

FAMILY FIRST

Dissenting Report

Provisions of the Trade Practices Amendment (Predatory Pricing) Bill 2007

FAMILY FIRST introduced its *Trade Practices Amendment (Predatory Pricing) Bill 2007* because of a concern that anti-competitive conduct like predatory pricing can drive small businesses out of the market, driving up prices for consumers, and that small businesses are particularly vulnerable because of their limited resources.

When FAMILY FIRST introduced its bill, small business had been waiting for a Government bill for more than three years since the Senate Economics References Committee recommended action.

Predatory pricing is where powerful retailers use their substantial market power or substantial financial power to drop their prices in one area to drive out competitors.

Not only are small businesses affected, with some forced to shut up shop because they can no longer compete, but Australian families suffer as well from higher prices in the long term.

The *Trade Practices Act* states "the object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection."¹

The "welfare of Australians" is central, but to achieve that we need a mechanism to protect consumer welfare, which is fair trading and competition. There is a danger that without appropriate regulation, unfair trading and distorted competition can lead to higher prices and less choice for consumers as well as the loss of the benefit of small businesses to local communities.

FAMILY FIRST shares the Business Council of Australia's concern that "heavy handed responses risk stifling competition",² but believes there needs to be a good balance struck and that a lack of effective regulation to stop anti-competitive behaviour also stifles competition.

FAMILY FIRST agrees with the assessment of Professor Frank Zumbo, who states:

... competition is a ruthless process, but that proposition is not in any way inconsistent with the proposition that there must be effective laws against anti-competitive conduct. Just like excessive regulation may stifle

1 Section 2, *Trade Practices Act 1974*.

2 Submission 11 (Business Council of Australia), page 2.

competition, so too may competition be stifled by ineffective prohibitions against anti-competitive conduct. Accordingly, the central question to be addressed in relation to s 46 (and indeed any section of the competition provisions of the *Trade Practices Act*) is whether the section is operating effectively to prohibit anti-competitive conduct; in this case, abuses of market power by large and powerful corporations.³

Australian Competition and Consumer Commission Chair Graeme Samuel said in July this year "small business has a fine tradition in this country, thanks in no small part to our open, competitive market that provides an opportunity for anyone to become their own boss and succeed. But in order for those businesses to be able to realise their potential, they require the same opportunities as every other competitor. In short, they deserve a fair go."⁴

Small business concern about the Trade Practices Act

Small business groups such as the Fair Trading Coalition have pointed to problems in the operation of the *Trade Practices Act* to stop anti-competitive practices, arguing that:

... as markets become more concentrated (as is the case in many sectors of the Australian economy) Australia needs to have strong and properly administered laws which guard against the misuse of market power and in particular, predatory behaviour by large businesses. Without significant laws against such behaviour, the FTC believes that large businesses will continue to take advantage of their market power, resulting in further concentration of markets. That concentration will eventually lead to a loss of competitors and thus competition in markets, a loss of choice for consumers and ultimately less price competition, which further disadvantages consumers.⁵

There is a widespread concern that "... s 46 [of the *Trade Practices Act*] is not operating effectively to prevent large and powerful corporations from engaging in predatory conduct or other abuses of market power."⁶

One submission made the flimsy and circular argument that the fact there are few successful prosecutions under section 46 "should ... be regarded as proof of the law working as it should to ensure the protection of competition and not as a failure of those laws".⁷

3 Submission 25 (Professor Zumbo), page 2.

4 Submission 17 (Dr Evan Jones), page 1.

5 Submission 21 (Fair Trading Coalition), page 5.

6 Submission 25 (Professor Zumbo), page 2.

7 Submission 23 (Addisons Lawyers), page 7.

Evidence of market failure

Coles argued "... there is no evidence of market failure that would justify increased government regulation in retail"⁸, but that is not the case.

