

The ACCC's concentration thresholds for mergers

Introduction

The Commission assesses mergers under s. 50 on a case by case basis. However, as a guide to business, the Commission's *Merger Guidelines* include concentration thresholds which establish 'safe harbours' indicating the levels of concentration below which there is unlikely to be any concern at all. These are where:

- the market share of the merged entity is below 40 per cent; and
- if the market share of the merged entity is above 15 per cent, the combined share of the four largest market participants after the proposed merger is below 75 per cent.

A concentrated market is a necessary but not sufficient condition to enable the exercise of market power. The purpose of a concentration threshold is to identify levels of concentration below which the Commission would be unlikely to take any further interest in a merger. It is the starting point for an analysis of the likely effect of a proposed merger.

Industry Commission suggested thresholds

In its June 1996 information paper, *Merger regulation: A review of the draft merger guidelines administered by the Australian Competition and Consumer Commission*, the Industry Commission suggested that the Commission examine the implications of raising existing thresholds which indicate 'safe harbours' where mergers can proceed without further examination by the Commission. The IC suggested that there would be merit in lifting

the threshold market share of the merged entity to 50 per cent, and lifting the critical combined share of the three largest participants to 75 per cent with the merged entity having 20 per cent of the market or more.

The Commission undertook to conduct a review of all mergers completed in the 1996–97 financial year to identify the number which triggered its current thresholds compared with the number that triggered the thresholds suggested by the IC.

It also committed itself to conducting a qualitative review of those mergers which triggered its existing thresholds but did not trigger the alternative thresholds. The review would assess the degree to which those matters falling between the two thresholds may have warranted investigation, that is the extent to which there may have been a reasonable basis for considering whether such acquisitions might be likely to substantially lessen competition. The Commission agreed, consistent with commercial confidentiality, to publish that review.

The Commission has already complied with the first part of its commitment. A total of 202 matters were notified to the Commission during the 1996–97 financial year. Of those matters that were completed, 84 triggered the Commission's current thresholds and 77 triggered the IC's suggested thresholds. This information will shortly be published in *The ACCC's approach to mergers: A statistical summary*.

Analysis of matters which fell between the two sets of thresholds

The Commission went further than its second commitment because its qualitative review of merger matters extended beyond the end of the 1996–97 financial year. Table 1 lists the eight matters completed between the start of the 1996–97 financial year and the present which fell between the two sets of thresholds.

Table 1: Mergers matters completed since the start of the 1996–97 financial year which triggered the ACCC’s concentration thresholds but not the IC’s suggested thresholds

Matter	Market	ACCC decision
St George/Advance Bank	Retail banking in NSW, SA and ACT	Did not oppose
IAMA (Qld)/Primac	Retail market for rural merchandise in Queensland and northern NSW	Did not oppose
Sigma Pharmaceuticals/ Andrews Laboratories/ Guardian retail banner	Wholesale supply of pharmaceuticals in NSW	Did not oppose
North Suburban Taxis/ Services of Silver Top Taxi Service radio room	Provision of taxi radio despatch services in the Melbourne metropolitan area	Proposal did not proceed for commercial reasons. No decision
North Suburban Taxis/ Services of Black Cabs radio room	Provision of taxi radio despatch services in the Melbourne metropolitan area	Did not oppose
HJ Heinz/Southern Country Foods	Production of canned meals/‘hot packs’	Did not oppose
Westpac/Bank of Melbourne	Transaction accounts — Victoria Deposits — Victoria Small business banking — Victoria Home lending — National Credit cards — Victoria Personal loans — Victoria	Opposed initial proposal, concerns resolved with s. 87B undertakings
Confidential proposal		Proposal did not proceed for commercial reasons. No decision

A qualitative analysis of the key factors for each merger and a brief assessment of whether each was worth investigating follows.

St George/Advance Bank

The merger resulted in the formation of the largest regional bank in Australia, although its total assets were less than half of the total assets of the smallest of the major Australian banks. Before the merger, Advance was strongest in New South Wales, South Australia and the Australian Capital Territory. St George was strongest in New South Wales.

