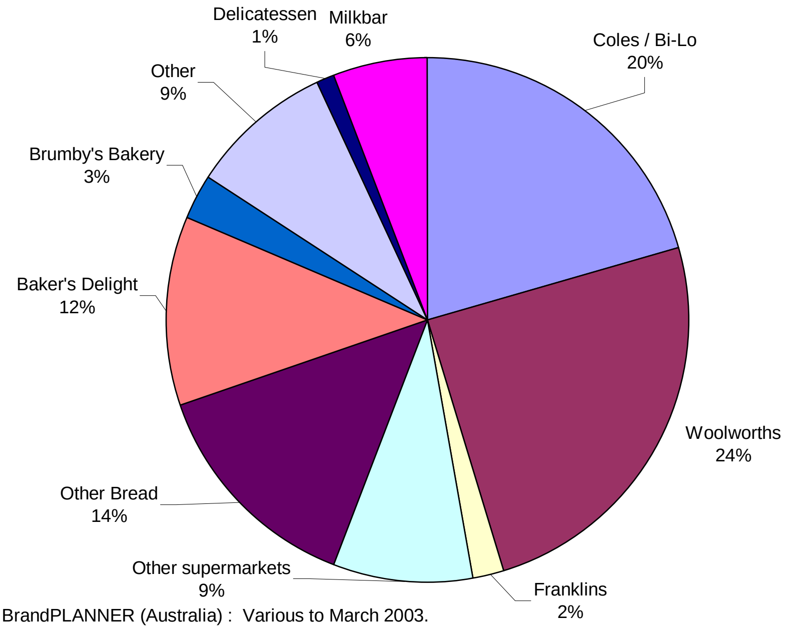
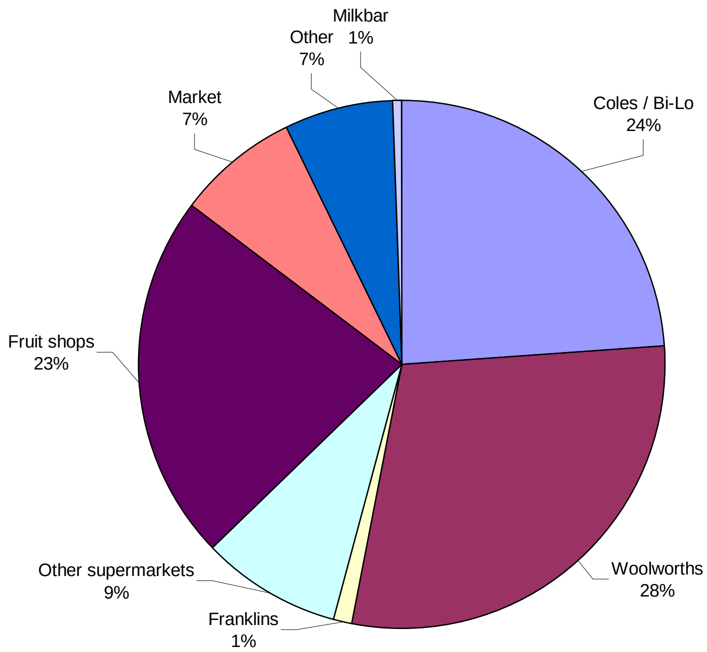
8 'Inside Aldi', *Business Review Weekly*, 17 July 2003, page 40.

FIGURE 2-8: DISTRIBUTION OF BAKERY SALES, YEAR TO SEPTEMBER 2002



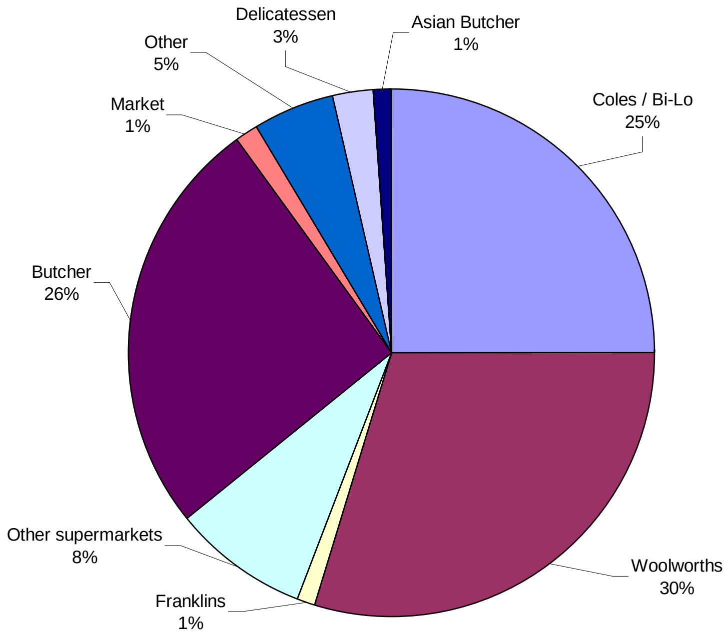
Source: Roy Morgan BrandPLANNER (Australia) : Various to March 2003.

FIGURE 2-9: DISTRIBUTION OF FRESH FRUIT AND VEGETABLES SALES, YEAR TO SEPTEMBER 2002



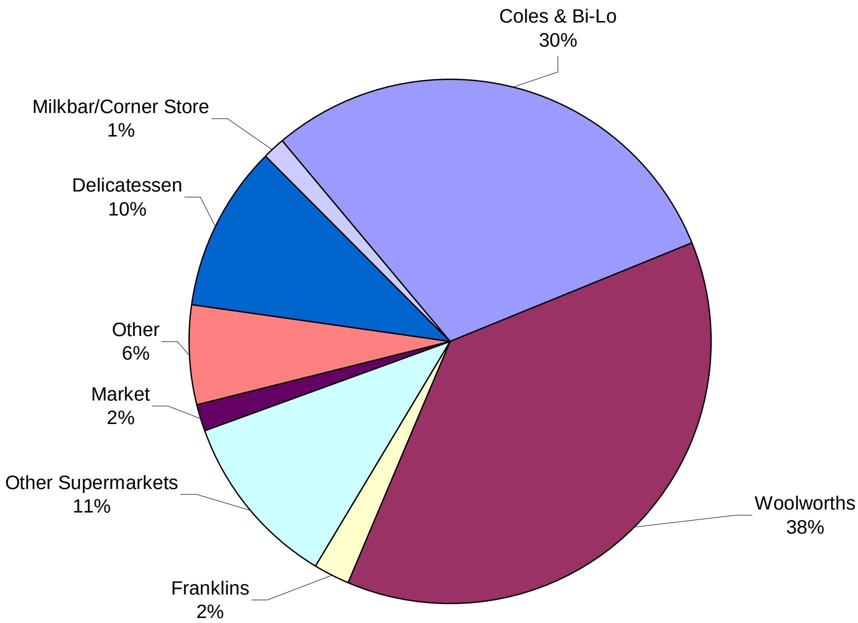
Source: Roy Morgan BrandPLANNER (Australia) : Various to March 2003.

FIGURE 2-10: DISTRIBUTION OF FRESH MEAT SALES, YEAR TO SEPTEMBER 2002



Source: Roy Morgan BrandPLANNER (Australia) : Various to March 2003.

