The Retailers Association
Serving Members Australia Wide™

TELEPHONE: 1300 721 730

FACSIMILE: 1300 554 552

EMAIL: qrtsa@qrtsa.com.au

WEBSITE: www.qrtsa.com.au

BRISBANE:

Suite 3, 321 Kelvin Grove Road
KELVIN GROVE QLD 4059

PO Box 105
KELVIN GROVE BC QLD 4059

MELBOURNE:

Level 27
101 Collins St
MELBOURNE VIC 3000

SYDNEY:

Level 57
MLC Centre
19-29 Martin Place
SYDNEY NSW 2000

PO Box 1133
CASTLE HILL NSW 2154

ADELAIDE:

Level 24
Westpac House
91 King William St
ADELAIDE SA 5000

PERTH:

Level 28
AMP Tower
140 St Georges Terrace
PERTH WA 6000

ABN: 53 009 660 495

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Scott Rogers
Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: scott.rogers@treasury.gov.au

Dear Mr Rogers,

Creeping Acquisitions

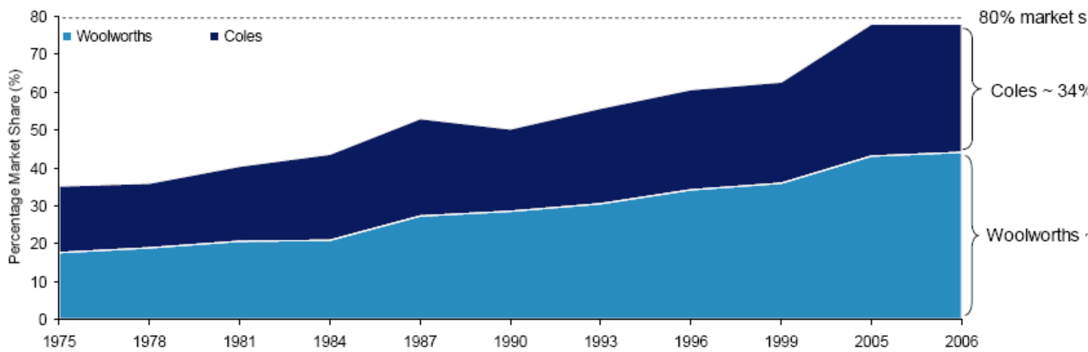
The Retailers Association is a peak national industry body with around 3000 independent retail members across Australia, registered in Queensland as the *Queensland Retail Traders & Shopkeepers Association.*

The independent grocery sector now comprises less than 20% of the national grocery market, yet provides essential supplies to thousands of regional and remote communities, particularly those considered too small to be of interest to the major supermarket chains, as well as providing competitive pressure to those chains through larger stores in metropolitan and regional centres.

The ongoing viability of the independent network is dependent on their share of the market not shrinking to the stage where that wholesaling and distribution network becomes unviable.

However, the market share growth of the major chains continues through both new sites and acquisitions of independent stores as is shown by the following graph:

Figure 2.10: Growth in market share of Woolworths and Coles, 1975-2006



Source: Retail World, ACNielsen

It is taken from a report on the retail grocery sector prepared by Pricewaterhouse Coopers in 2007, titled: '*The economic contribution of small to medium-sized grocery retailers to the Australian economy, with particular emphasis on Western Australia.'* A copy is appended for your information.

The above graph shows how, under the ACCC market share concentration has developed in the Australian retail grocery market to the point where the two major chains now sell close to 80% of all packaged groceries. A more detailed summary is given by the chart below taken from the same study:

Characteristics associated with market participants in the grocery industry

Market Participants	% Turnover	Stores	Turnover	FTEs	FTEs per store
Top 2 – Woolworths & Coles	78-79%	1,493 (24%)	$59 billion	108,833 (43%)	65
Top 4 – Woolworths, Coles, ALDI & Pick 'n Pay (Franklins)	80%	1,683 (27%)			
Independent grocery banner groups – IGA, FoodWorks, Ritchies	18.9%	2,140 (35%)	$15 billion	144,267 (57%)	32
Other independent grocery retailers	1.1%	3,291 (53%)			
TOTAL	**100%**	**6,183**	**$74 billion**	**253,100**	

Another measure of retail market concentration in Australia can be gleaned from ABS retail sales data and the annual reports of the two major retailing entities, the Woolworths Limited and Wesfarmers. It shows that these companies take in 40 cents in every retail dollar spent in Australia.