Concentrated supermarket industry

The supermarket industry is one that is frequently cited as an area of concern. A report commissioned by the National Association of Retail Grocers of Australia (NARGA) found that:

since the early 1990s, the supermarket industry has undergone significant restructuring. Australia's grocery market has become one of the most concentrated in the world. Current ACNielsen estimates indicate that the two major supermarket chains, Woolworths and Coles, have approximately 78-79% of the market. The Australian market share growth of these two key MGRs [major grocery retailers] over the past three decades has been significant – growing from approximately 35% to around 79% ...⁹

NARGA is concerned this market concentration is not helping consumers and the situation may get worse:

This dominance, whilst it is expected to offer consumers lower prices due to the economies of scale and lower unit costs, is generating growing concerns over the current high level of food price inflation and over the long-term implications for competition. The adverse impact of any reductions in the level of market share of SMEs would be likely to both further reduce the bargaining power of small primary producers and endanger consumer welfare in the form of reduced choice and less price competition.¹⁰

Dr Evan Jones argues that the major supermarkets raise their prices where there is no nearby competition:

A mid 2003 price survey by Choice magazine exposed that prices at Woolworths Leichhardt Market Town (suburban Sydney) after Franklins had been taken out as a competitor had increased by 23%, compared to the CPI increase for food of 13% over the same period. Another study of grocery retail prices has confirmed the inverse relationship between prices and local access to competing stores (especially those other than Coles or Woolworths).¹¹

8 Submission 4 (Coles Group), page 1.

9 *The Economic Contribution of Small to Medium-Sized Grocery Retailers to the Australian Economy, with a Particular Focus on Western Australia*. A report prepared by PriceWaterhouse Coopers for the National Association of Retail Grocers of Australia, June 2007. Page 14. (NARGA Report)

10 NARGA Report, page 44.

11 Submission 17 (Dr Evan Jones), page 11.

Another survey in suburban Sydney found that:

the residents of Moorebank, who purchased an everyday basket of fruit and vegetables from Woolworths consisting of; a Capsicum, Tomatoes, Potatoes, Avocado, Bananas, Apples, Grapes, Rockmelon, Pears, Beans, Cucumbers, Broccoli and a Cauliflower - on the understanding that these were Low Prices you can count on everyday - were in fact being slugged with prices 81% higher than what they would have paid for exactly the same items less than 5kms from another Woolworths outlet at Liverpool. The possible reason - at Liverpool a new independent competitor had recently entered the market - at Moorebank there was limited competition.¹²

The Southern Sydney Retailers Association argues that:

... the only thing that keeps firms from exploiting consumers is competition from other firms - and a clear indication of lack of competition in a market, (especially a mature market such as grocery retailing) is if the majority of the firms in the market are making excessive profits well above international averages of similar markets - and all continue to raise their profit margins at the same time over a substantial period of time.¹³

The Australian National Retailers Association (ANRA), which represents some of Australia's largest retailers, conceded that the major supermarkets have a profit margin before interest and tax (EBIT) of up to 5 per cent. While they claimed comparable margins in the United States were up to 7 per cent,¹⁴ other evidence given to the Committee disputes this.

The Southern Sydney Retailers Association points out that the US Food Marketing Institute states "the intense competition among food retailers for the consumer dollar is best demonstrated by profit margins that continue to be less than 1.5 cents on each dollar of sales [1.5% EBIT%] ... This measure has remained in the 1 percent range throughout the industry's history ...".

This means that major Australian supermarkets are making big profit margins by international standards.

Continuing growing food prices is evidence that competition is not working effectively in the supermarket industry.

ANRA states that "in relative terms [food prices compared to income, calculated as minutes worked for a basket of groceries], food is cheaper now than it was 26 years ago."¹⁵ But this is an attempt to mask the increase in real prices over time.

12 Submission 15B (Southern Sydney Retailers Association), page 16.

13 Submission 15B (Southern Sydney Retailers Association), page 17-18.

14 Submission 16 (Australian National Retailers Association), page 10.

15 Submission 16 (Australian National Retailers Association), pages 9-10.

Even ANRA admitted "Australia's food price growth is higher than in many other countries".¹⁶

In fact, "... food prices have consistently grown at a higher rate than the CPI [1982-2006] and in the most recent years food price inflation has risen significantly."¹⁷

The Southern Sydney Retailers Association points out:

Australia has the developed world's highest food inflation since 1990 [to 2006] ... However the truly alarming situation of food price inflation in Australia is even more apparent when we compare food inflation v CPI since 1990 [to 2006] - everywhere in the developed world consumers seem to be benefiting from competitive retail markets, where food inflation, especially supermarket prices, are lower than the CPI – well everywhere in the developed world – except one remarkable stand-out exception [Australia].¹⁸

NARGA argues that "... the lower [food] prices in Perth [compared to Sydney and Melbourne] [are] substantially a result of the higher market share of the independent grocery sector [in Western Australia]."¹⁹

FAMILY FIRST also acknowledges the importance of small locally owned businesses to keeping wealth in local communities and the impact the decisions of large retailers have on the viability of Australian primary producers and food manufacturers.²⁰

FAMILY FIRST believes that one of the major reasons for high food and grocery prices in Australia is that the market is not working. There is not enough competition to keep prices as low as they should be and families are suffering because of it. Families and small businesses are the victims of the market power being wielded by some of Australia's retail giants who dominate key sectors.