Regional banks impose a strong competitive constraint on the rest of the participants in the banking sector. In the absence of the merger, both parties were likely to have been takeover targets for the four major banks or a foreign bank.

The Commission ascertained in its inquiries that the proposed merger appeared not to raise any significant competition concerns. Rather, it appeared to put the merged entity in a position to compete more vigorously with the four major banks, because of its increased capital base and geographic spread.

This transaction was one of several in the industry and occurred about the same period as other market participants rationalised their operations. The banking industry is very important commercially and sensitive to small business and consumer groups. The Commission has a responsibility to investigate acquisitions in vital sectors of the economy. The financial sector is one such industry.

IAMA (Qld)/Primac

IAMA was a specialist rural merchandise retailer with 137 retail outlets across Australia including 30 in Queensland and the North Coast of New South Wales. Primac was a Queensland based diversified rural service company with 59 rural merchandise retailing outlets in the relevant region.

The three major areas of rural merchandise were fertiliser, agricultural chemicals and animal health products. The merged entity would have had a market share of more than 40 per cent for sales of all three products.

Barriers to entry appeared to be significant but not insurmountable. Other rural merchandise retailers such as Wesfarmers Dalgety and Elders offered a competitive force in the marketplace.

There is a significant independent retail sector operating in the Queensland and North Coast NSW area. Many independent rural merchandise retailers are members of buying groups which seem to be becoming increasingly important.

The Commission decided that it would closely monitor any further moves to increase concentration in rural merchandise retailing with particular regard to agricultural chemicals and animal health products.

Because of the importance of the retail outlets of the form run by the parties, especially in outlying rural areas, the Commission considered that the acquisition was an important one to investigate, to ensure the interests of primary producers would not be affected detrimentally by the acquisition.

Sigma Pharmaceuticals/Andrews Laboratories/Guardian retail banner

Sigma was a major wholesaler of pharmaceuticals which operated in most Australian States. Andrews was a NSW-based pharmaceutical wholesaler, offering only a limited range of pharmaceutical products to pharmacists. Guardian was an association of about 220 retail pharmacists which traded under that banner. Before this acquisition, these retail pharmacists were independently owned but formed a loose alliance to gain the benefits of being part of a banner group.

Despite triggering the thresholds in the Commission's *Merger Guidelines*, the merged entity would have only 15 per cent of the market for pharmaceutical wholesaling in NSW, significantly smaller than either of the two main participants in the sector. The Commission considered that on this basis the acquisition was unlikely to substantially lessen competition.

The Commission would have been interested in examining this acquisition even if the parties had not approached it. In recent years in the pharmaceutical wholesaling industry the Commission has opposed Faulding's acquisition of QDL. It also had serious concerns about Sigma's proposed acquisition of QDL's Victorian operations, concerns which were resolved with the aid of s. 87B undertakings.

North Suburban Taxis/Services of Silver Top Taxi Service radio room

No qualitative analysis was conducted by Commission staff at the time of the proposal because the proposal was withdrawn by the parties almost immediately.

Even if the parties had not initially made the approach to the Commission, it is likely that the Commission would still have wanted to consider the proposal. This was potentially an important matter for the Commission to examine, especially considering that it had previously opposed North Suburban's proposed merger with Silver Top and also subsequently denied authorisation for the same transaction.

North Suburban Taxis/Services of Black Cabs radio room

This proposal also followed previous attempts by North Suburban to merge with Silver Top Taxi Services Ltd, which was opposed by the Commission and for which authorisation was not granted. North Suburban sought to acquire communication services from Black Cabs for a monthly fee, based on the number of North Suburban taxis accessing the service.

Black Cabs would handle the communications business of North Suburban in conjunction with its own booking communications business, using its existing facilities. North Suburban considered the arrangement to be a cheaper and more efficient alternative to upgrading its own obsolete radio communication network to a computer system, which has become the industry standard. It was, in effect, a de facto merger.