Their dominance is evident in their presence in every major shopping centre, often in several formats, and their growth in markets outside of groceries including general merchandise, electronics, liquor, petrol and gambling. This high level of retail concentration is unprecedented and underscores the need to address the question of creeping acquisitions that, little by little, augment the retail dominance of the two chains.

The role of acquisitions in general and creeping acquisitions in the growth of the major chains is shown by the following chart taken from the recently published report[1] on the ACCC inquiry into the retail grocery sector. In spite of the fact that such acquisitions represent a significant proportion of the majors' market share growth over time the ACCC, in its report, concluded as follows:

> The ACCC considers that such acquisitions do not appear to be a significant current concern in the supermarket retailing industry. Most of the new growth by MSCs in recent years has not come from acquisitions of independent supermarkets. No specific evidence has been provided to show that acquisitions of existing businesses have caused significant competitive detriment in the grocery industry in recent years.

[1] Report of the ACCC Inquiry into the competitiveness of retail prices for standard groceries, ACCC, Canberra, July 2008

Table 19.1 Coles and Woolworths—store openings in the past 15 years

	1993–97	1998–2002	2003–05	2006–07	Overall
Development of a new site	73%	46%	67%	90%	61%
Site previously occupied by a supermarket: Franklins and Action acquisitions	—	21%	13%	—	13%
Site previously occupied by a supermarket: store openings other than the Franklins and Action acquisitions*	27%	33%	20%	10%	26%

*Note: this figure is likely to slightly overstate the level of acquisitions of single independent stores because it includes a small number of acquisitions of small supermarket chains; for example, Woolworths' acquisition of nine Cannons stores in 1996.

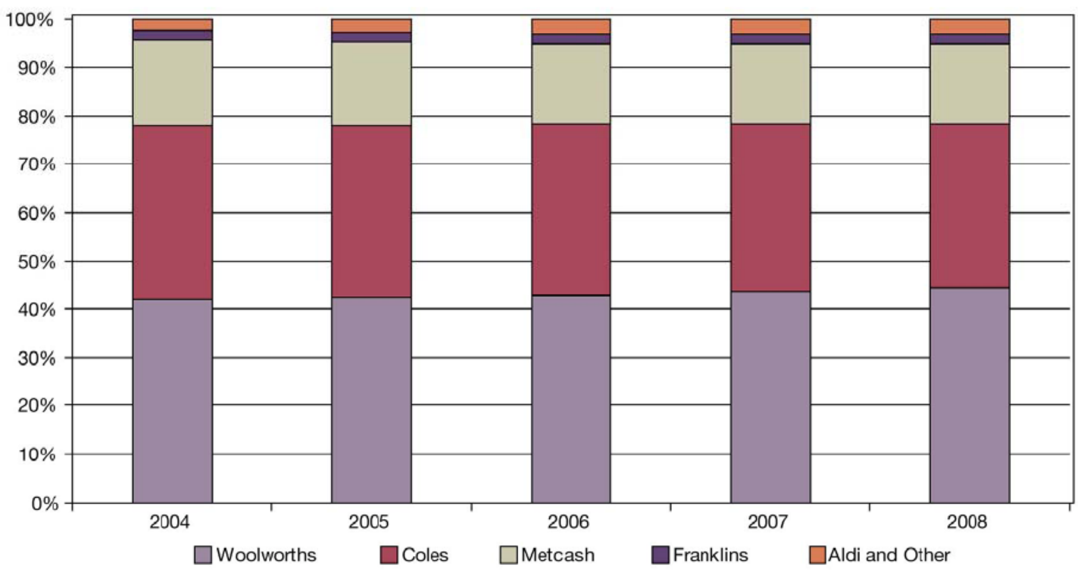
As the above chart shows, acquisitions in the period 1993 – 2007 represent 39% of the growth in the number of sites of major chains, making a substantial contribution to their market share growth over that period. If nothing is done to deter further creeping acquisitions, the practice could resume at a higher rate at any time.

