Public Submission to the Senate Standing Committee on Economics Inquiry into the Trade Practices (Creeping Acquisitions) Amendment Bill 2007

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EXECUTIVE SUMMARY

The Australian National Retailers Association (ANRA) supports an open competitive retail market in Australia.

In 2008, Australians benefit from a dynamic retail market. Price competition is intense across the sector. The entry of new retailers and the growth of independent retailers confirm that the sector is open to competition.

Nevertheless some critics claim that the retail sector is not competitive and requires government intervention. The main critic has been the National Association of Retail Grocers (NARGA), which is funded by wholesale distribution giant Metcash. NARGA have argued that governments should effectively prevent the growth of leading retail grocery chains. The commercial self-interest of these proposals is clear.

While Senator Fielding's private member's bill is a general proposal applying to all sectors, the Senator's second reading speech singles out the retail sector.

The argument about creeping acquisitions rests on two false claims:

- The two largest retailers – Woolworths and Coles – have 80 per cent of the retail grocery market and are using acquisitions to entrench this market share; and
- Existing controls under the Trade Practices Act 1974 are inadequate to deal with store-by-store acquisitions which over time reduce competition.

The 80 per cent market share claim is based on sales data which excludes essential consumer grocery purchases (eg. fresh meat, fruit and vegetables) and points of sale other than supermarkets and grocery stores. A broader measure suggests that the grocery market is more evenly divided between large and independent retailers. In any event, the concern of government should be to promote competition, not to protect individual competitors.

Nor does the claim that "creeping acquisitions" are contributing to a purportedly high level of market concentration bear scrutiny. Analysis of recent acquisitions shows that few independent stores have been acquired by Woolworths and Coles; the most likely buyer of an independent retail store is in fact another independent retailer. In a market with literally thousands of supermarkets, the sale of a handful of sites each year has virtually no impact on the level of competition in the market.

The second claim ignores that the Trade Practices Act provides the Australian Competition and Consumer Commission (ACCC) with ample powers to consider the acquisition of any retail store. The ACCC has intervened in cases where it believes that the acquisition of a store may diminish competition in a local market: the most recent example is the Commission's veto of a proposed acquisition of Karabar supermarket by Woolworths in June 2008.

ANRA has considered the terms of Senator Fielding's bill. ANRA believes that the bill does not materially change the terms of s.50 of the Act. When assessing an acquisition, the ACCC has broad discretion in deciding whether a substantial lessening of competition is likely to occur. The ACCC defines the market in question, identifies the level of existing competition and assesses the likely impact of the acquisition on that competition. Past acquisitions are relevant to the extent of their effects on present competition.

Senator Fielding's bill will not change the established processes for assessing acquisitions. The bill would not require the ACCC to assess any new factors.

Finally, as the committee will be aware, calls for further government regulation must demonstrate market failure and how intervention would improve competition. Restricting the expansion of major chains such as Woolworths and Coles will deny consumers choice. Preventing independent retailers from selling their businesses to the highest bidder will affect the retirement incomes of owners.

Vigorous enforcement of Part IV of the Trade Practices Act 1974 and regulatory reforms to lower the barriers to entry to the retail sector are far more likely to enhance competition and consumer welfare.

INTRODUCTION

The Australian National Retailers Association (ANRA) represents the leading national retailers in Australia, across a broad range of retail products and services. Members of the Association include Australia's most trusted household names in supermarket chains, department stores and speciality retailers. A full list of ANRA members is included in Appendix A.

In 2007 ANRA members employed more than 600,000 Australians.

ANRA was formed in 2006 to ensure that governments, and the community, understand the contribution retailing makes to the national economy. ANRA seeks to ensure that public policy makers understand the retail sector and support policies which enhance the capacity of the sector to meet consumer needs.

ANRA members endorse the Council of Australian Governments' (COAG) Competition Principles Agreement and the COAG Principles of Best Practice Regulation which state that legislation should not restrict competition unless it is demonstrated that the community benefits of restricting competition outweigh the costs and that the regulatory aim can only be achieved by restricting competition.

STATE OF THE MARKET

The Australian retail market is highly competitive.

By a large margin, at $95.6 billion (2007), food retailing is the largest single segment of the $233 billion retail sector. Supermarkets and grocery stores account for about 70 per cent of food retail sales. Specialist retailers account for almost 20 per cent of food retail sales, with much higher market shares in key product categories such as packaged milk and cheese, fresh meat and poultry, fresh fruit and vegetables and bread.