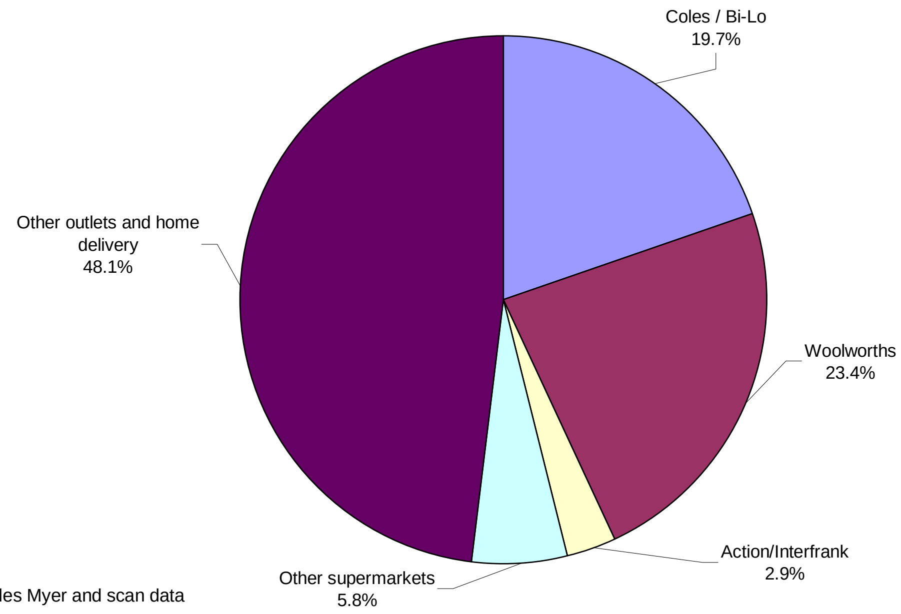
FIGURE 2-11: DISTRIBUTION OF DELICATESSEN SALES, YEAR TO SEPTEMBER 2002



Source: Roy Morgan BrandPLANNER (Australia) : Various to March 2003.

Consumer preference for lower priced housebrands and generic milk helped increase supermarkets' share of retail milk sales to 51.9 per cent in 2001-02[9]. Market shares for milk are shown in Figure 2-12. Here the effect of the variety and number of alternative outlets and distributors is particularly marked. Slightly less than half of the total is still sold through other outlets and home delivery.

FIGURE 2-12: DISTRIBUTION OF MILK SALES BY VOLUME, 2002-03



Source: Coles Myer and scan data

The apparent success of Coles and (more successfully) Woolworths in building market share on the back of the collapse of Franklins may well only be temporary. The simultaneous growth of other incumbent chains, consolidation of the Metcash/IGA group and the establishment of new (and return) entrants signals that there is likely to be a period of particularly vigorous competition while the various chains establish or scale-up their existing distribution networks and tailor their product offer to new local markets.

2.3 FREEDOM OF ENTRY AND EXIT

As discussed in Section 2.2 of our 1999 report, the economic efficiency of concentrated markets will depend, *inter alia*, on the ability of potential competitors to enter at low cost, including the expected costs of exit. We noted there that retailing has relatively low barriers to entry and firms are free to enter and leave at lower cost than in many other industries. This, together with the diversity of sources of wholesale supply, suggested that retailing is in

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9 Australian Dairy Corporation, *Australian Dairy Industry In Focus 2002*.

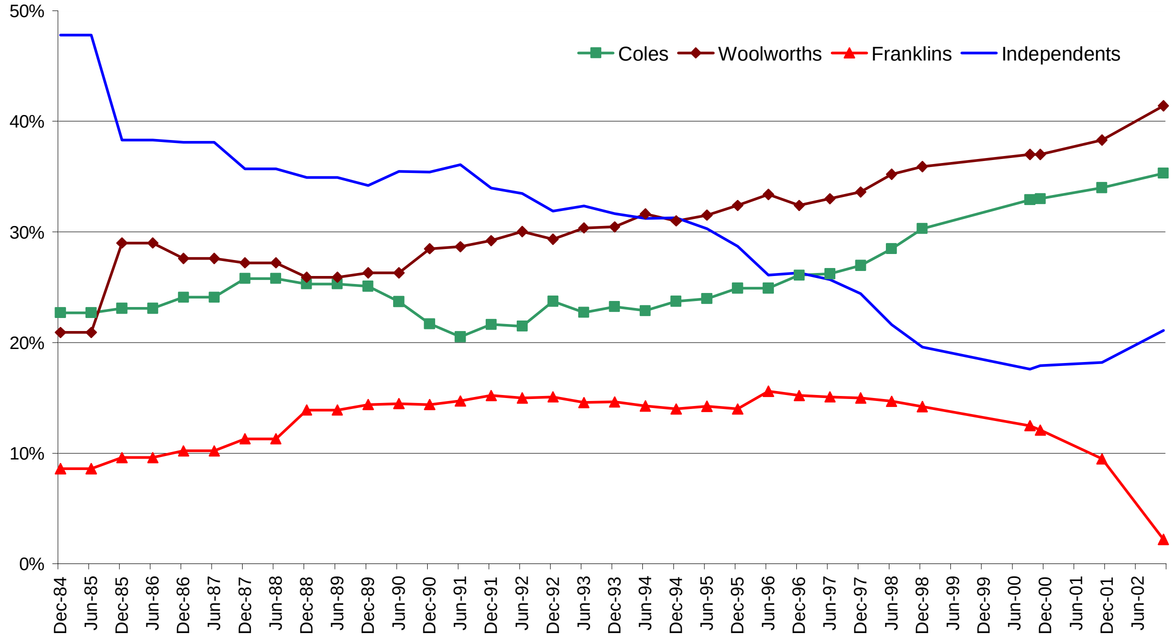
reality likely to be more competitive than other industries with comparable levels of concentration.

We also argued that the ability to spread establishment costs means that a retail chain can enter a market more cheaply than an independent retailer. This, in turn, implies that more competition is likely to occur between larger chain retailers than between smaller independent or specialty retailers. The factors that reduce the costs of entry and exit for large retail chains also generate economies of scale, in terms of both store numbers and size. This however creates an offsetting impediment to entry - market niches are fewer and harder to establish.

One consequence of all this is the claim commonly made that no one can provide effective competition to the major retailers - that their market shares are "too big" to be challenged. Theory and experience suggest that this is false. As discussed in Section 2.2 of our 1999 Report, size is not an impediment to competitors if a market is relatively open. We argued that, while it was admittedly unlikely that any of the major retailers would cede a substantial part of its market share without responding energetically, successful new entry into Australian retailing on a large scale would be still be possible. In the event, as noted above, entry on a substantial scale is happening – witness the arrival and expansion of the German Aldi and South African Pick ‘n’ Pay.

Similarly, the shares of retail markets held by the major retail groups have varied substantially, both historically and in recent times. After a period in the 1980s and early 1990s, during which Woolworths supermarkets' share overtook Coles' market share. Coles has begun to claw back a larger share of this particular market. This battle for market share, together with the rise and fall of the old Franklins group and the trend decline in the market shares of independents, is illustrated in Figure 2-13 below.

FIGURE 2-13: BRANDED DRY PACKAGED GOODS MARKET SHARES, 1984 TO 2002



Sources:AC Nielsen, *Retail World* Vol 50 No 18 Sept 15 - 1997, Sept 2000 and Dec 2002.

Possessing large market share is no guarantee of high returns and many of the major retailers (Myer Grace Bros and David Jones, for example) have been through periods in which declining sales and rising costs have reduced their profitability. **In most cases the large retail chains have responded to ailing fortunes by addressing costs and reviewing their customer focus, and have been able to restore their returns, if not always their market share.** There have also been examples of retail chains that have grown strongly in the last decade, carving a niche for themselves by providing particular types and qualities of products (Harvey Norman in furnishings, electrical goods and, especially, home computer hardware and software; Harris Scarfe in general retailing; and Bakers Delight, Cheesecake Shop, Lenard's and Deli France in specialised fresh foods).

