

Thursday, 5 July 2007

The Secretary
Senate Standing Committee on Economics
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Senate Standing Committee on Economics' Inquiry into the
Provisions of the Trade Practices Legislation Bill (No 1) 2007-07-02
Trade Practices Amendment (Predatory Pricing) Bill 2007

Coles Group Limited is keenly interested in the *Trade Practices Act 1974 (Cth)* and particularly in maintaining the aims of the Act, namely "...to enhance the welfare of Australians through the promotion of competition and fair trading...".¹ Coles is a strong supporter of this principle, and cautions the Government and the Senate from adopting amendments that pervert the Act's intent to one of protecting competitors rather than competition and imposing regulation that protects the interests of a class of competitors over the interests of the consumer.

Coles does not propose to comment on the Government's Bill, other than to indicate that we recognise it is the outcome of considerable consultation with a wide range of stakeholders and experts. While we believe the amendments go further than is necessary, we accept the Government's position. We will comment on Senator Fielding's Bill because it is targeted at the retail sector.

There has been considerable airplay of late about the alleged failings of the retail sector, often citing Coles as one of the culprits. Our reputation has been attacked and our size used as an argument for more draconian legislation that impedes our ability to respond to competition and, in turn, meet the needs of our customers.

Despite the discussion of perceived or potential threats, the on-ground evidence either fails to support these concerns or demonstrates the opposite. In short, Coles believes there is no evidence of market failure that would justify increased government regulation in retail. Indeed there is considerable evidence to suggest the maintenance of an open and free market is providing the dynamic and responsive retail sector that consumers want.

The Australian Bureau of Statistics indicates that the number of independent supermarket and grocery stores has remained relatively constant over the last 10 years² approximately 4,400. The continued presence of a significant number of independents demonstrates that independents are successfully competing in the retail sector.

Further, a report prepared by Price Water House Coopers for one of the main detractors of the major supermarket chains, the National Association of Retail Grocers, details the vibrancy and growth of the independent grocery stores.

¹ Section 2, *Trade Practices Act 1974 (Cth)*

² There are approximately 4,400 supermarkets and grocery stores, excluding Coles and Woolworths (ABS 86622.0(1998-99). *Price Waterhouse Coopers 'The economic contribution of grocery SMEs in Australia and WA'*, June 2007.

Over 1,209 stores were operating under the IGA banner, the largest independent retailing banner group as of mid 2006. Over 39,000 square metres of selling space were added to the IGA brand by the opening of 44 new stores in 2005/06. More than 48 major refurbishments were completed during the year and the completion of 76 new independent stores is believed to be undergoing consideration for the end of the financial year 2007. FoodWorks, the other large independent banner group and Metcash's largest client also rebranded 350 stores in the financial year 2006. During the next 12 months it is estimated by Metcash that 37 new FoodWorks stores will be opened and 44 stores refurbished and expanded.

According to Metcash, sales increased by 6.3% for comparable IGA stores and by 6% for comparable FoodWorks stores in financial year 2006. ...Metcash, the major supplier for these SMEs, highlighted in their most recent Annual Report that the strong growth in independent retailers was underpinned by a strong eastern seaboard television campaign and local areas marketing.³

When coupled with the introduction and expansion of the ALDI supermarket budget offer, this clearly indicates a retail sector in which new entrants can emerge and existing members can develop. It is not suggestive of a sector in the stronghold of one or two players.

It is interesting to note that the same report states on page 27:

Through their [SMEs] capacity to tailor their offering to local needs and demographics, and their attempts to customise their product range and store layout to the preferences of local shoppers, independent retailers are able to add value to their sales offering.

Coles seeks to pursue the same opportunity; to tailor its offering to best meet the needs of customers.

Regarding predatory pricing, Coles' position is quite clear - we do not engage in predatory pricing. Our efficiencies and relationships with many suppliers, to obtain the best quality goods for the best price, enable us to offer retail prices everyday that are often lower than many of our competitors. This is supported by a recent Choice survey indicating that Coles prices are generally lower than Woolworths and many independents⁴. We seek also to match catalogue prices of our major competitors on key selling lines, such as bananas or milk. Additionally, store managers have the discretion to drop below our regional prices to match, not better, local competitors on those items. It is strong retail competition that delivers customers lower prices.

Given the uncertainty with the way Senator Fielding's amendments may be interpreted, they could well hamper our ability to respond to price competition. The end result could be a retail sector that is much more cautious in price setting, resulting in higher costs being paid by consumers.

The Senator Fielding's Bill targets only the grocery, fuel and pharmaceutical, proprietary medicines and toiletries markets. These are all markets in which Coles and Woolworths operate or would like to operate. Again there is no evidence of market failure peculiar to these markets. However, we note that the pharmacy sector is highly insulated against open

³ See 2 above, p28.

⁴ Choice Supermarket Price Survey July 07.

competition. New entrants and prices are strictly controlled and supermarkets are prohibited from either co-locating or operating pharmacies. We would argue that a freeing up of the regulations in that area would result in more effective competition and better value for customers— as has been the case overseas. We do not think Senator Fielding's Bill will effectively promote competition in these sectors.

Additionally, we are unaware of any evidence to support more stringent controls on predatory pricing in these markets as opposed to any other. That these areas are selected for the Bill could (albeit unintended) result in dampening competition, limiting discounting, and margin protection for some in these sectors, rather than delivering real benefits to consumers.

Advocates of tighter regulatory control cite overseas experience where major supermarket chains have a smaller share of the overall market, yet overlook the fact that typically there is one major supermarket chain to about every six million people. Australia's 21 million people supports two major chains and a third major banner group of independent supermarkets and this ratio is broadly consistent with international experience.

Coles is particularly concerned with the concept of financial strength or financial power being introduced into the legislation. While it is generally understood that market power relates to a corporation's ability to raise prices above supply cost without rivals taking away customers over time— something neither Coles nor its competitors can do - financial power is not a relevant concept in current Australian competition law. It is therefore unclear how it would be interpreted. Would a triple-A credit rating or access to a substantial amount of low rate finance at short notice constitute financial power? If so, how does this relate to competition if, in the market where a corporation operates, there is intense price competition or the corporation in question is a new entrant with a very small market share yet has international financial backing? The introduction of this concept creates considerable uncertainty for business.

Consequently, depending on how the concept of financial power is interpreted, a much greater range of conduct could fall within the scope of the 'financial power' concept and result in an increased number of court actions and ACCC investigations, even though a company's conduct could well be constrained by competitive forces in the market.

These factors could lead to greater caution, less competition, less discounting and increased costs to customers. From our perspective, this consequence would be diametrically counter to the objective of the Act and the interests of Australian consumers.

We believe the legislative framework should encourage retailers to be more efficient, entrepreneurial and responsive to consumer needs, not less so. We encourage the Senate Committee to proceed with caution in relation to the Government's Bill and reject Senator Fielding's and other calls for more restrictive regulation.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Fletcher', with a long, sweeping horizontal line extending to the right.

John Fletcher
Managing Director & Chief Executive Officer
Coles Group Limited