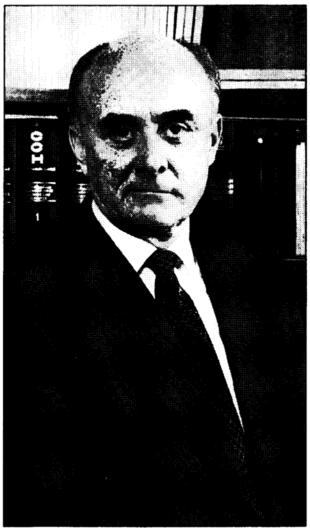
Forum



This speech was presented by Commission Chairman, Professor Allan Fels, at the Supermarket to Asia Conference, Sydney, on 8 October 1997. It discusses the issue of international competitiveness in the context of the Commission's consideration of mergers.[1]

Exports and the Trade Practices Act

The Commission, in its role as the 'guardian' of competition, can guide firms in meeting the challenges of an increasingly competitive international environment.

This is not as widely recognised as it should be, perhaps because of the unfortunate misconception of some firms that the merger provisions of the Trade Practices Act and their enforcement by the Commission hamper the ability of firms to enhance their export development and international competitiveness.

This misconception rests to some extent on the significance of the proposition that mergers are necessary to allow manufacturers to reach a sufficient scale of operations, sometimes as 'national champions', to compete effectively in world markets.

It has been said that there are two competing hypotheses relating to the formation of national champions. On the one hand, there is the proposition that economies of scale, cooperation between competitors and a relaxation of competition laws are necessary to enhance international competitiveness. A competing hypothesis claims that domestic rivalry and a vigorous enforcement of competition law produces more internationally competitive businesses.[2]

Whether you subscribe to one view or the other, the issue of the Commission's involvement is actually not as problematic as you might think. This is because the Commission recognises the importance for firms to achieve international competitiveness, and it administers the merger and authorisation provisions of the Act in a way that is responsive to this.

Critical mass and other benefits from mergers

It is well recognised that mergers can yield significant benefits. These might take the traditional form of internal efficiencies such as economies of scale and scope, or transaction

1 This paper has been prepared with the valuable assistance of Tim Grimwade.

2 This latter hypothesis has gained support from a recent study where empirical research into 32 US food manufacturing industries led to a conclusion that followed the Porter line: namely, that vigorous enforcement of competition laws to maintain effectively competitive domestic industries is likely to positively affect the success of those industries in global markets: Kim D and Marion B, 'Domestic Market Structure and Performance in Global Markets: Theory and Empirical Evidence from US Food Manufacturing Industries', *Review of Industrial Organization*, Vol. 12, 1997, pp. 335–54.

cost savings through vertical integration. Firms may merge in order to achieve a consistent and reliable supply of quality products, or because complementary technology will help advance their exports, or to achieve international distribution synergies. Mergers can also play an important part in the overall 'market for corporate control', in which outsiders who believe they are able to improve the efficiency of a firm are prepared to bid above market values.

The Commission recognises that in a number of cases Australian companies must reach a sufficient scale of operations or 'critical mass' in order to compete effectively in international markets, and in some of those cases they may need mergers and the efficiencies that follow to achieve that critical mass. For instance, a critical mass might be needed if firms face high international cost pressures and they must negotiate with large multinational customers.

However, in some situations, achieving economies of scale does not necessarily equate with being internationally competitive. It may be that, in some industries, firms choose to enhance their international competitiveness by establishing manufacturing operations in export markets; in other industries, for various reasons, barriers to overseas markets may be insurmountable. In such situations, it will be apparent that export opportunities are not available for Australian firms simply by merging.

Guidelines on Exports and the Trade Practices Act

There is a certain lack of appreciation by the business community of the importance the Commission ascribes to claims of efficiencies in mergers, particularly those claimed to be generated by enhanced international competitiveness. This is partly the fault of the Commission in that it has not articulated well its thinking on these issues.

The Commission is proceeding to rectify this, and has prepared a set of guidelines on *Exports and the Trade Practices Act*. These guidelines outline the Commission's approach to collaborative arrangements, particularly mergers and acquisitions, which aim to enhance exports and the international competitiveness of Australian industry. They supplement the Commission's *Merger Guidelines* (revised July 1996).