Our previous report included (paragraphs 90 to 95) discussion of some measures of the ease of entry and exit into the Australian retailing industry compared with other industries which was available from ABS business surveys. Those surveys were occasional and have not been updated, so our previous report summarises the best available information. We concluded that the data showed relatively high rates of business turnover (entry and exit), substantially accounted for by change of ownership, rather than business failures and new business creation. Once this was accounted for, barriers to entry into the retailing industry appeared to be not distinctly different from those in other industries. Similarly, business turnover in the retail industry (the sum of the exit and entry rates) was just below the total average turnover of businesses across all industries. However, retailing had the highest turnover rate once the relatively high rate of changes in business ownership within retailing was included. **The data demonstrated that barriers to the entry of firms into the retailing *industry* are no greater than for other Australian industries. Changes in**

ownership control were actually slightly above average, suggesting lower barriers to entry for control of retail *firms*.

While local institutional factors are important in determining whether theoretically open markets are actually open in practice, these observations were all consistent with our *a priori* descriptions of the basic characteristics of retailing in Australia. **To our knowledge, there have been no major changes to the regulatory or institutional landscape that would have weakened our conclusions about the contestability of Australian retailing.**

2.4 COUNTERVAILING POWER

The trends towards greater consolidation in the product supply chain that we noted in our previous report have continued over the past four years, further intensifying the countervailing power to the retail chains and monopoly wholesalers.

In our previous report we noted that the global consolidation in the retail industry and a tendency towards concentration of retail supply matched by increased concentration of suppliers of major brands and product categories, and the growth of wholesale warehouse and distribution companies. This tendency produces both countervailing power operating against any market power associated with growing concentration at the retail level, and also puts more importance on the role of retailers as consumers' representatives to producers.

The particular trends we previously identified in increased concentration in the Australian retail supply chain have continued. Although competition policy reforms have largely been maintained, telecommunications, electricity, gas and water industries are all still dominated by a small number of large firms.

Australia also still has a highly concentrated market for retail floorspace. While many smaller retail stores are owner occupied, ownership or control of the Australian major shopping complexes centres is still relatively concentrated. Table 2-11 below shows the ownership and market shares of the major regional shopping centres. Three groups control two-thirds of these regional shopping centres which together account for a similar proportion of both their total gross lettable areas and retail turnover, a slight increase on the fraction in 1999. Supermarket chains clearly still face only a limited number of suppliers of suitable retail space in major regional shopping centres. Although there are benefits to both retailer and property owner from agreeing to anchor a regional shopping centre, neither side has a clear negotiating advantage.

TABLE 2-11: 2003 OWNERSHIP OF AUSTRALIAN RETAIL SPACE (REGIONAL CENTRES)

Owner (or controlled by)	Regional Centres		Gross Lettable Area (Retail)		Moving Annual Retail Turnover (2002)	
	Number	% Total	sq m	share %	$m	share %
Westfield	28	41.8%	1,946,454	46.3%	8,937	44.1%
Lend Lease	11	16.4%	583,034	13.9%	3,125	15.4%
AMP	4	6.0%	254,534	6.1%	1,283	6.3%
Total Top 3	**43**	**64.2%**	**2,784,022**	**66.2%**	**13,345**	**65.8%**
Gandel	4	6.0%	275,892	6.6%	1,527	7.5%
QIC	5	7.5%	327,006	7.8%	1,479	7.3%
Total Top 5	**52**	**77.6%**	**3,386,920**	**80.5%**	**16,351**	**80.7%**
Centro	5	7.5%	254,881	6.1%	1,138	5.6%
Other	10	14.9%	565,080	13.4%	2,778	13.7%
Total	**67**	**100.0%**	**4,206,881**	**100.0%**	**20,267**	**100.0%**

Notes:
Some centres are jointly owned, and includes AMP centres acquired or partially owned by other owners.
Includes centres with at least one department store.
Figures extracted from the Property Council of Australia (Sept 2002) and updated to reflect recent Westfield acquisitions from AMP.

Our previous report also gave an indication of the level of concentration of ownership of major product supplies using AC Nielsen retail sales data. Table 2-12 shows updated figures for the 20 companies with the largest sales of packaged dry groceries to Coles supermarkets in the year to the beginning of August, together with those companies' shares of their respective primary product markets in Australia. These mainly multinational brand owners include: Unilever, Coca-Cola, Kimberley-Clark and Nestlé.

The figures give a good indication of the relative importance of these major producers, although the figures are not necessarily directly comparable with those in our previous report. Nevertheless, they suggest that, while the packaged dry grocery share of Coles' total sales has diminished, Coles' reliance on these largest outside suppliers has increased since 1999. **The top 20 companies supply 47.6 per cent of total packaged dry grocery sales. Moreover, the top three suppliers together account for 11.42 per cent of total sales. Although their rankings have changed, two of these suppliers were also in the top three in 1999.**

TABLE 2-12: COLES' TOP 20 BRANDED GROCERY SUPPLIERS, YEAR TO 3 AUGUST 2003

	Share of total sales (%)	Share of product market (%)	Primary Business
Nestle Ltd	4.12%	54.0%	Coffee
Unilever	3.73%	32.9%	Laundry
Goodman Fielder Ltd	3.56%	38.6%	Brought in Bread
British American Tobacco	3.34%	39.3%	Cigarettes
Philip Morris	3.28%	38.6%	Cigarettes
Masterfoods ANZ	2.93%	28.4%	Meal Bases
Arnott's Campbell's	2.76%	54.3%	Biscuits/Cookies
Cadbury Schweppes	2.62%	33.4%	Confectionery
The Coca-Cola Company	2.46%	63.6%	Soft Drink
Kimberly Clark	2.12%	79.9%	Infant Nappies
Dairy Farmers Ltd	2.01%	16.3%	Dairy Milk
National Foods	1.91%	32.2%	Chilled Desserts
Simplot P/L	1.83%	34.4%	Canned Fish
Imperial Tobacco	1.81%	21.3%	Cigarettes
Kraft Foods	1.69%	36.9%	Spreads
George Weston Foods	1.67%	28.0%	Brought in Bread
Kellogg P/L	1.57%	49.0%	Cereal
Colgate-Palmolive P/L	1.50%	40.1%	Dental Health
Berri Ltd	1.35%	39.4%	Juices
Parmalat P/L	1.32%	20.4%	Dairy Milk
Other suppliers	52.41%		
Total suppliers in market	100.00%		

Source: ACNielsen ScanTrack

Each set of brands and products represents a significant share of the relevant Australian product market, with the top 20 suppliers representing almost half of Coles sales, and reflects the brand power the market shares give these suppliers in negotiating with retailers. The rise of discount grocery retailers and the major retailers' increased promotion of generic and own-brand goods is partly in response to the influence of the major suppliers of popular brand groceries. Nevertheless, it is clear that the major suppliers of branded "staple" grocery items (such as coffee, bread, confectionery and nappies) still represent a significant countervailing power to the major retail and wholesale buyers. As we concluded in 1999, a retail market comprised solely of small independent retailers would be at a significant commercial disadvantage in the face of this supplier concentration.

3. GOVERNMENT ASSISTANCE FOR SMALL BUSINESS

Australian governments have removed a number of distorting mechanisms over the last decade, including the repeal of some small business legislative protection, such as restrictions on shop trading hours. Governments nevertheless continue to support small business through a range of measures which provide a significant competitive and commercial advantage at potential cost to consumers.

