Forum

Retail, groceries and food: an ACCC perspective

Following is the edited text of a speech given by Commission Chairman, Professor Allan Fels, to the Food and Grocery Council 11 May 2002.

Professor Fels first outlined how various parts and sections of the Trade Practices Act applied to the grocery industry. He then provided a list of examples of Commission action against anti-competitive practices under ss. 45 and 46 of the Act. The text below is largely on the Commission's approach to codes of practice and mergers and acquisitions in the grocery industry.

Codes

Of great relevance to food processors has been the development and implementation in the past two years, of the Retail Grocery Industry Code of Conduct—a voluntary code established between primary producers, processors, wholesalers and retailers of grocery items. The code's aims included creating clear ground rules and greater transparency of terms and conditions, clarifying and standardising requisite standards of products and establishing fairer mediation and dispute resolution processes through an independent ombudsman.

Mechanisms connected with the code have not produced instant results, but there are promising signs. The Commission is working closely with the ombudsman on various types of complaints and examining how some of the processes under the code—for example, threats of victimisation against complainants—can be overcome.

Consistent with the Commission's approach to codes in other sectors, we believe the retail grocery code can be a useful framework for addressing issues of concern between parties in the supply chain.

In the grocery industry the supply chain includes distribution and retailing through banner groups. Although some in the industry may disagree with the approach of the Commission, we regard most banner groups as franchises. This provides the basis for light-handed regulation, through the mandatory Franchising Code of Conduct, to prescribe the disclosure of information to franchisees and a process of mandatory mediation to resolve disputes.

The Franchising Code of Conduct is strongly supported by most participants in the broader franchising industry.

There are voluntary codes that the industry subscribes to such as the Price Scanning Code of Conduct and the Fruit Juice Code (for labelling and content). The Commission supports the use of codes of conduct and industry self-regulation.

Section 50

Section 50 generally prohibits mergers or acquisitions that would substantially lessen competition.

As background, in 2000–01 we considered 265 mergers, assets sales and joint ventures. Of these, the Commission objected to 13 on the grounds they were likely to substantially lessen competition; 10 later proceeded after parties signed s. 87B undertakings to eliminate anti-competitive effects. The remaining three were withdrawn.

Recent examples of mergers approved by the Commission include:

- Bunnings and BBC Hardware
- Toll and Lang's acquisition of National Rail/ Freight Corp
- the Grain Pool of WA and Cooperative Bulk Handling Authority
- Suncorp/Metway and AMP/GIO

- the acquisition of Wreckair Hire by Coates
- Mayne's purchase of Faulding
- the Commonwealth Bank's acquisition of Colonial.

The fact is that the Commission opposes fewer than 5 per cent of mergers notified to it, and opposes no merger proposal for which imports make up 10 per cent or more of the market on a sustained basis. Moreover, the Commission has not opposed any merger in the past decade for which import competition is significant.

After undertakings by SPC Limited, the Commission did not oppose its merger with Ardmona Foods Limited. Although the merger resulted in an entity having 90 per cent market share in the deciduous canned fruits market, we considered that low import barriers made the market highly contestable to imported product. In coming to this conclusion, the Commission took special care to consult with, and weigh the comments of, parties likely to be most affected.

That said, mergers resulting in a substantial lessening of competition are prohibited. Most recently the Commission opposed the proposed merger between Australian Pharmaceutical Industries Limited and Sigma Company Limited.

However, the example closest to home for you would be the sale of the 287 supermarkets making up the Franklins chain.

At the time, the Commission accepted that the Franklins business was in rapid decline, and that the withdrawal of key stakeholder support was imminent. Our primary concern was that a collapse of the chain would see the bulk of stores go to the major supermarket chains, and fewer stores available for independents and new entrants.

That is, not acting and refusing to countenance a merger would have increased concentration and reduced competition.

The Commission agreed to the sale of 200 stores to independent retailers, and a maximum of 67 stores being sold to Woolworths. Independents were offered around two-thirds of the total sales value of the Franklins stores.

Approval of the agreement was conditional on the parties to the acquisition providing the Commission with enforceable undertakings to transfer designated stores to independent chains. In addition, to address concerns about local competition, the Commission required the divestiture of some Woolworths stores.