Importantly, the guidelines look at how the Commission considers international competitiveness factors when it looks at collaborative arrangements between firms, such as mergers and joint ventures. The guidelines include a checklist of issues that firms and their advisers should consider when approaching the Commission to discuss such arrangements that aim to enhance international competitiveness. The guidelines also contain a number of case studies to illustrate the Commission's approach in this regard.

In conjunction with the release of the guidelines, the Commission has nominated its regional directors as 'export contact officers' who can be directly contacted by industry to discuss issues relating to the Commission's treatment of export issues and the guidelines. At the Commission level, the Commission's Deputy Chairman, Mr Allan Asher, who participates in the Supermarket to Asia Council's Working Group on Business Competitiveness, is the nominated Commissioner to handle inquiries relating to export issues and the guidelines.

Before I briefly discuss how international issues are considered by the Commission in merger analysis, as described in the new guidelines, I should give a basic outline to the legislative and administrative framework in which the Commission operates in this area.

Overview of merger review and authorisation

Essentially, the Trade Practices Act provides the Commission with two tiers of regulation of mergers and acquisitions. At one level, the Commission has the role of enforcing s. 50 of the Trade Practices Act which prohibits acquisitions that would have the effect or likely effect of substantially lessening competition in a substantial market in Australia, in a State or in a Territory. At another level, there is a superstructure of provisions (under Part VII of the Act) which enable the Commission to authorise mergers where they would be likely to result in such a benefit to the public that they should be allowed to take place.

A merger is therefore not prohibited unless it is anti-competitive, and, in the Commission's experience, most mergers do not raise competition concerns and therefore do not raise problems under the Trade Practices Act. Since the adoption of the substantial lessening of competition test in 1993 the Commission has considered on average each year about 160 mergers and acquisitions, of which only about eight are challenged by the Commission as anti-competitive. On average, a third of the mergers that are opposed by the Commission are resolved by the parties putting in place alternative arrangements so that the mergers may proceed. In addition, each year the Commission receives about three applications for authorisation of mergers that might otherwise be challenged as anti-competitive. The majority of applications have been successful over the years.

As explained in the new guidelines on *Exports and the Trade Practices Act*, the Commission looks at international competitiveness issues at various stages of its merger and authorisation analysis.

Merger review

The relevant market

First, analysis of competitive effects must, of course, take place within the context of a defined market (which will include all closely substitutable products). The Commission has shown flexibility in this area. In some circumstances, the Commission has found it more practical to define the market as broader than Australia, e.g. trans-Tasman, or even a world market.

The merger factors

Should the level of concentration in the particular market following the merger be of concern to the Commission, it is required by statute to look at various 'merger factors' in order to determine whether the merger would have the likely effect of substantially lessening competition in that market. The most important of these in an international context is the level of import competition. If import competition, or the potential for import competition, is an effective check on the exercise of market power, it is unlikely that the Commission will intervene. In fact, the Commission has not opposed any mergers where comparable and competitive imports have held a sustained market share of 10 per cent or more in the last five years, and as an indicative guideline it is unlikely to do so.

Where a merger raises competition concerns on the demand side of a market, exports can play a similar role in constraining market power of buyers to the role played by imports in constraining the market power of suppliers. If the merged firm buys goods or services from producers in an export industry it will not be able to depress domestic prices below competitive levels if this would result in supply switching to export markets.

When undertaking its merger review process the Commission will consider, amongst other things, the dynamic characteristics of a market, including growth and innovation. Exposure to international competition can have significant implications for the dynamics of a market. For instance, regulatory changes such as tariff reductions or the removal of import quotas can enhance the competitive constraint that imports provide in a market.

Focusing on inputs into exporting industries

The importance of imports (and exports) as an effective constraint on the exercise of market power has underpinned a change of focus in the Commission's approach to mergers and acquisitions. As exposure of the traded sector to the disciplines of international competition has reduced the Commission's concern at the level of domestic concentration in that sector, the focus for merger policy is increasingly in the non-traded sector where the Commission is concerned with ensuring that there is effective competition, particularly in the public utility and infrastructure industries.