New policy measures to assist small business, should ideally be:

- transparent to allow scrutiny and review: and
- the community costs and benefits of their operation should be capable of measurement.

Consequently, as far as possible, such measures should not take the form of legislative or regulatory bias.

Introducing exemptions from competition for small business in the Trade Practices Act would be contradictory to the competition reforms that have occurred over the past decade.

Over the past decade all Australian governments, State and Commonwealth, have supported competition reform to produce more competitive outcomes for consumers, a fairer business environment and ensure Australia is competitive in global markets. Over the period, a number of distorting mechanisms have been removed including the repeal of some small business legislative protection, such as restrictions on shop trading hours. Governments continue to support small business through a range of measures which already provide a significant competitive and, in some cases, a commercial advantage to small business.

Further discrimination in favour of small business in competition law is likely to come at the expense of consumers and Australia's international competitiveness. Special protection from competition in the *Trade Practices Act* (TPA) could be seen as a means of replacing the previous legislative protection for small retail businesses.

Two key reasons for Government support of small business are:

- the desire to nurture innovative business development in the economy and therefore competition; and
- the desire to ensure the largest possible market, in order to reconcile the consumer benefits arising from (i) allowing the operation of scale economies and (ii) the preservation of strong competition.

This Section sets out some standard principles for government assistance, especially where the assistance is inherently discriminatory, and summarises some examples of current assistance targeted specifically to small businesses including retailers.

3.1 SOME OVER-ARCHING PRINCIPLES

If governments are to adopt measures explicitly to discriminate in favour of small business and against larger businesses, there are some basic principles for "good" policy design in this respect:

- Ideally such measures should be *transparent* to allow scrutiny and review.
- The community costs and benefits of their operation should be *capable of measurement*. If assistance is delivered by subsidies or tax concessions, it is often possible to quantify the extent to which the favoured businesses enjoy dollar benefits associated with the relevant assistance. This benefit will generally come at the expense of a cost to the community as a whole.
- As far as possible, such measures should *not* take the form of legislative or regulatory bias:
  - In many if not all cases, this delivery mechanism is less transparent.
  - While regulatory or legislative proscriptions do not *appear* to entail dollar costs (to the community and those discriminated against) and dollar benefits (to the favoured groups), such measures *do* have such effects. Analytically, such measures can be translated into tax- or subsidy-equivalent alternative measures. Indeed, most standard quantitative modelling of the effects of such measures would start by attempting to translate them into tax- or subsidy-equivalents.

3.1.1 WHAT ABOUT TRADE PRACTICES LEGISLATION OR ASSOCIATED REGULATION?

These principles imply some clear corollaries in relation to trade practices legislation:

- Discrimination before the law in relation to business matters generally is not a good basis for effective legislation. There is a strong presumption of equity before the law. In the case of business law, the strongest presumption is in favour of *horizontal* equity (like treatment of equals), or, legally, a level playing field.
- Where the legal action relates to matters such as "unconscionable conduct", *and such cases in practice tend to involve the actions of larger businesses in relation to smaller businesses*, the existing legislative provisions of the TPA already cover the problem: *not* as a large business versus small business issue, but on the merits of the case.
- Assistance discriminating against larger businesses and in favour of small businesses generally should not be delivered via legal or regulatory means. This is neither transparent nor easily amenable to cost-benefit analysis from a community-wide perspective (even though the costs and benefits can be very large).
- Changing laws or regulations to *remove* existing biases in favour of any parties is generally desirable (see Section 3.4 below).

3.1.2 CAN SMALL BUSINESS, INCLUDING SMALL RETAILERS, BE ASSISTED?

The foregoing basic points generally would be regarded as unexceptional from an objective public policy perspective.

The fact is that, at all levels, governments *already* provide very substantial (and costly) assistance through other mechanisms that are explicitly biased in favour of small business.

Sections 3.2 and 3.3 below very briefly illustrate this reality.

3.2 POLICY DISCRIMINATION FAVOURING SMALL BUSINESS: COMMONWEALTH LEVEL

Both in its outlays and via tax concessions, the Commonwealth Government is a major discriminator in favour of small businesses.

3.2.1 COMMONWEALTH OUTLAYS SUPPORTING SMALL BUSINESSES

Within the Department of Industry, Tourism and Resources (DITR) there is a large suite of small business programs[10]. These include, under the *Small Business Assistance* program, for example:

- skills development;
- the establishment of small business incubators; and
- advisory and support services for small businesses.

In addition, substantial amounts of Commonwealth Budget funding are available to small businesses. Moreover, the Commonwealth Government facilitates access thereto via the *GrantsLINK* website that details links to all Commonwealth grants programs for small businesses. The Commonwealth's *Business Entry Point* can help small business with an extensive range of government information and transactions across Australia.

3.2.2 COMMONWEALTH REVENUE MEASURES SUPPORTING SMALL BUSINESSES

The Commonwealth Government provides tax concessions to various groups within the community, including small businesses. In some cases the amounts of the benefits available to the recipients can be quantified. These measures are summarised in the annual *Tax Expenditures Statement* issued by the Treasury[11].

There are many such discriminatory measures. These include (as an illustrative sub-set):

- small business 50% capital gains tax (CGT) exemption;
- small business CGT roll-over relief;
- small business CGT partial exemption for goodwill;

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10 See for example DITR, www.industry.gov.au, Small Business.

11 See for example *2002 Tax Expenditures Statement*, The Treasury, January 2002, especially pages 80-104.

- the Simplified Tax System – STS – (for small businesses with average annual turnover of less than $1 million);
- transitional exemption of small business from abolition of accelerated depreciation, balancing charge offset and low-value pooling;
- R&D refundable tax offset for small companies;
- prepayment rule for STS taxpayers.

3.3 POLICY DISCRIMINATION FAVOURING SMALL BUSINESS: STATE/TERRITORY LEVEL

At the State/Territory level, there are also substantial discriminatory measures operating in favour of small businesses. For example:

- on the taxation side, the biggest single concession is the ubiquitous scale rates and low-payroll exemption from payroll tax for small businesses;
- in respect of land tax, most States have progressive rate scales, plus aggregation provisions (as for payroll tax), that favour small business over larger business.

At the State/Territory level, some small business assistance/discrimination is delivered via legislation/regulation, notwithstanding the principles set out in Section 3.1 above. For example (as also discussed in Section 4.1):

- while not uniformly applied across Australia, some retail trade regulations in some States (notably Western Australia) are explicitly intended to confer trading hour advantages on small retailers over large retailers;
- more generally across Australia, State-level legislation and regulations favour particular *types* of retailers (eg, newsagents, pharmacies and some petrol outlets), and the range of merchandise offered for sale in the favoured retail outlets has steadily expanded to exploit this favourable discrimination.

3.4 CONSISTENCY WITH THE COMPETITION PRINCIPLES AGREEMENTS

The Competition Principles Agreements (CPA), to which all States and Territories, and the Commonwealth, are signatories, explicitly provides for a framework for regulatory reform, accompanied by a system of financial rewards and penalties provided by the Commonwealth to the States and Territories, that is designed greatly to reduce discriminatory legislation and regulation currently hampering the emergence of a truly national competitive market.

Notable amongst the “bad” legislation and regulation that the CPA is intended to eliminate is the discriminatory legislation and regulation favouring small retail businesses over larger retail businesses. The CPA regulatory reforms required that, where such legislation has anti-competitive effect, all Australian Governments should by now have assessed that effect and repealed or amended the legislation unless it was demonstrated to have net public benefit.