It is surprising to us that, given the clear requirement under S.50 of the Trade Practices Act 1974 (TPA) for the regulator to consider competition issues in national markets, that the ACCC has allowed acquisitions that have led to such a high level of concentration in the retail grocery sector.

The importance of national market concentration cannot be overstated, as the non-majors have to survive and compete in the remaining space. Any further shrinkage of that space has major ramifications for the independent sector at both wholesale and retail levels.

Measuring retail concentration

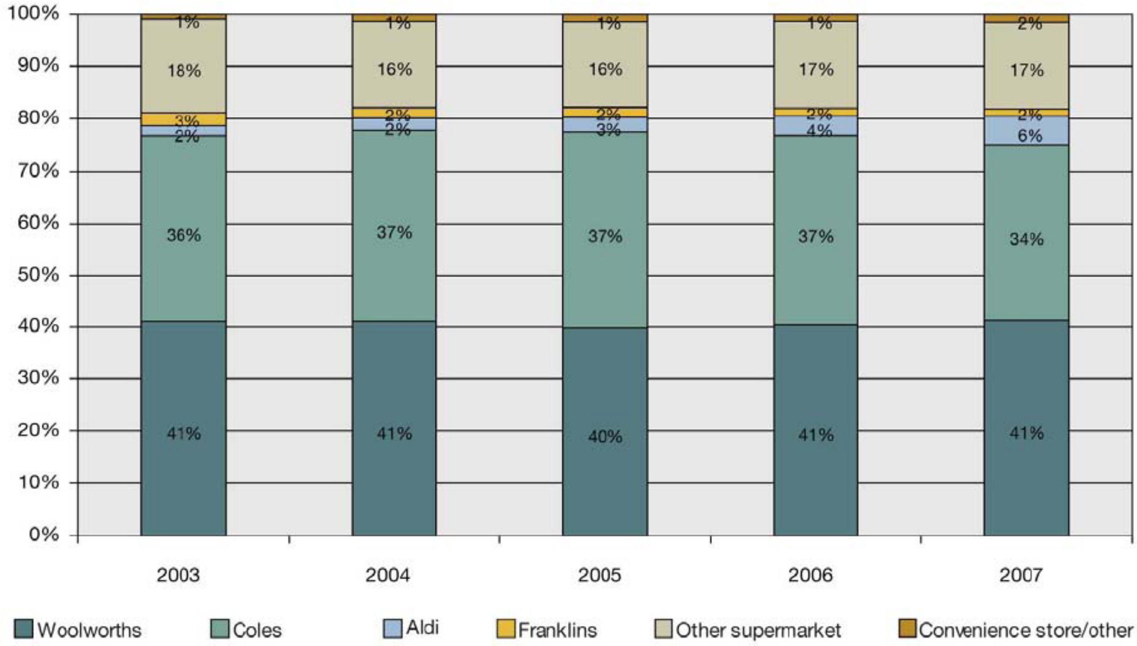
Chart 3.2 Nielsen: retailers' shares of packaged grocery sales (national)



If we look at the analysis of retail grocery market concentration in the ACCC report we find that, in its comparison of market concentration in the Australian grocery sector with that of overseas economies, the ACCC is quite happy to use ACNielsen data whilst in the Australian context that data is ignored in favour of its own unsubstantiated assessment that suggests that the two major chains have a combined market share of around 70% - contrasting with the ACNielsen assessment of around 78-79% as shown by the graph above taken from the report.

