

22 July 2008

Mr John Hawkins
Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100 Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Mr Hawkins

Re: FuelWatch inquiry

Woolworths is pleased to provide the following submission to the Senate Economics Standing Committee Inquiry into the National FuelWatch (Empowering Consumers) Bill 2008 (Bill).

As the Committee is aware, the Australian Competition and Consumer Commission conducted an inquiry into petrol prices last year and in its report of December 2007 the Commission found that:

- there is a significant degree of price competition at the retail level (where Woolworths participates)
- the retail margins are relatively small and have remained broadly constant over the last four years, despite short term fluctuations
- retail average margin in the major metropolitan markets over the last 4 financial years is a 4.2cpl, which the commission considered "relatively small".

In our view the ACCC findings were valid in December last and since then, there have been no structural or tactical changes that would justify the need for new regulations such as that proposed under the FuelWatch system in a market that is, as acknowledged by the ACCC, very competitive already.

Whilst Woolworths is encouraged by the Government's move to improve transparency for customers in the form of an online website, we hold strong reservations about the impact that FuelWatch will have on the price cycle and in turn the impact this will have on the most price sensitive customers.

Given petrol is a homogeneous product, consumers are heavily influenced by price. This price competitive environment creates a weekly price cycle where retailers often make little or no margin on volumes sold at the low point of the cycle as they compete for market share. Retailers then increase prices towards the end of the week to restore their economic margin.

Woolworths is concerned the proposed FuelWatch scheme will interfere with this cycle, inhibiting our ability as an independent petrol retailer to differentiate on price by restricting our ability to decrease prices during the day. Furthermore, the scheme is likely to lengthen the petrol pricing cycle and reduce the magnitude of its peaks and troughs. The end result to consumers may be fewer days when petrol is the cheapest and higher prices at the bottom of the cycle.

Woolworths strongly recommends the Federal Government amends the National FuelWatch Bill to enable retailers to move prices downwards through the day to allow them for example to match competitors. Woolworths also recommends that the government commits to conducting an early review of the scheme to ensure negative impacts are remedied.

If you have any questions regarding the matters raised in the submission, please contact Group Manager – Government Relations, Nathalie Samia on 02 8885 3446 or nsamia@woolworths.com.au.

Yours faithfully,



Ramnik Narsey
General Manager Petrol

WOOLWORTHS LIMITED

Woolworths Limited

Inquiry into the National Fuelwatch
(Empowering Consumers) Bill 2008; National
Fuelwatch (Empowering Consumers
Consequential Amendments) Bill 2008

22 July 2008

1 Executive summary

Woolworths welcomes the opportunity to make the following submission to the Senate Economics Standing Committee Inquiry into the National Fuelwatch (Empowering Consumers) Bill 2008 (Bill).

Woolworths Limited first entered the Australian retail petrol market in 1996 when we opened our first petrol outlet in Dubbo, New South Wales. Our petrol business has since expanded to 522 outlets across Australia - 389 outlets owned and operated directly by Woolworths and 133 owned and operated by Caltex under an alliance arrangement. This agreement involves Caltex supplying petrol to Woolworths for retail sale.

We recognise the importance of creating a competitive environment in petrol retailing to ensure Australian's enjoy the lowest possible price at the bowser. As one of Australia's leading retail companies that is made up of some of the most recognisable and trusted brands in retailing, serving our customers every day with great choice, low prices and excellent quality is our core purpose.

Recognising the importance of competition in the retail petrol market and reflecting our experience with the Western Australian FuelWatch scheme, Woolworths is concerned a National FuelWatch scheme will have the unintended consequence of reducing competitive pressures with the risk of reducing the opportunity for consumers to take advantage of the lowest point of the price cycle. As a result, we encourage the government to conduct an early review of the scheme to take place within six months of introduction.

We urge the government to review its scheme design so that it allows for intra-day price movements downwards. The ability for retailers to compete on price during the day is vital to ensure Australian motorists benefit from a fully functioning competitive environment.

These recommendations reflect our view on the likely impact of FuelWatch on competition and pricing; and the likely impact of FuelWatch on retailers (i.e. compliance costs, penalties etc). The following submission outlines each of these points in more detail.

2 Price impacts

2.1 Current practices

Petrol is by and large regarded as a homogeneous commodity by consumers with little loyalty to brand. Price is therefore the key driver of competition in petrol retailing.

Currently, Woolworths determines its pump prices based on an intra-day price monitoring process of competitor sites within the local area of each site. The aim is for Woolworths to offer among the lowest petrol pump prices within its competitive markets - before any petrol discounts such as our shopper docket saving offer are applied.

We set our prices based on information received from independent company Informed Sources Pty Ltd (Informed Sources). Informed Sources collects advertised prices at each site based on information provided by participating retailers through an automated electronic system. Informed Sources also manually collects posted price data from retailers.