Most States and Territories have made progress in reducing discriminatory retail trading hours legislation and regulation. Some States – notably WA – are more reluctant at present to move, despite the likely financial pain that may come via reduced competition payments from the Commonwealth.

But the "big picture" message is clear.

- At one level – the Competition Principles Agreement level – the Commonwealth and States have already agreed to move to a more level playing field, including in relation to retail trading hours during which small and larger retailers may open for business.
- However, elements of industry are endeavouring to have the focus on introducing new discriminatory elements into legislation and regulation that favours small retailers.
- If moves to introduce discriminatory elements into the Commonwealth's TPA are successful, then how does it fit with the support by all governments for the competition reform process?

Both thrusts of policy cannot be right. The CPA is consistent with the principles set out in Section 3.1 above. A legislative or regulatory response to this Inquiry is almost certainly not. As discussed in the following Section, the regulatory and legislative changes implemented since the Baird Inquiry have sought to address most of the problems it identified in the retail sector. Despite the complaints about the difficulties faced by small retail business, it is too soon to be considering more changes to retail regulation or to legislation.

3.5 THE CONSUMER PERSPECTIVE

As ever, consumers vote with their feet and take their dollars with them. This is the clearest evidence that the scale/scope/cost economies driving the growth of the larger retailers are generally being used where policy *wants* them to be used, to the benefit of consumers and the community generally: *In the form of lower prices to consumers, combined with the convenience of greater variety and savings in time, to improve customer benefits, not fatten retailer profits.*

If they were not so used, and this is obvious from the discussion in the previous Section, the larger retailers' market share would wither.

4. RECENT CHANGES IN REGULATION OF AUSTRALIAN RETAILING

Restrictions on trading hours have been lifted in most States, but remain a selective constraint on large retailers' ability fairly to compete in Western Australia and, to a lesser extent, in Queensland.

Additionally, retailing-specific regulatory initiatives have recently been introduced that are designed to assist small business. They include the establishment of a Retail Grocery Code of Conduct and Ombudsman Scheme and changes to the *Trade Practices Act*, including representative actions, lifting the per transaction limit for unconscionable conduct cases to $3 million, and a regional test for acquisitions.

These changes have had some direct influence on the behaviour of the large retailers, but it is likely that more substantial indirect effects have occurred within the organisations and in their dealings with suppliers and smaller competitors, to the advantage of these other parties.

In some cases, the reforms have directly helped improve the large retailers' relationships with their suppliers, to the likely ultimate benefit of all parties, including consumers.

In all cases the reforms have probably not been in place long enough to be able to judge whether they have been successful in correcting the perceived problems they were intended to address.

In our previous report we noted the impetus given to pro-competitive reforms by the National Competition Policy (NCP) agreed between the Commonwealth and State governments in April 1995, and the associated programs of microeconomic reforms.

The guiding principle behind these microeconomic reforms is that consumer welfare and sovereignty is clearly enhanced by the opening up of markets to competitive forces. This does not mean the pursuit of competition *per se*, but as a means of gaining some of the efficiencies of competition, and of removing the inefficiencies of prior regulatory structures where no offsetting public benefits can be demonstrated. This principle was applied in the program of competition reviews of potentially anti-competitive legislation undertaken by the States and Commonwealth as part of the NCP agreements. Foremost for retailing among the reforms arising from that process was the relaxation of trading hours that followed in most jurisdictions, either through explicit legislative reform or through less restrictive application of existing powers.

A number of regulatory and legislative reforms followed the 1999 Joint Select Committee on the Retailing Sector, either directly, intended to address some of the problems identified in the Inquiry, or because of processes already in train. Some of these reforms and their effects on, and implications for, competition in retail markets are discussed below.

4.1 TRADING HOURS REFORM

Restrictive shop trading hour legislation has been substantially reformed since 1999, with only Western Australia and regional areas of Queensland retaining significant restrictions that specifically benefit small retailers over larger retailers.

Under the NCP obligations, most of the States and Territories moved to review their regulations on retail trading hours where these existed. None of the jurisdictions that has undertaken a review has presented a net public benefit case that warranted controls being retained. In 1996 the ACT introduced limits on the opening hours of supermarkets in major shopping centres as an explicit means of assisting supermarkets in smaller suburban shopping strips. However, these were quickly withdrawn in the light of public disapproval and no evidence of effectiveness in shifting demand to the relevant small stores.

Western Australia initially responded to its NCP obligations by proposing to review shop trading hours legislation (the *Retail Trading Hours Act 1987*) in June 1999. As noted by the NCC[12], this review took over twelve months to complete but, despite the wide consultation during the review, the final report has not been made public.

Following a second review, the Western Australian government announced in June this year that, it would not be lifting existing restrictions on trading hours until after the next State election. Although it concluded that regulation of Sunday trading was not in the public interest, the Western Australian government, contrary to the requirements of NCP, did not explicitly present a case that justified preserving the current restrictions.

While the TPA provides protection for consumers and small suppliers from *potential* abuses of market power by the major retailers, the restrictions of trade imposed by trading hours regulation *presently* works against the public interest.

4.2 RETAIL GROCERY CODE OF CONDUCT AND OMBUDSMAN SCHEME

In response to two of the specific recommendations of the Baird Inquiry, the Commonwealth Government appointed a Committee that developed a Retail Grocery Industry Code of Conduct (the Retail Code) which was implemented in September 2000. The Code is intended to cover all participants in the Australian retail grocery industry on a voluntary basis, with the object to[13]:

- *promote fair and equitable trading practices amongst industry participants;*
- *encourage fair play and open communication between industry participants as a means of avoiding disputes; and*

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12 National Competition Council (2002), *Assessment of Governments' Progress in Implementing the National Competition Policy and Related Reforms*, August, page 10.5.

13 *Retail Grocery Industry Code of Conduct*, March 2001, paragraph 2.1.

- *provide a simple, accessible and non-legalistic dispute resolution mechanism for industry participants in the event of a dispute.*

In particular, the Retail Code is intended to smooth relationships between food and grocery retailers and their suppliers. In the event of disputes, mediation services are provided by the independent Retail Grocery Industry Ombudsman. These services are fully funded by the Commonwealth Government and provided, as needed, by a private mediation company.

The Retail Code is administered by a committee whose membership includes representatives of organisations representing farmers, fruit and vegetable chambers, grocery suppliers, and small food and grocery retailers and the major supermarket chains.

To date, the Ombudsman scheme appears to have provided a useful circuit-breaker on disputes that would otherwise have been left unresolved or might have required the involvement of the ACCC to resolve through legal processes. Moreover, it has heightened the major supermarkets' awareness of the concerns of their small suppliers of primary produce and led them to strengthen their internal Trade Practices compliance programs to avoid the likelihood that disputes will arise that could end up with the Ombudsman. However, despite having completed nearly three full years in operation, many small suppliers are apparently still not aware of its existence as an avenue for airing and resolving disputes. An assessment of the success of the Retail Code and Ombudsman scheme will be made as part of the review of the Retail Code that is presently under way and due to report by November 2003.

4.3 THE REGIONAL TEST FOR ACQUISITIONS

In 2001 the TPA was amended to broaden the definition of a market in s.50, which prohibits anti-competitive mergers and acquisitions. The TPA now states that a market means a substantial market for goods or services in Australia, a State or Territory, or a region of Australia.

The effect of this amendment is to put beyond doubt that, for a market to qualify as substantial and thus be subject to s.50, it need not be a State market. The ACCC had already taken the view that this was the case, as expressed in its merger Guidelines, but now has specific legislative backing.