You will be aware of proposals that current merger law should be relaxed to allow so-called 'national champions' to be developed. These would be firms achieving the critical mass to generate economies of scale and scope to enable them to compete internationally. Some segments of business are arguing that merger law is working to drive firms offshore, the so-called branch office economy syndrome.

However, it is important to note that obstacles to export growth may face industry participants of all sizes.

Size is often not necessary to enhance the ability to compete on world markets. Domestic rivalry rather than national dominance is more likely to breed internationally competitive businesses.

However, when firms merge to enhance exports, domestic prices may rise to the point of import parity, and product is exported at a lower price. And it is highly likely the national champion will subsidise exports by using new-found market power to increase domestic prices.

Ultimately, Australian consumers and industry may be forced to pay a higher price to underpin the merged entity's export sales.

I believe that a weak or compromised merger policy in response to national champion arguments could damage the international competitiveness of Australian firms.

The prevention of anti-competitive structures fosters a more efficient, resilient and responsive domestic economy. This leads to more efficient and lower costs for Australian exporters and import competitors. Competitively supplied inputs are essential for the health of domestic industry.

Rejecting the idea of a national champion, should we then go on to conclude that we should cap the market share of individual firms? I know that proposals have been made to cap market share, most prominently in the Baird Committee report of 1999 *Fair Market or Market Failure*.

What complicates the issue is that there are at least three measures for defining market share.

The market may be supermarkets and grocery stores, including convenience stores of petrol stations—in effect, retail groceries. It may be those stores plus liquor retailing stores and fresh produce and bakery outlets. This measure may be further expanded by the addition of take-away food outlets. The end result is that major retail chains such as Woolworths and Coles can vary their

combined market share from about 50 to just over 70 per cent, depending on the measure. The Baird Committee noted that there are measures that give an even lower percentage.

At the time of the Baird Committee hearings, the National Association of Retail Grocers of Australia called for a market cap for the major retail chains of 25 per cent each. In comments I made to the Baird Committee I outlined a potential but serious problem for consumers if the cap caused a high cost and inefficient retailer in a particular location to be protected or established. For example, a cap would have meant that, say, Coles or Woolworths would have to sell an existing outlet if they entered and competed in a new market. Ironically, a protective cap could inhibit the sale of an independent outlet by an operator who, for genuine reasons, wants to exit the market by selling to a major retail chain.

When combined with definitional difficulties, these factors cause problems of consistency in both approach and policing. On this, I note that the Baird Committee also recognised the difficulties inherent in the adoption of a market cap approach.

I, too, acknowledge that this is a difficult business. Therefore, to ensure dependability and fairness in process, the Commission applies the Act in a steady fashion. Our approach is to avoid a predetermined view of the dimensions of the market, but to examine closely the circumstances of each case and apply defined criteria. This process, I believe, generates coherent and consistent results. And it protects the dynamic operation of the market and the gains that can be had from competition more effectively than applying a policy that fixes levels of market share.

Report to the Senate on prices paid to grocery suppliers

I would like to comment on the utility of a code of conduct for the grocery industry and on the concept of a food chain.

A particular code I would like to mention is the Retail Grocery Industry Code of Conduct and the accompanying Retail Grocery Industry Ombudsman Scheme. This voluntary code was introduced in September 2000 and, after a settling-in period, it is emerging as a useful mechanism to reduce disputes in vertical supply arrangements.

The fresh fruit and vegetable growers are now looking to this code to help them achieve more transparency in the conditions and specifications that apply under their terms of trade.

Growers consign their produce through various supply routes including those to cooperatives, to processors, to metropolitan markets, direct supply to grocery outlets and to export markets. The complex variables that interact between the farm gate and the consumer require careful assessment—and improved transparency in business dealings and clarity in terminology is welcomed. I look forward to the day when the industry can finally settle on the distinction between merchant and agent.

Because prices paid to grocery suppliers was the subject of a reference from the Australian Senate, and we have not yet made our report, I am constrained in what I can say here.

But it is appropriate for me to discuss in general terms some of the issues that arose in the course of the Commission's work.