Woolworths and other petrol retailers pay a subscription fee to receive regular reports per geographic area via an internet service. Woolworths monitors the price data throughout the day and adjusts prices at our various sites to ensure each is competitive at all times within its relevant geographic area.

Despite fluctuations through the week, pump prices follow the movement in international prices (MOPS95).

2.2 Competition benefits from the current system

Woolworths believes the current system of constantly monitoring competitors' prices instils a dynamic market efficiency that leads to higher levels of competition and, in turn, lower prices for consumers.

There are a number of factors that underpin this competitive environment. As noted above, petrol is regarded by consumers as a homogeneous commodity, with little brand loyalty. Consumers are also highly price conscious resulting in large daily volume shifts for relatively small price differences.

In addition, there is a marked difference between the brand perception, location strength and quality of offers between the major oil companies and supermarket petrol retailers compared to smaller independent retailers. This reality requires independent retailers to compete more heavily on price to attract consumers.

Aware of the fact that consumers will switch retailers for small pump price differences, major retailers match the lower prices posted by independents, with varying speeds of response. At the bottom of this cycle, retailers are often selling petrol at very low margins. This downwards price spiral therefore continues until the margins become uneconomic for the major retailers, who have multiple sites affected by this behaviour. Major oil companies are then forced to increase prices to a point where the average volume weighted margin between the top and bottom of the price cycle generally equals their economic margin.

There is a time lag between when major oil companies move sites to the top of the price cycle and when independent retailers match this price. This lag allows independent retailers to create and maintain their "low price" perception and to sell larger volumes. The price differential between independents and the majors during this time can be as high as 15 cents per litre.

The key to greater competition and downward price pressure is the ability of independent retailers to quickly move to better the prices of the big oil companies and for other retailers to subsequently match these downward movements.

While retailers will inherently seek to offset the low or perhaps negative margins received at the low ends of the price cycle with higher prices on the other days of the weekly cycle, consumers are prepared to change their buying behaviour to capture better prices. This is clearly reflected in the significantly higher sales volumes recorded on the days pump prices are lowest.

Woolworths believes the magnitude of this price cycle range has grown by between four to six cents per litre over the last four to five years as a result of increased market competition. Consumers who take advantage of the low end of the price cycle benefit significantly.

2.3 Impact of FuelWatch on petrol prices

Woolworths is concerned the proposed FuelWatch scheme will not reduce the price of petrol in metropolitan areas, regional centres or rural Australia. Moreover, we are concerned the limits on intra-day price changes may mean FuelWatch reduces competitive price outcomes. This will subsequently reduce the capacity of retailers to engage in dynamic competition with one another.

In Woolworths' view, not allowing immediate price competition to exist has the potential to force motorists to pay higher prices on a given day or otherwise be forced to travel long distances to find cheaper fuel.

The above observations are based on Woolworths' recent experiences in Western Australia, where a FuelWatch scheme similar to that proposed under the Bill has been in place since January 2001. In our experience, the fuel pricing legislation in Western Australia is an impediment to efficient and competitive pricing.

In addition to the specific anti-competitive effects, increased Government intervention that impedes the free market and efficient operation of industry is likely to increase operating costs and force retailers to increase fuel margins over the longer term to remain viable or force more operators to exit the industry (see section 3 below). This could result in higher average prices for consumers.

2.4 Impact of FuelWatch on price cycles

The price cycle behaviour described in section 2.2 above is similar in all key metropolitan markets in Australia other than Perth.

Since the current Western Australia legislative regime does not allow full intra day competition in the major Western Australia markets (most notably, Perth), independent retailers are unable to react quickly to the prices set by the major oil companies. This reduces the price cycle range and lengthens the price cycle itself. Consumers' ability to take advantage of the lower pump prices at the bottom of the price cycle is therefore reduced.

According to the paper *"Has FuelWatch delivered lower prices?"*, prepared by Informed Sources in April 2008, the FuelWatch scheme in Western Australia *"has extended the typical price cycle from a seven day cycle that motorists benefit from in Eastern States, to a slower moving 14 day cycle with a slightly reduced amplitude or swing"*.

According to Informed Sources, the 14 day cycle is a result of "stickiness" created in the market. This stickiness reflects the less aggressive pricing strategies of retailers who try to minimise the potentially adverse impact of pricing either too high or too low and having to maintain that price for 24 hours.

The 14 day cycle significantly disadvantages consumers by reducing their opportunity to capture the low points in the cycle, which now only occur every second week (rather than every week under current conditions in the other states). In addition, data for average daily petrol prices shows the price range within the 14 day cycle in Western Australia is lower than that within the 7 day cycle in other states.¹

While the reduced amplitude of the cycle means that prices do not rise as high as they do in the 7 day cycle, they also do not fall as low. That means cost-conscious consumers cannot access as low a price and can only purchase petrol at the lowest point in the cycle every second week.