Were it the case that a market could not be considered substantial because it did not extend beyond a region, the ACCC's powers to block some mergers that substantially lessened competition would be constrained. In particular, a merger that substantially lessened competition in a retail market in a part of a State but not when the market was considered across the whole State, could not be prevented.

In economic terms, whether or not a market is substantial is determined having reference to its geographic boundaries but would not be decided purely by the extent of those boundaries. Other factors would need to be taken into account. Some markets that are broad in geographical extent may not be substantial while others that are confined to a small area may be substantial.

The amendment to the TPA thus ensures that the common-sense and economic view of a market cannot be ruled as inapplicable simply because of the way the TPA is drafted.

No court cases have been brought under s.50 since the amendment to the TPA, and it may in any case be difficult to know whether the amendment will make a difference. Certainly, it has not been uncommon in the past to refer to markets covering certain regions, such as South-East Queensland or Northern New South Wales.

The point is that there is no impediment to ACCC action against anti-competitive mergers in retail industry (or any other sector) at the regional level, provided the market is substantial. Observation suggests that the requirement that a market be substantial – which is necessary to prevent the TPA being applied to cases where the detriment to competition is trivial – has in practice not prevented the ACCC taking action whenever it felt it was justified.

4.4 REPRESENTATIVE ACTIONS

The ACCC has been able to bring representative actions under the consumer protection provisions (eg relating to misleading and deceptive conduct) for many years, but is now also able to do so in respect of restrictive trade practices such as misuse of market power. This amendment was part of the 2001 legislative package. The ACCC is able to seek compensation on behalf of, for example, a small business that has suffered loss or damage as a result of the anti-competitive conduct of another firm.

This means that a small business that does not have the time or resources to engage in lengthy legal proceedings to protect itself is not left without remedy, but may be able to enlist the ACCC to act for it. This could extend to a group or class of small businesses hurt by alleged anti-competitive behaviour.

If, for example, a supermarket chain was to misuse its market power against its suppliers, the ACCC is now able to take the chain to court not only to seek penalties for breach of the TPA but also to seek compensation for the suppliers. Similarly, the ACCC would be able to take action on behalf of small supermarket competitors in respect of the conduct of large retailers – for example, in the case of misuse of market power or exclusive dealing – and seek compensation.

4.5 TRANSACTIONAL LIMIT FOR UNCONSCIONABLE CONDUCT

The unconscionable conduct provisions of the TPA originally applied only to conduct affecting individuals. That has been extended to business transactions involving the supply of goods or services to, or the acquisition of goods or services from, a corporation, other than a listed company. The provision now applies to an acquisition of up to $3 million, increased from the previous limit of $1 million.

This is a significant extension of the protections available to small business, although in the period since the amendment came into effect (December 2001) it does not appear to have affected any enforcement actions by the ACCC. Nevertheless, it is probably only a matter of time before a case will be brought where the previous $1 million limit would have prevented that from occurring.

The ACCC has expended considerable efforts on small business and unconscionable conduct cases over recent years, including by being funded by the Commonwealth government specifically to run test cases. The first successful case was where the ACCC took action against a franchiser in respect of its treatment of its franchisees, where the judge described the behaviour as "unreasonable, unfair, bullying and thuggish"[14].

The unconscionable conduct provisions (s.51AC) supplement the provisions of s.46 relating to misuse of market power, where there is an existing commercial relationship, as in a supplier and acquirer of goods. Even though the treatment by a major firm of its suppliers or competitors may not fall within s.46, it may be construed as unconscionable conduct.

4.6 SUMMARY EFFECT OF REGULATORY CHANGES

The changes to the Trade Practices legislation and guidelines and other retailing-specific regulatory changes since the Baird Inquiry have had some direct influence on the behaviour of the large retailers, but it is likely that more substantial indirect effects have occurred within the organisations and in their dealings with suppliers and smaller competitors. That is, although there have been few instances of the ACCC explicitly using its new powers or relying on new interpretations of the TPA to allow it to bring cases, the large supermarket chains have nevertheless modified their behaviour in ways that are likely to have improved the terms of trade in favour of smaller suppliers or competitors.

As noted in Section 3, this is not necessarily a good thing. Where the behaviour previously engaged in was, and is still, strictly legal, but is now less clearly permissible, the large retailers may have simply acceded market share to smaller rivals or accepted higher costs, both to the detriment of consumers as a whole, in order to reduce their risk of prosecution under the new regulations. That said, there is no evidence that this has necessarily been the case. The reforms may have simply given large retailers good reason to revamp their Trade Practices compliance programs and increase awareness of the issues amongst their staff, with little real effect other than better compliance and less likelihood of "accidental" breaches occurring through the actions of a few individuals acting against company policy.

In other circumstances, the reforms have directly helped improve the large retailers' relationships with their suppliers, with the consequence that the long-term costs of negotiation and contracting have probably been reduced, to the likely ultimate benefit of consumers.

In all cases the reforms have probably not been in place long enough to be able to judge whether they have been successful in correcting the problems claimed by the Baird Inquiry.

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14 ACCC v Simply No-Knead (Franchising) Pty Ltd [2000] FCA 1365 at 51.

5. RECENT OVERSEAS EXPERIENCE

The trends driving the structure of Australian retailing are similar to those effecting retail markets overseas. The technology (such as techniques for distribution and storage; and ideas about marketing and framing the offer of branded stores) of the industry is international.

Local markets all have their peculiarities, including differences in regulation and competition law, but there are few countries where incumbent retailers are able to resist the pressure to adopt innovative methods to reducing costs or improve customer service.

Consequently, many of the trends in and features of Australia's retail industry, including concentration levels and low net profit margins, are also observed in other countries.

Similarly, in the context of the international comparisons, Australia has about the number of major national retailers that might be expected to serve a market of 19 million people disbursed over a large land mass in a small number of large metropolitan areas.

5.1 RECENT CHANGES IN OVERSEAS RETAIL MARKETS

We noted in our 1999 report that there had been deregulation of the retail sector in many OECD countries, a trend that has continued in the last three years, albeit slowly. This has allowed some notable structural changes.

Internationally, the retail trade is becoming more concentrated with global retailers increasing in importance and other successful chains expanding their presence in other regions. In the United States, in which the retail market has been one of the least regulated and is generally regarded as the most innovative and productive, this means the expansion of retail chains out of their geographical oligopolies and into neighbouring (or more distant) States. In Europe, there is naturally far more cross-border expansion, although many of the chains are venturing much further a field (i.e. into the United States and Australia).

International markets are also feeling the influence of the growth of discount retailers, such as the US-based Wal-Mart chain and the German-based Aldi. In food retailing, these chains concentrate their offer on a narrower range of goods, primarily through limited numbers of brands and package sizes, but also by heavy reliance on house brands and generic products. Discount stores also operate with lower capital and labour intensity and have closer links with manufacturers, leading to more efficient cost structures than traditional food retail chains. In many countries, the strong market position of incumbent retailers is being challenged by these chains, primarily because they are able to offer consumers a substantial part of their regular food and grocery shopping at an attractive quality and price combination. This both competes away part of the incumbents' core business and reduces the flow-through that generates other sales in their stores, helping to divert custom to other specialised retailers.

Incumbent retailers are responding to the competitive threat from discounters by devoting significant effort to cutting costs out of their supply chains and, most significantly in the UK, through increased reliance on house brands. Consequently, the growth of discount chains is likely to have more effect on small retailers that are reliant on less efficient distribution systems. These include out-dated warehousing and transport systems and reliance on direct delivery by manufacturers. For instance, an average of only 65% of food retailer purchases are centralised in the United States, compared with over 95% at Wal-Mart, and almost 25% of deliveries are direct by manufacturers[15].