Unilateral changes in terms

There is other evidence that big businesses are taking advantage of their market power.

The unilateral change in terms of payment to suppliers is one way big businesses exert their market power over small businesses. One small business owner contacted FAMILY FIRST with an example:

[Company Alpha] purchases \$5Billion from 20,000 suppliers. If they delay payment by 30 days (as they dictate in the attached letter) they are

16 Submission 16 (Australian National Retailers Association), page 12.

17 NARGA Report, Page 6.

18 Submission 15A (Southern Sydney Retailers Association), page 18-19.

19 NARGA Report, page 39.

20 NARGA Report, pages vii and 7.

generating a benefit to themselves of \$33M of interest savings per annum. But more importantly, they are generating an increase in the working capital demands of their supplier businesses of over \$400 Million. To the extent to which that impacts on small businesses, chances are that small businesses are having to go to second mortgage funding or cash flow finance in order to be able to fund the extension in days receivable. That would be charged at effective interest rates around 11.5% to 13% - a cost of around \$50 Million, if all of the \$400M was small business. If small businesses can't manage the account, the inevitable result is that the business transfers to large consolidators (like internationally-owned wholesale chains) who have adequate capital resources and can maintain heavy cross-subsidization from one customer category to another.

The small business was reluctant to put this information in a submission to the Committee as the businessman explained: "if I was to put in an official submission I risk damaging very important business relationships. So how can I protest without damaging my own interests or waiting until I get out of the business?"²¹

Other large companies also make unilateral changes to terms. FAMILY FIRST has a copy of a letter from a large retailer informing suppliers, not negotiating with them, that "... your settlement terms will change from 3.00%, 30 days to 3.00%, 60 days". This obliges suppliers to find finance to cover their bills for another 30 days before payment.

Rebates and discounts

The Pharmacy Guild of Australia argued that supplier discounts should be transparent so that small businesses can band together to make large purchases for the same prices available to big businesses for the same volume:

I think it is reasonable that we should at least have the information in the marketplace so that when somebody wishes to buy something they can say, 'If you buy 500,000 of these, you get this price and, if you buy two, you get this price and there are steps in the middle.' Then you at least know that, if you want to compete, you have to buy 500,000. But the market sometimes does not allow people to have that information.²²

Mr Scott commented on products he had bought in cooperation with a group of others for a maximum volume discount, but found others retailing the same product for less than he was able to buy it wholesale:

Either the company is not being honest about what the cost price is or, alternatively, the other group is selling it for less than it purchased it for. Either way, those things are commonly used to cause the opposition to go

21 Email from Businessman A, 29 July 2007.

22 Mr Scott, Pharmacy Guild of Australia, Committee Hansard, 27 July 2007, page 23-24.

out of business or to cause the opposition considerable trouble. I do not believe they are reasonable ways for trade to take place.²³

Shelf space

One submission refers to a statement on Dick Smith Foods website, since modified, which refers to the difficulty the company was having finding shelf space to sell products through Coles and Woolworths:

In recent weeks the problem has been compounded by Coles [a major supermarket] suggesting to many of our manufacturers that unless they receive large sums of money by way of an up-front payment, which in some cases is up to \$100,000, then they will no longer be prepared to carry our products. Interestingly, none of the requests for money are being sought in writing. As our own company and most of our manufacturers are small businesses, there is simply no way we can afford to pay these amounts and remain financially viable. If this policy continues, it will force the remaining small Australian manufacturers out of business and open the door to even more products from overseas.²⁴

The Southern Sydney Retailers Associations comments that:

Although Dick Smith Foods may be technically free not to sell to the large supermarket chain that made these coercive demands - the reality is, that when just two buyers are the gatekeepers of 80% of the supermarket shelves of the nation (up from 35% in 1975) - just how conceivable is it for Dick Smith Foods or any other Australian food producer to walk away and say no? These food producers have long term leases on plant & equipment, they have investments in machinery, bank loans that require servicing, on-going commitments to their skilled employees - to say no to any demand from one of the major supermarket chains and to walk away, would simply be suicidal. The producer simply has no way to replace the lost sales, or any practical alternate mechanisms to get his products to the consumer, in such a highly concentrated market as has evolved in Australia, under the *Trade Practices Act*.²⁵

These practices demonstrate the market power exerted by big businesses that mean fair competition is not always available to small businesses. They also demonstrate that changes in the law are necessary to ensure competition and fair trading.