Merger regulation in these trade-sheltered industries is critically important to ensure that the trade-exposed sector of the economy has competitive input markets, so as to be able to compete effectively both domestically and internationally. In doing so, the Commission can assist in removing barriers to exports by ensuring, as far as possible, that input costs to exporters are minimised.[3]

Efficiencies

Allowing mergers that substantially lessen competition will result in a decrease in international competitiveness. In light of the increasing internationalisation of world markets, efficient industries in Australia are necessary to ensure that each sector of our industry performs at its maximum capacity. Globalisation has encouraged Australian firms to increase their efficiency in production, distribution and management, and has encouraged innovation.

Like imports, internationalisation of markets can impose constraints on the behaviour of an exporter in its domestic market(s). For example, Australian firms trading with the subsidiaries of multi-national companies in Australia and overseas are unlikely to be able to raise domestic prices following a merger while charging lower prices overseas. Consequently, efficiency gains resulting from a merger aimed to increase international participation may be relevant in assessing the consequences of the merger under s. 50 of the Act.

With declining tariffs, it is more difficult to prevent arbitrage in tradeable products and so the efficiency improvements required to enter international markets are also likely to flow through to domestic consumers (this will not usually be the case where a company enters the international market by establishing a separate offshore operation).

Thus, during its analysis of the competitive effects of a merger, the Commission will consider the issue of efficiencies, which many firms set out to achieve in order to become more internationally competitive. Essentially, where efficiencies impact on the competitive process and make a merger more likely to be pro-competitive, there will be no conflict with s. 50. In this respect, efficiency gains are part of the assessment of competition under the Commission's merger review process.

Traditionally when firms argue that a merger may lead to greater efficiency, this has been regarded as most relevant to a public benefit analysis carried out in respect of applications for authorisation of mergers under Part VII of the Trade Practices Act. The *Merger Guidelines* now expressly recognise that in some circumstances a merger that results in cost and/or dynamic efficiency gains may contribute to improved competition and that this may be taken into account at the stage of considering whether or not a merger is likely to breach s. 50.

Authorisation

However, where there is likely to be a conflict with s. 50, authorisation should be considered by parties to a merger or acquisition. For instance, although there may be cost or dynamic efficiency gains, a merger may also reduce competitive pressures which may cause allocative efficiency to suffer. In such a case, the authorisation process and its public benefit test provide a mechanism under which these conflicting claims can be offset. Put more broadly, the authorisation process provides a mechanism by which various 'trade-offs' that arise in the context of merger analysis can be determined. For example, while a relatively large size may be necessary to achieve economies of scale, it may also lead to a concentration in market power domestically, the exercise of which can lead to losses in efficiency and a reduction in consumer welfare.

The Commission will consider any such trade-offs on a case by case basis.

3 Manufacturing industries are generally substantial users of infrastructure based services: for example, the costs associated with water, power, freight (air, rail, road and sea) and other services constitute between 15 and 25 per cent of the total costs of business within the agri-food industry: Mina G and Gibbons P, *op cit*, p. 15, referring to Prime Minister's Science and Engineering Council, *Food into Asia: The Next Steps*, AGPS, 1994, p. 16.

International competitiveness as a public benefit

Parliament has specifically provided in s. 90(9A) of the Trade Practices Act that a significant increase in the real value of exports and a significant substitution of domestic products for imported goods must be regarded by the Commission as a public benefit for the purposes of determining applications for authorisation of mergers and acquisitions. Further, all other relevant matters that relate to the international competitiveness of any Australian industry must be taken into account. The legislation makes explicit what has been implicit in the Commission's practice for many years.

Therefore, in circumstances where the Commission considers that a proposed merger may breach s. 50 but the proposal appears to have redeeming features, such as producing efficiencies that assist an Australian company to compete in markets overseas, then the Commission will suggest to the parties that they seek authorisation for the proposed merger. This will ensure that the process for assessing any net public benefits is exposed to public scrutiny. The Commission will use its resources to facilitate speedy consideration of such applications.