Larger retail chains can adapt their product offer to match the narrower discount chain offer (as well as meeting niche competition on other goods) and they have the buffer of economy of scale advantages and the possibility of minimising costs in supply by adopting new methods and technology. Conversely, small independent retailers are less able to adapt, and change in this part of the market is likely to occur through natural cycles of failure, merger or acquisition by more efficient (but not necessarily larger) rivals. This process is usually associated with a period of lower average profit margins and greater than usual competition. This is something that has characterised the United States market in recent years (with the prospect of more to come), but has not been as evident in Europe except for Germany, where the discount chains are expanding their already large market share[16].

5.2 INTERNATIONAL RESTRICTIONS ON RETAIL MARKETS

We noted in our previous report that several countries have town planning laws to restrict large scale developments occurring outside existing town centres. These rules typically apply in countries that have limited space for such developments, like Britain, or wish to preserve heritage areas. If such restrictions were to be implemented in Australia they would only further enhance the negotiating positions of existing operators in Australia.

For instance, France has two laws aimed at protecting smaller retailers. The first, the 1995 Raffarin law, limits the expansion or development of new retail sites and has been responsible for "structurally surplus profitability" of incumbent retailers[17]. The second is the Gallard law, which bans below cost selling (loss-leading).

The Raffarin restrictions on new retail developments has seen new floorspace growth in France fall well below those in other countries (1 per cent annually in France in recent years, compared with 4 per cent in the US and 2.5 to 3 per cent in the UK and 2.9 per cent in Australia[18]). With demand for retail space in France growing at close to 2 per cent annually,

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15 Deutsche Bank, *Eat Cheese or Surrender!*, Global Food Retail, Global Equity Research Report, 18 March 2003, page 20.

16 There have been suggestions that a similar retail market 'shake out' could follow the entry and expansion of discount grocery retailers in Australia ('Overcapacity clouds supermarket prospects', *Australian Financial Review*, 27 August 2003, page 15). However, because a large part of the growth of discounters in Australia has occurred in the wake of the collapse of the old Franklins chain, we expect that that any disruption would be within the bounds of recent past experience and likely to be dominated by other external influences on retail profitability.

17 Deutsche Bank, *op cit*, page 102.

18 Based on the change in the GLAs of the 60 regional shopping centres listed in both sets of Property Council of Australia data underlying Table 3-13 of our 1999 report and Table 2-11 above.

the Raffarin law gives a significant advantage to existing retailers by limiting the entry of new entrants, and enables existing retailers to become more profitable. Similarly, Italy moved to deregulate its strict planning regulations in 1997 (the Bersani reform), but entry remains constrained by minimal implementation of the law.

The French ban on below cost selling, intended to protect small retailers, is somewhat less effective in achieving its objective and is currently under review. Predictably, it is seen as too restrictive for all participants, detrimental to consumers, problematic to administer and favours the lowest cost operators, Carrefour and Leclerc, the biggest chains.

5.3 CROSS-COUNTRY COMPARISONS

RETAIL PROFIT MARGINS

As noted above, Australian retailing historically has the lowest profit margins of all industries, although there is considerable variation between the margins experienced by large and small firms, and by individual firms and classes of firms over time. This alone suggests that the relatively high levels of concentration in Australian retailing have not translated into excessive profits, something that can be attributed, at least partly, to the relative ease of entry and exit. Australian retail margins are also unremarkable when compared with those experienced overseas. Table 5-1 below shows the retail sector EBITDA (earnings before interest, tax, depreciation and amortization) margins in the United States, United Kingdom and for continental Europe as well as for selected chains in each region.

TABLE 5-1: RETAIL EBITDA MARGINS IN THE US, THE UK AND EUROPE, 1992 TO 2002E (%)

	1992	1997	2002E
United States	**5.0%**	**6.6%**	**7.4%**
Safeway Inc.	5.0%	7.9%	10.0%
Albertson's	6.5%	8.3%	7.7%
Kroger	4.1%	5.2%	7.3%
Winn-Dixie	4.5%	4.8%	4.4%
UK	**9.0%**	**7.8%**	**-**
Tesco	9.0%	7.3%	8.8%[1]
Sainsbury's	9.1%	7.8%	5.7%[1]
Safeway Ltd	9.0%	8.3%	7.6%[1]
Continental Europe	**4.0%**	**5.0%**	**6.1%**
Carrefour	4.3%	6.1%	6.9%
Casino	3.7%	4.8%	6.5%
Metro	-	4.3%	4.8%

Source: Deutsche Bank, *Eat Cheese or Surrender! Global Food Retail,* Global Equity Research Report, 18 March 2003, Figure 26.
1. Deutsche Bank estimates for 2003

Although a direct comparison between international grocers' margins tends to be skewed by differences in accounting conventions (including depreciation lives), in capital intensity and in financing, the level shown are generally above those shown above in Section 2 for Australia and CML Food and Grocery. Coles Myer, for example, has an EBITDA of 4.1 per cent and Woolworths 4.8 per cent. The UK averages in particular reflect the higher margins required as a consequence of the scarcity of retail sites and statutory barriers to entry that drive up the cost of land and buildings.

MARKET CONCENTRATION

In our previous report we explained that the level of concentration is generally lower the higher the markets population and geographic density of that population. This effect is consistent with the efficient scale of a retail firm being correlated to these variables. Although in 1999 the top three supermarket chains' total share of the Australian dry packaged goods market appeared high by international standards, it was not the greatest level of concentration observed in developed nations. Table 5-2 of our 1999 report also showed packaged groceries market shares of the largest three and five food retailers across nine developed economies. A similar comparison of food and grocery retailing concentrations in European Union countries is presented in Table 5-2 below. Clearly, Australia's level of food and grocery market concentration, however measured, does not rank as highly as in Sweden or the Netherlands.

