



The Australian National Retailers Association (ANRA)

**Submission in response to
the Treasury Discussion Paper
on Creeping Acquisitions**

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TABLE OF CONTENTS

TABLE OF CONTENTS	2
EXECUTIVE SUMMARY	3
INTRODUCTION	5
STATE OF THE MARKET	5
ACQUISITIONS	7
TRADE PRACTICES ACT	7
DISCUSSION PAPER OPTIONS	9
Option 1 – Aggregation	10
Option 2 – Substantial Market Power	10
APPENDIX A: THE AUSTRALIAN NATIONAL RETAILERS’ ASSOCIATION MEMBERSHIP	11

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 strong across the sector. The entry of new retailers and the growth of independent retailers confirm that the sector is open to competition.

Despite this competitive market, the National Association of Retail Grocers (NARGA), which is funded by wholesale distribution giant Metcash, claims that competition is being undermined by so-called “creeping acquisitions”.

NARGA’s claims about creeping acquisitions rests on two false claims:

- The two largest retailers – Woolworths and Coles – are using acquisitions to grow their market share; and
- Existing controls under the Trade Practices Act 1974 are inadequate to deal with store-by-store acquisitions which reduce competition over time.

The claim that “creeping acquisitions” are contributing to a purportedly high level of market concentration does not bear scrutiny. Analysis of recent acquisitions shows that few independent stores have been acquired by Woolworths and Coles; since 2005, only **six** stores have been bought as individual acquisitions by the two chains. Over the same time, about 600 new supermarkets and grocery stores have been opened. Woolworths alone has opened 82 stores.

In a growing 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 the fact 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 Dawson review reached this conclusion in 2003. The ACCC has intervened in cases where it believes that the acquisition of a store may diminish future 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.

The ACCC has found that, contrary to the claims advanced by NARGA,

- “none of the submissions ... identified specific markets where there had been a substantial lessening of competition”;
- “the ACCC has not been able to identify any supermarket acquisitions in the last 5 years where the result would have been different (if a creeping acquisitions laws was in place)”; and

- “overwhelming proportion of new growth for (the chains) over the last five years has come from ... new sites”.

At worst, the ACCC claims that creeping acquisitions are a “potential” problem.

Calls for government regulation must demonstrate market failure and how intervention would improve competition.

Restricting the growth of retailers such as Woolworths and Coles will deny consumers choice. Consumers will also pay more for groceries: even independent retailers admit that typically they do **not** compete on price with the chains. The Government’s GroceryChoice website confirms that standard baskets of goods are invariably more expensive at independent stores compared to Woolworths or Coles. Preventing independent retailers from selling their businesses to the highest bidder will affect the retirement incomes of owners.

For all these reasons, ANRA believes that there is no reason to introduce ‘creeping acquisitions’ legislation. The two options identified in the Government’s issues paper would stifle competition in the market to solve a non-existent problem.

Proposal 1 (the Aggregation Model) creates uncertainty by combining two very different tests – the established ‘look forward’ test which assesses the effect of an acquisition on the likely state of future competition with an ill-defined retrospective ‘look back’ test which considers past acquisitions by the same business.

Proposal 2 (the Substantial Market Power Model) is a broader and more disturbing change. This proposal would replace the “substantial lessening of competition” test with the much lower test of just a lessening of competition. This shift makes the degree of market power held by the corporation the key issue, not the expected impact on competition.

Both proposals strike ANRA as inconsistent with best regulatory practice which requires that restrictions on competition are only made to address a genuine problem, deliver a net public benefit and are proportionate to the issues being addressed.

Under both options, the ACCC would be required to examine a huge number of business transactions every year. By one count, there have been 890 mergers and acquisitions worth more than \$100 billion conducted in the first nine months of 2008.¹ Amending the Trade Practices Act to include proposal 1 or proposal 2 will add a multitude of small scale acquisitions to this imposing list.