The retail market is open to competition.

Since 2001, the German retailer Aldi has entered the market, establishing 166 stores with plans to have 200 stores open by the end of 2008. In just seven years, Aldi has grown to become one of Australia's top ten retailers with turnover of $1.5 billion. More than one million people shop at Aldi stores every week.[1]

The US giant Costco will open its first Australian store – a 1.3 hectare site in Melbourne's Docklands – in 2009.

At the same time, a more efficient and competitive independent retail sector has emerged. The consolidation of small retail chains and stores into larger "banner groups", in particular the Metcash/IGA and Foodworks groups, has enhanced the capacity of independent retailers to compete.

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1 . Aldi submission to the ACCC retail grocery inquiry, p.1.

The Metcash/IGA group has grown more quickly than the market as a whole, through acquisitions as well as higher retail sales. Metcash's share of the supermarket and grocery stores market has grown from 11.2 per cent (2001) to 19.2 per cent (2008). IGA sales rose by 8 per cent over the 12 months to 30 April 2008, compared to a market growth of just 4.5 per cent.

Since 2001, 270 new independent supermarkets have been opened as part of the Metcash distribution network. In the 12 months to 30 April 2008, IGA opened 55 new stores, including 17 stores acquired. IGA plans to add another 39 stores over the 12 months to 30 April 2009.

Since its formation in November 2007, the Foodworks chain has grown to be a successful independent retailing group with over 700 stores and more than $1.5 billion in annual turnover. Foodworks has announced plans to open 300 new or redeveloped stores. The group has identified 900 potential development sites for its stores.

Over the last ten years, the number of supermarkets operated by both the major chains and independent retailers has steadily increased.[2]

Supermarkets in Australia

Retailer	**1998**	**2008**
Coles	556	740
Woolworths	603	765
Franklins*	270	80
IGA	1036 (2001)	1288
Aldi**	N/A	166
Foodworks***	N/A	710

* Franklins was restructured and partly sold off in 2001.
** Aldi entered the Australian market in 2001.
*** Foodworks was formed in 2004 by the merger of 10 independent chains.

MARKET SHARES

For many years, the National Association of Retail Grocers of Australia (NARGA) has promoted an image of the retail grocery sector as overwhelmingly dominated by the largest retailers with small and independent retailers facing extinction. NARGA has gained widespread acceptance for its claim that 79 per cent of the market is

2 . Jebb Holland Dimasi *Retailing in Australia 1997/98: Industry Analysis*, p.22; Coles annual full year profit news releases, Metcash annual reports, public information available on Franklins and Aldi web-site.

controlled by Woolworths and Coles. This claim is then cited as proof that the market is not competitive.

The NARGA claim is premised on the narrowest definition of the retail grocery market (ie. just supermarkets and grocery stores) and is based on one data source. NARGA uses ACNeilsen ScanData which reports sales of 105 "defined packaged grocery" products. NARGA claims this data is indicative of all supermarket sales. The result is a national figure of 78 to 79 per cent of sales for Woolworths, Coles and Franklins. State by State figures vary from 84 per cent in New South Wales to 68 per cent in Western Australia.[3]

Relying solely on ScanData gives only a partial snapshot of retail grocery sales. ACNeilsen has advised against using ScanData as a measure of the total grocery market, suggesting that the market must also include fresh meat, fresh fruit and vegetables, delicatessen sales, bread and liquor.[4]

At its simplest, ScanData does not include all food products nor does it cover all food retail outlets.

The data collected, for example, excludes fresh foods, such as fruit and vegetables, and in-store products such as bakery items. Products delivered directly to supermarkets and grocery stores - estimated by one study in 1999 to be worth at least 20 per cent of food and grocery sales - are not included.[5]

Nor does ScanData capture food retail sales in outlets other than supermarkets and grocery stores. Specialist retail stores such as bakeries or butchers' shops are not included.