The higher market share attributable to the majors is supported by the Roy Morgan research commissioned by ACCC as demonstrated by the chart below:

Chart 3.1 Retailers' shares of grocery sales



Given that the research was based on store visits – i.e. a consumer could report shopping in two or more locations as many do – and the fact that many of the smaller stores do not provide all of consumers' grocery needs, this data underestimates the grocery sales share of the majors. When multiple store visits are taken into account, the two estimates of share show that the majors have close to 80% of the market.

Nevertheless, the ACCC suggests the following:

> The ACCC considers, based on the information available to it, that all the data indicates that packaged groceries is the category most heavily dominated by the MSCs. While 78 per cent represents the highest the share is likely to be, the ACCC considers that it is not likely to be much less. A figure of approximately 70 per cent seems a reasonable assessment.

The 70% figure is unsupported by fact and begs the question that, if Independent supermarkets now have 17% of the market (ACCC estimate) and Franklins and ALDI have a few per cent between them (ACCC estimate) – where is the other 10%?

The report admits a high level of concentration in the sector by suggesting that the major chains have 87% of stores over 2000 sq metres in size and 96% of stores over 3000 sq metres in size (which have the highest turnover). Also ACCC suggests that the sector has a high HHI[2] - even with the reduced estimate of the majors' combined market share:

[2] The Herfindahl index, also known as Herfindahl-Hirschman Index or HHI, is a measure of the size of firms in relationship to the industry and an indicator of the amount of competition among them. Named after economists Orris C. Herfindahl and Albert O. Hirschman, it is an economic concept but widely applied in competition law and antitrust. It is defined as the sum of the squares of the market shares of each individual firm: ie the average market share, weighted by market share. As such, it can range from 0 to 10,000 moving from a very large

The HHI for the retailing of packaged groceries based on this assessment of sales shares is between 2750 and 3000. Although these figures show a high level of concentration in this segment of the retail grocery industry, other factors including barriers to entry and expansion must be considered before any conclusions are drawn on the effectiveness of competition.

It would appear that the ACCC is trying to downplay the market share of the major chains and to find reasons to justify why it has not acted in the past and need not act in the future.

However, if we examine the ACCC's recently revised merger guidelines we find that:

The ACCC considers markets to be 'concentrated' for the purposes of notification when a small number of firms accounts for a large proportion of sales, output or capacity, giving a HHI of greater than 2000. The HHI is calculated by summing the squares of the market shares of each supplier in a market (see paragraph 6.15 for further detail).

Clearly, according to the ACCC's own definition, the market for packaged groceries is concentrated – to a level that requires action on the part of the regulator – a calculation of the HHI using ACNielsen industry data would yield an index of over 3500.

We also find that, according to the ACCC, it has had the power under S50 of the Act to act on development sites and retail leasing as well as the acquisition of retail businesses:

The inquiry has also revealed a misconception held by some industry players that the ACCC can only analyse transactions where there is an acquisition of an existing supermarket business. This is incorrect.

The ACCC considers that leases of sites, acquisitions of leases currently held by other parties and acquisitions of sites that are currently empty or used for other purposes can all be considered acquisitions of assets under s. 50 or other provisions in Part IV of the **Act.**

Given the level of concentration in the sector, it is surprising that this power has not been used more extensively.

The question that now must be asked is whether further concentration in the sector is desirable and, if not, what can be done to address the issue?

(It should be noted here that, although our submission deals with the retail grocery sector, similar problems exist in other markets – liquor, petrol, consumer electronics and hardware – to name just a few.)

Preventing further concentration in the sector

The Treasury discussion paper suggests two approaches to the issue of creeping acquisitions:

An 'aggregation model' which would involve a corporation being prohibited from making an acquisition if, when combined with acquisitions made by the corporation within a specified period, would be likely to substantially lessen competition; or

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amount of very small firms to a single monopolistic producer. Decreases in the Herfindahl index generally indicate a loss of market power and an increase in competition, whereas increases imply the opposite

A new prohibition to S50 in the Act prohibiting a corporation from making an acquisition if it already has a substantial degree of power in a market and the acquisition would result in any lessening of competition in that market.