1. Merger Connect Newsletter 2 October 2008, which can be founded at http://www.capconnect.com.au/newsletter/spreadsheets/q3_2008_FA.pdf

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. ANRA members have a combined annual turnover of more than \$80 billion and employ about 500,000 Australians.

A full list of ANRA members is included in Appendix A.

ANRA was formed in 2006 to ensure that governments, and the community, understand the contribution retailing makes to the national economy. The retail sector touches the lives of all Australians every day. 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. The market is open to competition.

In 2001, the German retailer Aldi entered the market and has now established 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.²

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 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 strengthened the independent sector.

The Metcash/IGA group has grown more quickly than the market as a whole, through acquisitions as well as higher retail sales. On its own calculations, 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.

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

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.³

Supermarkets in Australia

Retailer	1998	2008
Coles	556	740
Woolworths	603	783
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.

In the last five years, there has been a net increase of more than one thousand supermarkets and grocery stores. There are now more 8,500 supermarkets and grocery stores in Australia.

Often lost in this debate is the key point that a significant market share does not 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 restrictions, would do far more to enhance competition than intervention to distort prices or the market.

3 . 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.

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”.⁴

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.⁵

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: as ACCC brokered break-ups of chains these are not creeping acquisitions. Most of the stores acquired were purchased by independent retailers. In 2001, Metcash bought most of the Foodland chain (104 stores).⁶ 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 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.

4 . 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.

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

6 . 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.

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.

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.

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 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).

In their report into grocery prices, the ACCC concluded that “the ACCC has not been able to identify any supermarket acquisitions in the last 5 years where the result would have been different (if a creeping acquisitions laws was in place)”.

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 1,250m², 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.

DISCUSSION PAPER OPTIONS

The Government’s discussion paper identifies two possible amendments to the Trade Practices Act 1974.

The two options are:

- the “aggregation model” which would allow the ACCC to reject an acquisition if it, combined with past acquisitions by the same corporation, would be likely to lead to a substantial lessening of competition; or
- the “substantial market power” model which would allow the ACCC to reject an acquisition if the corporation has a substantial degree of market power and the acquisition would be likely to lessen competition.

Option 1 – Aggregation

At the moment, the ACCC and the Courts apply a “forward looking test”. The ACCC assesses the existing state of competition and then decides how this will change if the acquisition occurs or is blocked. The aggregation model adds a retrospective ‘look back’ test. The ACCC and the Courts would have to consider the impact on competition of both past acquisitions and the proposed acquisition.

Option 1 would seem to require the ACCC or the Courts to reassess past acquisitions in light of the present (and future) state of competition in the market.

This approach seems to open the possibility that an otherwise neutral acquisition which would not diminish competition could still be rejected on the assumption that past acquisitions by the same business in the market were now seen to be constraining competition. Such past acquisitions may have been approved by the ACCC but could, in the conditions of a changed market, be regarded at the time of the proposed acquisition as now a competition concern.

Option 2 – Substantial Market Power

The substantial market power option is far broader. This option replaces the “substantial lessening of competition” test with the much lower test of just a lessening of competition. This shift makes the degree of market power held by the corporation the key issue.

If the corporation is held to have substantial market power, it would be prohibited from making any acquisition which would lessen competition. The substantial market power option risks reversing the onus of proof: a corporation would need to either show that it does not have substantial market power in the defined market or that its proposed acquisition would not lessen competition.

In the case of retail grocery, the ACCC defines the geographic market as an area of 3 to 5kms radius around the store in question. In such a small market, many businesses – independents as well as chains – are likely to have market power. The effect of Option 2 would be to make any acquisition by these businesses subject to scrutiny and possible veto by the ACCC. Such an acquisition would not necessarily need to be of an identical business: for example, an independent grocery retailer could seek to purchase a liquor outlet.

APPENDIX A: THE AUSTRALIAN NATIONAL RETAILERS' ASSOCIATION MEMBERSHIP

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