The authorisation process, as a mechanism that incorporates efficiency considerations, and the Commission's ability to assess efficiencies that impact on the competitiveness of a market under s. 50, make Australian treatment of efficiencies in mergers among the most progressive in the world. Evidence before the recent US Federal Trade Commission Hearings on *Competition Policy in the New High-Tech, Global Marketplace* referred to the Australian incorporation of efficiency considerations in respect of mergers as being more progressive than the United States and the European Union.[4]

Other collaborative arrangements

It should be noted that many of the objectives of mergers may be achieved through other mechanisms which may also fall for examination by the Commission, such as registration of an export agreement with the Commission (under s. 51(2)(g) of the Act) or formation of a consortium or joint venture in respect of export operations.

The Commission's administration of these arrangements reflects a similar appreciation of the needs of Australian firms to compete in a more internationally competitive environment. The Commission's concern with them is that they may provide an opportunity for firms to engage in conduct that has the purpose or likely effect of substantially lessening competition in a market in Australia. Firms should ensure that the operations of export consortia do not impact adversely on the competitiveness of the domestic market, or that, in respect of those that are subject to an authorisation application, there is a net public benefit to such arrangements.

The Commission's approach to these arrangements is also spelled out in the new guidelines.

The international framework

The Commission will take account of the international framework that surrounds any merger or acquisition. This may mean taking account of arguments that Australian firms are competitively disadvantaged in external markets, tariff and non-tariff barriers in export markets, other impediments to export enhancement, and whether the merging firms have historically sought to expand exports by investing in operations in an export market rather than exporting there.

4 Griffin J and Sharp L, 'Efficiency Issues in Competition Analysis in Australia, The European Union, and the United States', Vol. 64, 1996, *Antitrust Law Journal*, pp. 651, 672, referring to 'Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace', Volume 1, A Report by the Federal Trade Commission Staff, *Antitrust & Trade Regulation Report*, Vol. 70, No. 1765, Special Supplement, 6 June 1996, p. S-36.

The Commission can guide businesses that may confront non-tariff barriers to export markets, both directly and indirectly:

- by taking a pro-active role in developing cooperative arrangements with foreign competition agencies in Australia's export markets, it can assist in creating a less restrictive international environment in which Australian firms can compete; and
- as a source of information for domestic firms on competition law issues they may face in foreign markets.

Conclusion

In conclusion, I would like to reiterate that the merger laws and the Commission's administration of them are consistent with enabling Australian firms to realise greater international competitiveness. In this respect, the Commission's thinking is outlined in the new guidelines on *Exports and the Trade Practices Act*. I hope that this publication can further clarify how the Commission can guide Australian industry to meet the challenges of an increasingly competitive international environment.

Benchmarks for dispute avoidance and resolution

The Commission receives many complaints from small businesses, particularly those in commercial relationships with larger businesses in franchise, retail tenancy and supply type arrangements. Its belief that many of these issues are best dealt with by the businesses themselves led to the formation of a round table on small business dispute avoidance and dispute resolution.

As a totally voluntary initiative the round table was formed in 1996 with representatives of:

- small and large businesses;
- the Commission's Small Business Advisory Group; and
- alternative dispute resolution specialists.

The work of the round table and its smaller task groups centred on making the business case for embedding dispute resolution practices in everyday operations, for using alternative dispute resolution processes when disputes arise and for developing benchmarks for both dispute avoidance and dispute resolution.

The round table found a strong business case for implementing and using dispute resolution practices, and using alternative dispute resolution mechanisms. It found that this approach:

- brought cost savings by preventing management focus from being diverted;
- meant that disputes could be dealt with quickly and the process controlled by the parties themselves;
- represented an overall less costly form of settling disputes;
- acted as a compliance/risk avoidance mechanism for businesses to avoid contravention of the unconscionable conduct provisions of the Trade Practices Act;
- encouraged business people to develop business solutions to business problems;
- allowed for more creative remedies and outcomes compared with litigation;
- provided a self-regulatory approach to dealing with disputes;
- reduced the risk of bad publicity flowing from disputes and concomitant low morale;
- provided the benefits of confidentiality that most dispute resolution processes provided;