Proposed changes to the Trade Practices Act

The Fair Trading Coalition has declared its support for FAMILY FIRST's *Trade Practices Amendment (Predatory Pricing) Bill 2007*, noting that it would support "the

23 Mr Scott, Pharmacy Guild of Australia, Committee Hansard, 27 July 2007, page 20.

24 Submission 15B (Southern Sydney Retailers Association), page 3.

25 Submission 15B (Southern Sydney Retailers Association), page 4.

wider application" of the bill.²⁶ Other small business groups like the Independent Liquor Group²⁷ have also asked to have their markets included in the bill.

FAMILY FIRST's predatory pricing bill received support from a significant number of small businesses and other submissions.²⁸

FAMILY FIRST's bill introduces the concept of "substantial financial power" as one of the requirements to prove predatory pricing. This received support:

Substantial financial power is a useful concept because financial strength is ultimately what allows the anticompetitive conduct to be sustained for a period way beyond what it would have been in a context where the firm had no market power or substantial power. So the 'deep pockets' aspect is very important to fund the anticompetitive conduct—or the allegedly anticompetitive conduct. The High Court has said that financial power is not a factor that should be taken into account. I respectfully disagree because, if we are trying to assess whether conduct is procompetitive or anticompetitive and if what the firm actually does when it has substantial market power has an adverse effect on competition, we should be looking very carefully as to how that financial power has been used.²⁹

FAMILY FIRST's bill also states that a company may be held to have engaged in predatory pricing even where it has no intention to recoup the funds it spends engaging in predatory pricing. This also received support:

... we do not need proof of recoupment, because recoupment is not mentioned in section 46. You have substantial market power and you take the advantage of that market power for an anticompetitive purpose. That is conduct at a point in time. If at a point in time you have substantial market power and substantial financial power and you use that power in an anticompetitive way—that is, you behave at that point in time to destroy competition, to deter competition or to prevent competitive conduct—then that should be the only issue that is relevant under section 46, because that is how section 46 is worded. To introduce new concepts is to add new hurdles by judicial law making ...

If you have a recoupment element, it becomes almost impossible because you are asking for proof about the future. And if you are asking for a dead body—that is, that the small business or the smaller player has been driven out of business—as an element of proving a breach of section 46 then section 46 is not working effectively to protect competition because the competition is gone ...³⁰

26 Submission 21 (Fair Trading Coalition), page ii, iii.

27 Submission 19.

28 Submissions 5, 15, 19, 20, 22, 24.

29 Professor Zumbo, Committee Hansard, 27 July 2007, page 11.

30 Professor Zumbo, Committee Hansard, 27 July 2007, page 11.

FAMILY FIRST is certainly not against price cutting, but when you undercut for extended periods of time with the purpose or effect of squeezing out a competitor that's not on. FAMILY FIRST rejects the argument that it wants to protect small business by any other method than by ensuring fair competition.

The Bill also adds an "effects test", which means those corporations that do have "financial" or "market" power need to be careful in how they use that power so they do not substantially lessen competition or eliminate competitors.

A number of submissions were critical of FAMILY FIRST's bill.³¹ FAMILY FIRST will consider whether it is necessary to amend the predatory pricing bill to meet its objectives, mindful that most submissions criticising the bill were from big businesses or organisations that represented big businesses, which are doing well under the current laws.

Conclusion

FAMILY FIRST introduced the *Trade Practices Amendment (Predatory Pricing) Bill 2007* to give small businesses much needed protection from predatory pricing, by ensuring competition and fair trading. Fair competition will help to ensure the lowest prices for families.

FAMILY FIRST is convinced that food and grocery prices are soaring because the market is not working, especially in concentrated markets like the grocery market where Coles and Woolworths control 80 per cent of turnover. This is one of the most concentrated grocery markets in the world. Coles and Woolworths also dominate the petrol market.

There needs to be a good balance in the *Trade Practices Act* between too much regulation and not enough. FAMILY FIRST believes a lack of effective regulation to stop anti-competitive behaviour is stifling competition.

Senator Steve Fielding
FAMILY FIRST Leader
FAMILY FIRST Senator for Victoria

31 For example, submissions 13, 16 and 23.