A full copy of "*Has FuelWatch delivered lower prices?*" is attached as Schedule 1 to this submission.

3 Impact on fuel retailers

3.1 Reduced ability to compete on price

As noted above, FuelWatch has the potential to inhibit retailers' ability to compete with their competitors on price.

In the case of Woolworths, our brand promise is that our customers enjoy the equal lowest price of all competitors within the local area of our site and, in addition, the full value of the discount docket. Over 1.3 million customers outside of Western Australia benefit from this promise every week. In the localities covered by the Fuelwatch legislation in Western Australia it has been impossible to constantly deliver this promise because of our inability under the legislation to move prices downwards to match competitors through the day. This has been to the detriment of our customers in that state.

3.2 Compliance costs to retailers

We expect that there will be significant cost for IT development required to communicate some 2000+ prices daily to the ACCC under the proposed legislation. In addition we expect that we will have to set up processes for ensuring the prices advised to the ACCC are duly changed at 6am in order to minimize the risk of a breach. We have not estimated the cost of such a compliance regime. Until the Fuelwatch scheme has been in operation nationally for some time, we are unable to say how the additional development and compliance costs compares to the potential savings from not subscribing to the current Informed Sources service.

In addition to these costs, the potential for fuel retailers to receive an ACCC infringement notice for failing to change the standard fuel price at 6 am on a given day represents another unnecessary cost to business. This will impact the vast majority of retailers including Woolworths and the smaller independent retailers who do not operate electronic price boards.

Under the proposed FuelWatch legislation, site operators will be required to change the price board to display the price that will apply that day. At 6 am each day, retailers face a potential penalty of \$2750 if they do not immediately update their displayed standard

¹ See data with respect to average daily unleaded fuel prices in "*Has FuelWatch delivered lower prices?*", Informed Sources, **April 2008**

fuel price to that notified to the ACCC at 2 pm the previous day. If the price is changed prior to 6 am, retailers similarly face a potential penalty of \$2750 for failing to maintain the notified price for the previous day for the full 24 hour period.

Logistically, changing the price at exactly 6 am each day will be nearly impossible for retailers who open sites before 6am as most of Woolworths sites do. It is likely that most retailers, including Woolworths will only have one member of staff on duty at a site at 6 am. There is therefore a significant risk that that one member of staff will be busy with a customer at 6 am (particularly if customers are trying to take advantage of the pre-6 am price) and hence hindered from changing the price at that particular site at the required time. Retailers will be forced to close the site for up to half an hour to re-set their pump prices and signs leading to delays for customers.

Under the proposed Bill, the ACCC could issue the retailer with an infringement notice carrying a penalty of \$2750 on each occasion that this occurs. To mitigate the risk of being fined, retailers would have to roster a second member of staff to be on duty at 6 am each day, increasing labour costs accordingly. Given the usual level of demand at this time of the day, a second member of staff would otherwise be unnecessary.

Furthermore, under the current drafting of the Bill a retailer could face civil penalty proceedings for contravening the law, despite having already paid an infringement notice in relation to the alleged contravention.

4 Conclusion

Woolworths is concerned FuelWatch will not result in lower petrol prices for consumers. The existence of price cycles in the retail petrol market is a direct result of the competitive forces driving petrol prices down as retailers (including independents and the supermarkets) strive to create a "price break" between themselves and the major oil companies.

Experience from Western Australia suggests the dynamic competitive forces that result in shorter and more highly amplified price cycles (which give consumers the opportunity to purchase petrol at lower prices on a more frequent basis) are impeded by the regulatory burdens imposed by FuelWatch, particularly with respect to the fixing of prices for a 24 hour period.

We point to the following statements in the Report of The Senate Economics Legislation Committee in December 2006 as further evidence that the current market conditions achieve optimum competitive pressures:

"...the dynamics of the Australian petrol industry have changed over the past decade or so. The market has evolved from one that was highly regulated with a variety of participants to a deregulated market in which there are fewer competitors at the wholesale level, as well as a smaller number of retail outlets. Nevertheless, the competitive forces are sufficient to place downward pressure on retail prices for consumers.

"...given the transparency and volatility of the market and its low margins, it is in fact indicative of vigorous competition.

"...The continued viability of large independents is yet further evidence of the absence of predatory behaviour by the major retailers...The supermarket chains have taken over the role of the independents as a strong discounting force in the markets in which they operate...

"...the Australian fuel market, particularly in the metropolitan areas, shows the characteristics of a strongly competitive market, from which consumers benefit.

We urge the Federal Government to amend the bill so that retailers can adjust intra-day prices down and commit to conducting an early review of the scheme to measure its effectiveness in reducing petrol prices for consumers.