The latter proposal comes closer to the Dawson concept whereby industries declared by the government to be highly concentrated would have to notify the ACCC of any intended acquisition – and, given the ACCC's recognition of sites and leases as acquisitions, would extend to the establishment of new facilities by the majors.

We see no reason why both models could not operate in parallel. In such a situation, an acquisition notified to the ACCC would be judged, not only on the basis of its impact on competition, but on the cumulative impact of it and prior acquisitions.

We see the current absence in the Act of a notification requirement as a major failure and part explanation of how the growth in market concentration in the grocery sector has gone unnoticed by the regulator.

In the case of concentrated markets that Act could require notification in any market where the HHI has exceeded 2000.

We believe, however, that changes to the Act will not be effective unless there is a corresponding change in the way that the ACCC addresses competition issues under S50.
We refer specifically to:
The tendency to ignore the requirement under S50 to consider the impact on geographic markets - national, state and regional. In the latter case these need to be properly delineated;
The tendency to ignore growing national concentration of sectors and therefore broader impacts on the competitive environment; and
The tendency to find excuses for approval – e.g. suggesting that a vacant lot could, at some time in the future, provide the needed competitive pressure, as was the case in Kalgoorlie.

In the case of local competition we suggest that the use of HHI as a measure of concentration could be augmented by a measure suggested during the UK Competition Commission inquiry into their grocery industry, where it was suggested that an entity's share of the local market could be related to the relative size of its retail space in relation to the total retail space taken up by that sector in the area. Note that here a clear distinction was made between supermarkets as opposed to non supermarket grocery outlets – e.g. convenience stores and other food retailers.

The UK CC suggestion is that should a particular retailer have a share of that retail space of 60% or larger that they would only be allowed to occupy additional space in that locality if they were to divest themselves of sufficient space so as to reduce their share to 60% or less. Such a reduction would occur only if the freed retail space was made available to a competitor.

Whilst the UK CC suggested that such a mechanism be managed under planning law, the ACCC has made it clear that the current form of S50 already gives it the power to act in this way.

Guidelines could be issued in relation to the acquisition of other businesses, leases or development sites that make it clear what the limits are in terms of regional market share expressed in terms of the HHI and in terms of share of retail space.

Summary and recommendation

The independent sector is extremely disappointed with the efforts made by the regulator to date to prevent concentration in the retail grocery sector. The lack of awareness of the issue and of an understanding of the sector is clearly demonstrated throughout the recently completed grocery inquiry and report, as well as by the make up of the GroceryChoice survey and website.

We confirm that there is a need to stop further concentration in the sector and suggest that, as well as appropriate changes to the Act, changes to the knowledge level, attitudes and approaches taken by the regulator are required.

In particular we recommend that:

The Act be amended to require the notification of acquisitions, including acquisitions of sites and new leases, by dominant corporations in a market that is concentrated as determined either by declaration or by exceeding an stipulated HHI.
The Act be amended to require that any acquisitions in such a market include the assessment of the effects of such an acquisition taken together with acquisitions that have taken place over a suitable prior period – to be determined;
That the competition test to be applied be a lessening of competition rather than a substantial lessening of competition, and that acquisitions that lessen competition be prohibited;
That, at the local level, the HHI as a measure of competition in the retail grocery sector be augmented by a requirement that no entity occupies more than 60% of the net retail space used by that sector in that local market and that where a proposed acquisition results in that percentage being exceeded, that the entity be required to divest itself of existing space until its share of retail space is less than the 60% limit.
That a review be undertaken of the practices and culture of the ACCC to ensure that these are no longer a barrier to the proper and diligent application of the competition tests required for acquisitions under the Act.

Yours sincerely

Scott Driscoll
Executive Director