In the case of some food products, sales in supermarkets and grocery stores can account for as little as 25 per cent of overall sales. In 1997-98, one study estimated that specialist stores sold 55 per cent, 49 per cent and more than 60 per cent of fresh meat and poultry, fresh fruit and vegetables and bread respectively.[6] Roy Morgan research indicates that butchers and stores other than supermarkets account for 31 per cent and 8 per cent of meat sales.[7] A study conducted for the Department of Agriculture, Fisheries and Forestry in 2004 found that 45 per cent of packaged milk and cheese sales are made outside the major supermarket chains.[8]

Often lost in this debate is the key point that a significant market share does <u>not</u> mean unconstrained market power; the potential for anti-competitive conduct in a market is determined by factors such as the barriers to entry, the availability of substitute goods and services and alternative markets. Lowering barriers to entry, such as planning

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3 . *ACNeilsen Grocery Report 2006*, p.12.

4 . Parliament of Australia. *Joint Select Committee on the Retailing Sector* (1999), chapter four.

5 . Jebb Holland Dimasi *Retailing in Australia 1997/98: Industry Analysis*, pp.32-33. This report was commissioned by Woolworths.

6. Jebb Holland Dimasi *Retailing in Australia 1997/98: Industry Analysis*, pp.32-34.

7. Australian Competition and Consumer Commission. *Examination of the Prices Paid to Farmers for Livestock and the Prices Paid by Australian Consumers for Red Meat*, 2007, p.10.

8 . Department of Agriculture, Fisheries and Forestry *Price Determination in the Australian Food Industry*, 2004, p.20 and p.24.

restrictions, would do far more to enhance competition than intervention to distort prices or the market.

Market share in itself tells us little about the conduct of a firm: "concentration statistics or even market shares attributable to individual firms by themselves tells us nothing about the dynamics of competition within a relevant market".[9]

ACQUISITIONS

The retail grocery market already operates under arrangements which ensure that sales of supermarkets are subject to careful scrutiny by the Australian Competition and Consumer Commission.

Since July 2005, Woolworths, Coles and Metcash have agreed to operate under a Charter for the Acquisition of Independent Supermarkets. The Produce and Grocery Industry Code of Conduct also requires notification to the ACCC of proposed acquisitions of supermarkets.

Under the Charter, participating retailers have agreed not to use arrangements which could prevent independent store owners from negotiating with multiple potential buyers. The Charter provides that retailers will not use confidentiality or other arrangements to restrict the commercial freedom of an owner seeking to sell.

Since 2005, ACCC has reviewed 93 supermarket acquisitions: 82 of these acquisitions were proposals from Metcash (ultimately 61 stores acquired); 28 from Woolworths (27 stores eventually acquired); and two proposals from Coles.[10]

The main acquisitions over the last decade have stemmed from the break-up of the Franklins (2000-01) and Foodland (2005) chains. All these acquisitions were assessed, and approved, by the ACCC. Most of the stores acquired were purchased by independent retailers. In 2001, Metcash bought most of the Foodland chain (104 stores).[11] In 2005, Metcash acquired 81 Action supermarkets in three States.

By contrast, acquisitions have made a much less important contribution to the growth of Woolworths and Coles. Since 2005, Woolworths has acquired only 6 independent stores – four stores in areas without an existing Woolworths store. Woolworths, for example, has opened 139 new stores since 2001.

TRADE PRACTICES ACT

Mergers and acquisitions which could lessen competition are regulated under s.50 of the Trade Practices Act. The protections in the Act apply equally to acquisition of a

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9 . David K Round "The Power of Two: Squaring Off with Australia's Large Supermarket Chains" *The Australian Journal of Agricultural and Resource Economics*, volume 50, 2006, p.54.

10. ACCC discussion paper for the retail grocery inquiry, 2008.

11 . Network Economics Consulting Group *Creeping Acquisitions in the Australian Grocery Industry: A Report to the ACCC prepared on behalf of Metcash*, 2003, pp.11-12.

single asset as to a group or chain of assets. The involvement of the Commission is triggered by any event which has the likely effect of a substantial lessening of competition.

Senator Fielding, in his second reading speech, claimed that

"It is very difficult for the Australian Competition and Consumer Commission (ACCC) to declare that a small purchase, on its own, leads to a substantial reduction in competition."

The suggestion that the acquisition of a single store would not trigger scrutiny is wrong in law and in practice. An inspection of the ACCC's public register of s.50 matters will show numerous cases where the Commission has undertaken a public competition assessment of a proposal to acquire a single supermarket.