During the Commission's market inquiries, taxi drivers and other competing taxi depots expressed concerns that such an arrangement might ultimately lead to a de facto acquisition of North Suburban by Black Cabs. The Commission accepted that North Suburban and Black Cabs would be maintained as separate business entities, and was satisfied that the arrangement would not substantially lessen competition.

Given the concern the Commission had with the proposal and also given its previous concerns about North Suburban's attempts to merge, it was entirely expected that the Commission would investigate this matter thoroughly.

HJ Heinz/Southern Country Foods

Both companies operated in a variety of food manufacturing activities within Australia. Heinz specialised in products such as baby foods, canned baked beans and spaghetti, and soups. Southern Country Foods produced a range of canned meals under the Tom Piper brand name for the Australian market, and canned meat products for export.

Barriers to entry to the industry appeared to be quite high, especially given the maturity of the

market and the lack of opportunity for substantial growth. The parties also stated that there was little scope for imported products to make much of an impact.

The acquisition would make the merged entity the largest producer in the market for canned meals/'hot packs'. Although both parties operated in the same market, they specialised in different sectors of it. Heinz concentrated mainly on soups, baby foods, and canned baked beans and spaghetti while Southern Country made meals for consumption on their own rather than as snacks. The Commission considered that, as there was little competitive overlap between the types of products sold by each party, it was unlikely that the acquisition would result in a substantial lessening of competition. It noted that Heinz would replace Southern Country Foods as a vigorous competitor in the market where there were a number of strong competitors including Kraft, Campbells and Simplot.

This matter was of interest to the Commission, and to the parties as well as their legal representatives, because the market definition was uncertain. In cases such as this, it may be unclear whether the thresholds are breached, depending on the market definition adopted.

Confidential merger

Because details of the parties concerned are still confidential, the Commission cannot name the parties involved or the relevant industry. However, the Commission can make public a few facts about the proposed acquisition. For instance, the merged entity would have had a market share of 35 per cent and the four largest firms together would have accounted for about 75 per cent of the relevant market. Thus the acquisition would have just triggered the Commission's existing thresholds.

This proposed acquisition would have taken place in an industry undergoing a substantial amount of rationalisation, and also one in which the Commission has had serious competition concerns with previous acquisitions.

Given these factors, the matter was one the Commission saw as important to examine.

Westpac/Bank of Melbourne

This matter was resolved in July 1997 with the aid of s. 87B undertakings.

Westpac Banking Corporation and the Bank of Melbourne announced their proposed merger on 15 April 1997. The Commission subsequently conducted comprehensive market inquiries in the banking industry, particularly in Victoria. It found that the merged bank would compete in a number of discrete product markets with their own geographic market dimensions. It identified the following distinct product markets:

- deposits;
- home loans;
- personal loans;
- small business banking;
- credit cards; and
- transaction accounts

While the Commission considered there was unlikely to be a substantial lessening of competition in most of these product markets, it concluded there was significant risk of the exercise of coordinated market power in the transaction accounts market in Victoria post-merger. In this market, the proposed merger triggered the Commission's threshold but not the IC's suggested threshold.

Transaction accounts are everyday banking accounts, used to withdraw and deposit cash, receive salary and social security payments, pay cheques, etc. They are accessible at bank branches and usually by phone, ATM, EFTPOS and, increasingly, other electronic channels such as PCs (personal computers) and the Internet. Typically, transaction accounts earn much lower rates of interest and attract account keeping and transaction fees. They include statement, passbook, cheque and school savings accounts. Unlike some of the other product markets considered, the geographic market is relatively local, reflecting customer dependence on local branches or ATMs. Accordingly, the Commission adopted a State-based geographic market.

Among other things, the Commission took account of:

- a lack of constraints to the merged firm arising from imports;
- high barriers to entry to the market;
- lack of countervailing power; and
- a history of vigorous and effective competition from Bank of Melbourne.