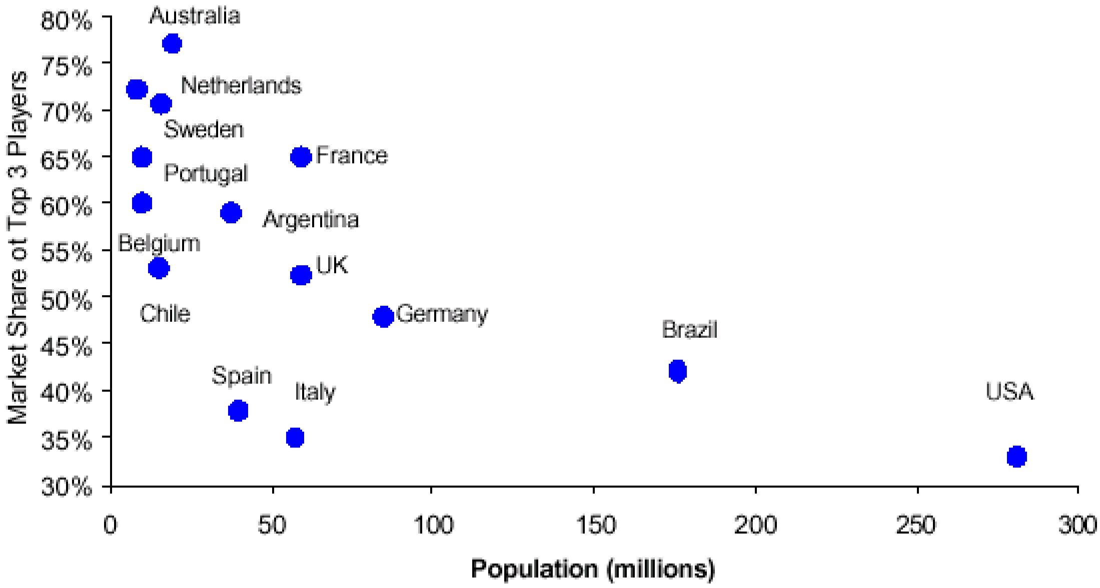
TABLE 5-2: MARKET SHARES OF THE TOP THREE GROUPS IN SELECTED EU COUNTRIES, 1999

Country	Groups	Market share
Sweden	Ica. KF, D Group	95%
Netherlands	A.Hein, Super Unie, Vendex	83%
France	Carrefour, Leclerc, Intermarché	66%
Belgium	Gib, Delhaize, Aldi	62%
Austria	BMI, Spar, Adeg	56%
Germany	Rewe, Edeka, Aldi	53%
United Kingdom	Tesco, Sainsbury, Asda	52%
Spain	Pryca, Continente, Alcampo	44%
Italy	Coop, Auchan, Carrefour	32%

Source: *ICT & e-Business in the Retail Sector, The European e-Business Market Watch,* Sector Report No.12/Oktober 2002, European Commission, Enterprise Directorate General e-Business, ICT Industries and Services, Table 1-10, page 16, http://www.ebusiness-watch.org/marketwatch/resources/SR12_Retail.pdf

As was evident in 1999, Table 5-2 also suggests that the level of concentration is generally lower the higher is a market's population and density. This effect is consistent with the efficient scale of a retail firm being roughly correlated to these variables. As shown in Figure 5-1 below, despite the changes in international retail markets in the last four years, this relationship still holds. In this comparison, Australian retailing appears to be at the extreme end of low population and high market concentration. Note, however, that the Australian top three market share appears to be overstated compared with most of the measures discussed above.

FIGURE 5-1: CONCENTRATION RELATIVE TO POPULATION: TOP THREE MARKET PLAYERS



Source: Deutsche Bank, *Eat Cheese or Surrender! Global Food Retail*, Global Equity Research Report, 18 March 2003, Figure 14.

The size and distribution of many of these markets means that the aggregate market concentration figures give a misleading impression of the degree of concentration in specific cities and regions. As noted in our 1999 report, and despite the substantial recent expansion and large market share of Wal-Mart and other chains, there is no truly national grocery chain in the USA. Concentration levels in some similarly populated regions are as high as in Australia. In many US States the market is dominated by two or three State-based chains and the top three retailers generally have market share in excess of 60 per cent. Consequently, retail concentration in some major US regions is higher than for the country as a whole (higher again in individual cities). As shown in Table 5-3, the top three share in Florida is as high as 73.3 per cent.

TABLE 5-3: RETAIL CONCENTRATION IN SELECTED US REGIONS, TOP 3 CHAINS, 2002

Region	Chain	Share (%)
California	Safeway	24.3%
Population 35 million	Kroger	17.6%
	Albertsons	16.0%
		57.9%
Florida	Publix	44.3%
Population 17 million	Winn-Dixie	21.7%
	Wal Mart	7.3%
		73.3%

Source: Deutsche Bank, *Eat Cheese or Surrender! Global Food Retail* , Global Equity Research Report, 18 March 2003, Figure 17.

As discussed in Section 2 of our 1999 report, market concentration is determined by a variety of factors which include the size and dispersion of the population and market. Australia's retail concentration level cannot be considered in isolation from its geography and market size. In the context of these international comparisons, Australia has about the number of major national retailers that might be expected to serve a market of 19 million people disbursed over a large land mass in a small number of large metropolitan areas.

As noted previously, our main conclusion is that retailing in Australia is relatively concentrated but that Australia is not out of line with other industrial countries. Where concentration has increased it has often been related to the benefits of economies of scale and the advantages of applying the latest in information technology.

COUNTERVAILING POWER

Just as the relative concentration of Australian retailing is not unusual in international experience. The countervailing power of branded goods manufacturers in Australia noted in Section 2.4 above is also evident overseas. Table 5-4 compares the market shares of the top three food manufacturers across nine developed countries. Although high levels of concentration are not present in all food categories in all of the countries shown, a market shares for top three manufacturers are in excess of 50 per cent for most categories in almost all countries. The exceptions are the UK and Germany, where there is more reliance on house brands and generic products.

TABLE 5-4: MARKET SHARE OF THE 3 LARGEST FOOD MANUFACTURERS BY CATEGORY, 2001 (%)

	US	Canada	France	Germany	UK	Spain	Italy	Japan	Brazil
Non-Alcoholic Beverages	68	61	46	22	31	44	44	57	55
Cheese	40	58	37	17	14	22	18	51	19
Biscuits	63	40	59	38	39	42	55	42	39
Coffee	43	51	69	57	69	75	61	67	33
Breakfast Cereals	66	59	72	49	63	84	79	84	73
Frozen Pizza	78	45	44	75	53	72	60	35	54
Soup	71	78	84	74	63	85	85	53	84
Canned Fish	73	65	60	36	55	41	51	41	84
Margarine	74	59	na	66	40	na	81	54	90
Average	64	57	59	48	47	58	59	54	59

Source: Deutsche Bank, *Eat Cheese or Surrender! Global Food Retail*, Global Equity Research Report, 18 March 2003, Figure 73.

6. CONCLUSIONS

The retail industry as a whole remains very important in the Australian economy. It accounts for about 44 per cent of total private final consumption expenditure and 15 per cent of total employment, while retail and wholesale trade together account for some 12 per cent of GDP. Retail trade outlets account for 14.4 per cent of Australian businesses, with 97 per cent of the nearly 170,000 retailers being small retailers.

Supermarkets and grocery stores between them account for just over half of all food sales (including food sold through takeaways, hotels and restaurants). Of that proportion, about 61 per cent (about one-third of the total) is sold through the major supermarket chains. The two major chains also account for about 77 per cent of the dry packaged groceries market, which is the subset of the retail food trade that excludes fresh food.

Over the past few decades the retail food sector has consolidated internationally, partly from striking developments in transportation, storage and distribution technologies that have cut costs for large networked chains more than for small stand alone ones. Market concentration in Australia is similar to that observed in other developed countries or regions with similar population densities.

Food and liquor retailing in Australia remains highly competitive and entry into Australian retailing remains open, as evidenced by new entrants since our last report. Retail profit margins remain low compared with other Australian industries and with the retail industries in other comparable countries. The openness and competitiveness of Australian supermarket retailing is reinforced by recent experience, with the collapse of the old Franklins chain and the (to date) successful entry and growth of foreign backed competitors.

Retailing-specific and other regulatory initiatives following the 1999 Joint Select Committee Inquiry into Retailing have had some direct influence on the behaviour of the large retailers. It is also likely that more substantial indirect effects have occurred within the organisations and in their dealings with suppliers and smaller competitors, to the advantage of these other parties. In some cases, the reforms have directly helped improve the large retailers' relationships with their suppliers, to the likely ultimate benefit of all parties, including consumers.

In all cases, the recent reforms have probably not been in place long enough to be able to judge whether they have been successful in correcting the perceived problems they were intended to address. In any event, to the extent that proposals for change to the TPA are driven by perceived need to further protect small retailers, and small business in general, there are more direct and transparent means available to governments that will serve the purpose with less cost to the Australian community.