The effect on competition test applied in s.50 is comprehensive:

"Without limiting the matters that may be taken into account for the purposes of subsections (1) and (2) in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

> (a) the actual and potential level of import competition in the market;
> (b) the height of barriers to entry to the market;
> (c) the level of concentration in the market;
> (d) the degree of countervailing power in the market;
> (e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
> (f) the extent to which substitutes are available in the market or are likely to be available in the market;
> (g) the dynamic characteristics of the market, including growth, innovation and product differentiation;
> (h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor;
> (i) the nature and extent of vertical integration in the market."

The ACCC has the power to reject an acquisition or to resolve competition issues through negotiated undertakings (e.g. divesting of assets, conditions on sale). The Commission can apply to the Federal Court for an injunction to prevent an acquisition, to require divestiture or to impose penalties. Parties who may be affected by a merger or acquisition may apply to the Federal Court for an injunction. The ACCC has strong information gathering powers allowing the Commission to obtain confidential commercial information to ensure the full impact of an acquisition is understood.

Very few mergers or acquisitions have been held by the ACCC to pose a risk to competition. In the retail sector, the ACCC appears to have rejected only one acquisition of a supermarket in recent years (the Karabar supermarket in June 2008).

CASE STUDY – FOODLAND CHAIN

The most significant acquisition of independent supermarkets in recent years was the break-up of the Action supermarkets operated by the Foodland group, a supermarket chain in Western Australia, Queensland, northern New South Wales and New Zealand.

The majority of Action supermarkets (60 of 82) and Foodland's wholesale distribution business were acquired by Metcash. Woolworths sought to acquire 22 Action stores (including 3 development sites) in Australia. In the end, Woolworths acquired 19 stores.

Over more than four months, the ACCC conducted a Public Competition Assessment of the proposed Woolworths acquisitions. The assessment included the following stages:

Date	***Stage***
1 June 2005	ACCC receives initial submission from Woolworths.
15 June 2005	ACCC posts market inquiries letter on its website - timeline for ACCC consideration commences.
1 July 2005	Due date for submissions from interested parties.
8 July 2005	Woolworths' submission received.
31 August 2005	ACCC publishes Statement of Issues. The Statement of Issues outlines the ACCC's preliminary view of the competition effects of the proposed transaction.
15 September 2005	Due date for additional submissions from interested parties on the Statement of Issues.
19 October 2005	Announcement of ACCC's findings and publication of Public Competition Assessment.

During the competition assessment, affected parties were given ample opportunity to present any concerns to the ACCC. The Commission assessed the potential impact of the acquisitions on competition in local markets (i.e. the market for retail groceries within a 3 to 5 kilometre distance of each site). The Commission discussed the acquisitions with suppliers and competitors of Woolworths, requested and received detailed information from Woolworths and

With all the facts to hand, the Commission concluded that the acquisition would not diminish competition and approved the purchase.

CASE STUDY - KARABAR

The latest competition assessment by the ACCC of a supermarket acquisition confirms that the Commission can prevent the sale of an independent supermarket when it believes that a sale would diminish competition in a local market.

On 25 June 2008, the ACCC announced that it would oppose the acquisition of the Karabar Supabarn by Woolworths. The ACCC stated that the proposed acquisition would be likely to substantially lessen competition in the Queanbeyan retail supermarket market.

The ACCC noted that Woolworths operates two supermarkets in the vicinity of the Karabar store. Coles operates another full-line supermarket in the area. An Aldi supermarket also offers a limited range of goods. The ACCC noted that, at only 1,250 m^2, the Karabar supermarket does not "provide a strong competitive constraint on the major supermarkets in Queanbeyan and Jerrabomberra."

The ACCC came to the conclusion that, if the Woolworths acquisition did not proceed, the Karabar store would be acquired by the Supabarn Group. It was considered that acquisition by Supabarn would see the store redeveloped into a full-line supermarket and create more "competitive tension" in the local market. For these prospective reasons, the ACCC opposed the acquisition.

The Karabar decision demonstrates that the ACCC can prevent the acquisition of a single supermarket.

Appendix A: Membership of the Australian National Retailers' Association

Woolworths Ltd
Coles Group Ltd
Franklins
Best + Less
McDonalds
Just Group
Bunnings Group Ltd
David Jones Ltd
Best and Less Pty Ltd
Angus and Robertson
Borders
Luxottica Australia