The Senate ordered the Commission report on the prices paid to suppliers by Australian grocery retailers for the goods they re-sell, and whether retailers and wholesalers of a similar scale, as customers of suppliers, are offered goods on like terms and conditions. Price, for the purpose of the inquiry has an expanded meaning and really means terms of trade or price support, not the individual price of a particular product.

In attempting to oblige the Senate, the Commission assessed the price difference in the market. This was based on a sampling of key suppliers and major retailers. We worked to determine:

- the extent of any price differences
- the impact of any such price differences on competition in the relevant markets
- whether there is public benefit in having price differences.

It is generally accepted that grocery suppliers operate from a price list and offer standard discounts to buyers at the wholesale point in the supply chain.

This produces a net price. What is of key concern to independent wholesalers is that there are additional discounts and rebates that are usually tied to promotional support of a supplier's product. This produces a 'net net' price. Some argue that not all buyers are assured of getting the same 'net net' price.

To understand more accurately the pricing behaviour of industry, the Commission surveyed 50 major suppliers and seven major buyers.

Specifically, for the period 1999–2000 to 2000–01, responses were sought on the total annual funding support and total annual gross sales for the top ten buyers (information was also sought on a per product category basis). In addition, participants were surveyed on the form of all funding support—including investment buying, case deals and deferred and off invoice terms and allowances. As a result, the Commission was able to determine total support funding as a percentage of gross sales.

Some suppliers argue that when the funding support for the independent wholesalers and the independent retailers is combined the result is much the same as price reductions offered at the single contact point of the major retail chains.

Independent wholesalers have argued that overall funding support should be governed by the 'general principle of like terms for like customers'. They argue that there should be no price discrimination at the upstream point of supply—otherwise the major retail chains will have a price advantage that may produce anti-competitive outcomes.

I am aware, however, that other sections of the grocery industry make the important distinction that the principle is better expressed as 'like terms for like performance'.

The senate order expressed the principle as 'like terms for customers of a similar scale'. At its simplest level what is suggested here is that a central distribution store at the wholesale point in the chain should receive groceries at the same price as a distribution point of a comparable size.

Our impression was that, allowing for obvious factors such as quantity buys (or volume) and regularity in ordering, the grocery industry focuses more on the promotion or presentation of the product at the retail point of sale. Suppliers are prepared to offer additional price support to buyers when they get a service from the buyer. By service, I mean that the buyer will promote the product in a clean and prominent location that attracts consumers.

At the wholesale point in the supply chain, suppliers do not want to see extended periods of warehouse storage of their products or excessive handling in getting the product to the consumer, but beyond that, the size of the warehouse does not appear to be the main impetus in the provision of a more favourable price. To that extent we may have a different view to that contained in the Senate order as to whether the principle they espouse is the most appropriate in explaining what motivates pricing.

Our intention is to respond to the Senate, formally, fully and quickly.

Review of the Trade Practices Act

The Government has recently announced details of a review of the competition provisions of the Act—a consequence of a commitment made by the Prime Minister during the 2001 election campaign. The purpose of the review is to establish if the provisions:

- continue to encourage an environment where Australian businesses can grow and compete internationally
- protect the balance of power between small and large businesses
- support the growth of businesses in regional Australia
- deal fairly with the affairs of individual consumers.

In discussing the review the Prime Minister stated that trade practices legislation was needed to promote effective competition.

The review provides the opportunity to test the arguments of those proposing change to the Trade Practices Act in a transparent manner. In particular, the review will provide those who argue for a change to merger law, or to the Commission's processes, to advance and substantiate their case.

The Commission's view is that the current mergers law works to competitive and public benefit, and that there is no coherent case for a weakening of merger provisions.

In fact, the Trade Practices Act has been recently amended to take specific account of business in regional areas. This means the Commission can now consider a substantial market in regional Australia when applying the mergers and acquisitions test. I believe this is critically important because the Commission can now assess the impact of mergers in smaller, but significant regional markets.

That said, I understand that sometimes people have a different view of life to the Commission's. I therefore welcome the opportunity the review provides to have these important matters openly discussed.