Accepting that the merger was likely to result in some efficiencies, the Commission assessed whether, post-merger, incentives existed to compete or to engage in coordinated pricing behaviour. It found several factors in the market facilitating coordination or price leadership, including:

- a history of regulation, price and quantity controls;
- four relatively evenly sized participants with similar interests;
- inelastic demand for transaction accounts;
- interest rates provide an easily identifiable single price for an essentially homogeneous product; and
- interest rates are public and easily monitored.

Without an independent Bank of Melbourne, which prided itself on 'cutting the cost of banking', the Commission considered that charges for retail transaction account services could well rise above full cost recovery levels as a consequence of price coordination by the few remaining competitors in the Victorian market.

The Commission formed the view that competition was likely to be substantially lessened in the Victorian transaction accounts market. But the parties offered undertakings under s. 87B of the Trade Practices Act that sufficiently alleviated the Commission's concerns in that regard. Consequently, the Commission decided not to oppose the proposed merger between Westpac Banking Corporation and the Bank of Melbourne.

The Westpac/Bank of Melbourne merger shows clearly that an important merger can fall beneath the IC's proposed thresholds and yet

still raise serious competition concerns. The merger in question also caused considerable concern among consumer groups. But if the Commission had adopted the IC's suggested thresholds, the merger would have proceeded without any action by the Commission at all.

Conclusions and future directions

As discussed, the Commission identified eight merger matters completed between the start of the 1996–97 financial year and the present that fell between its thresholds and the IC's suggested thresholds. Of these, six were assessed by the Commission and two withdrawn for commercial reasons before the Commission could consider them. The Commission drew the following conclusions from its qualitative review of the eight matters.

- While there are a few more matters that triggered the Commission's current thresholds than the IC's suggested thresholds, the difference was still minor compared with the total number of matters considered during the course of the 1996–97 financial year. The Commission has no direct control over whether parties to a proposed merger approach it for advice.
- The key issue is whether the matters in question were worth investigating. In some cases, the answer is an unequivocal yes. In some others, the answer is more problematic. But if it had been the case that they were not worth investigating, that would have been something which could be ascertained after an investigation had begun. Of the eight which fell into the relevant category, each one was worthy of investigation by the Commission, for one or more reasons.
- Often it will be unclear whether a proposal triggers the Commission's thresholds because the definition of the market is itself unclear. Frequently, the Commission is interested in examining the issue of market definition. Just as often, the parties themselves raise matters with the Commission because they are uncertain about whether the Commission will opt for a narrow or wide interpretation of the market. Changing the thresholds may have

little impact on the number of matters raised with the Commission.

- There are varying amounts of information that can be reported on the matters listed. This is because the length and the intensity of the Commission's investigation is tailored to the degree of concern expressed in the marketplace and relates specifically to the issues raised in the merger. Where the Commission considered that there was unlikely to be a substantial competition issue in the merger, it was able to advise the parties quickly that it would not take any further action.
- Of the six matters that were assessed, three were considered by the Mergers Review Committee within the Commission. This allowed those matters to be expedited because they raised no significant competition issue.
- The 'regulatory costs' imposed on those parties directly by the Commission's processes were quite minor.

Even where a proposal triggers the Commission's thresholds, the Commission will examine further details relevant to the proposal and also the characteristics of the market. Market concentration alone is not enough to enable a merged entity to exercise market power, or to cause the Commission to oppose a proposed merger. The Commission cannot provide an exhaustive list of industries where it is most likely to be concerned about a merger proposal. But the *Merger Guidelines* stand as a guide to the issues that are most relevant.

The Commission concluded that, given:

- the small number of mergers which fell between the two thresholds;
- the small regulatory cost to most of the parties involved; and
- its concerns with at least one major merger falling between the two thresholds,

it is not convinced that a change to its thresholds is warranted. The Commission will continue to collect information against both thresholds. Until it has more conclusive evidence, the Commission will continue to use its current thresholds.