AUSTRALIAN FOOD & GROCERY COUNCIL

AFGC SUBMISSION

Competition Review | Merger Reform Consultation Paper

29 Jan 2024

PREFACE

The Australian Food and Grocery Council (AFGC) is the leading national organisation representing Australia's food, beverage and grocery manufacturing sector.

With an annual turnover in the 2021-22 financial year of $144 billion, Australia's food and grocery manufacturing sector makes a substantial contribution to the Australian economy and is vital to the nation's future prosperity.

The diverse and sustainable industry is made up of over 17,000 businesses ranging from some of the largest globally significant multinational companies to small and medium enterprises. These businesses contributed to an industry-wide $3.2 billion capital investment in 2021-22.

Food, beverage and grocery manufacturing together forms Australia's largest manufacturing sector, representing over 31 per cent of total manufacturing turnover in Australia. The industry makes a large contribution to rural and regional Australia economies, with almost 40 per cent of its 271,000 employees being in rural and regional Australia.

It is essential to the economic and social development of Australia, and particularly rural and regional Australia, that the magnitude, significance and contribution of this industry is recognised and factored into the Government's economic, industrial and trade policies.

Throughout the COVID19 pandemic, the food and grocery manufacturing sector proved its essential contribution to Australian life. Over this time, while our supply chains were tested, they remain resilient but fragile.

The industry has a clear view, outlined in Sustaining Australia: Food and Grocery Manufacturing 2030, of its role in the post-COVID19 recovery through an expansion of domestic manufacturing, jobs growth, higher exports and enhancing the sovereign capability of the entire sector.

This submission has been prepared by the AFGC and reflects the collective views of the membership.

INTRODUCTION

The Australian Food and Grocery Council (AFGC) welcomes the opportunity to make a submission to The Treasury in response to the Competition Review Merger Reform Consultation Paper.

This brief submission is presented in two parts:

1) General comments on competition, and
2) Comments relating to mergers in the food and grocery retail sector.

The AFGC recommends the government to:

- consider broader market dynamics in the evaluation of mergers. While economic data and market concentration figures provide a valuable metric, a comprehensive understanding of the likely non-price effects resulting from a party with significant market power acquiring businesses in the same or related markets is equally critical.
- require merging parties to disclose critical negotiating dynamics with suppliers to ensure transparency and discourage unfair practices. Furthermore, in instances of mergers involving companies wielding significant market power, government should engage with other market participants to assess whether the merged entity should provide an undertaking to address concerns related to unfair practices.
- consider the cumulative impact of acquisitions by a party with significant market power, especially in related or adjacent markets to address the potential impact of creeping acquisitions.
- undertake post-merger market studies to assess the competitive landscape, identify potential areas of concern, and enhance insights for future mergers and acquisitions, particularly in highly concentrated markets.

GENERAL COMMENTS ON COMPETITION

The food and grocery manufacturing sector is a vital component of the Australian economy, contributing significantly to employment, and the overall well-being of Australian consumers. The AFGC supports the overarching policy objective of Australia's merger control regime, which aims to promote competition that enhances the welfare of Australians. A robust and effective merger control regime is crucial to foster a competitive environment, which, in turn, benefits consumers, encourages innovation, and contributes to the overall dynamism of the economy.

Increased competition is undeniably beneficial for the economy. It not only leads to fair prices, higher quality, and consumer choice but also serves as a catalyst for economic growth. Competition drives increased investment, encourages research and development, and promotes innovation. In a competitive market, businesses are motivated to constantly improve and differentiate their products and services, driving overall economic growth. Therefore, any reforms to the merger control process should be geared towards enhancing competition in the Australian marketplace.

The AFGC supports changes to the merger notification and review process, as these adjustments will alleviate uncertainty for market participants across the supply chain of the merging parties. However, we emphasise the importance of ensuring that any modifications result in an efficient and effective merger control regime. The primary objective should be achieved at the lowest cost possible and in a timely manner. Additional regulatory impost or increased costs could potentially undermine economic dynamism and influence investment decisions, hindering the overall competitiveness of the sector, both locally and globally.

COMMENTS RELATING TO MERGERS IN THE FOOD AND GROCERY RETAIL SECTOR

Australian food and grocery manufacturing faces the challenge of selling into one of the world's most highly concentrated retail markets. With approximately two-thirds of the market controlled by just two major supermarkets, these dominant players wield a significant asymmetric bargaining power over suppliers. Moreover, due to the substantial entry costs, incumbent supermarkets face minimal threats from potential rivals or broad substitutes, thus reinforcing their dominance in the market.

In recent years, major supermarket retailers have engaged in a significant number of mergers and acquisitions, emphasising their strategic objectives to bolster integration, both vertically and horizontally, and extend their reach into adjacent markets. In light of the considerable concentration levels and prevailing market dynamics, the AFGC recommends taking into account concerns and insights from the food and grocery sector when revising the merger framework. This approach will help in creating a structure that mitigates opportunities for market abuse.

A recent case that raised competition concerns among industry participants involved the acquisition of 65% percent of shares in PFD Food Services (PFD) by Woolworths Group Limited (Woolworths). The AFGC opposed the transaction at that time, due to concerns that the merger would allow the entity to exploit increased bargaining power to standardise trading terms- the cost of doing business with a trading partner- adversely affecting food and grocery suppliers. However, in June 2021 the ACCC decided not to oppose the transaction on the grounds that both parties operated in adjacent markets.[1]

Beyond the ACCC's economic analysis on potential competition effects, there could have been a more thorough examination of broader market dynamics resulting from enhanced bargaining power over suppliers and the overall strategy to bolster their position as a wholesale buyer of food. Economic analyses offer a snapshot of market structure but may not fully reveal the merged entity's strategy or the potential impacts to suppliers.

Therefore, the merger reform should encompass a more comprehensive consideration of broader market dynamics during the evaluation of mergers, particularly in highly concentrated markets. It is essential to actively involve other market participants to gain a thorough understanding of the complexities involved in interactions across the supply chain.

> **Recommendation 1:** government to consider broader market dynamics in the evaluation of mergers. While economic data and market concentration figures provide a valuable metric, a comprehensive understanding of the likely non-price effects resulting from a party with significant market power acquiring businesses in the same or related markets is equally critical.
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> **Recommendation 2:** Require merging parties to disclose critical negotiating dynamics with suppliers to ensure transparency and discourage unfair practices. Furthermore, in instances of mergers involving companies wielding significant market power, government should engage with other market participants to assess whether the merged entity should provide an undertaking to address concerns related to unfair practices.

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[1] ACCC. Woolworths Group Limited - PFD Food Services Pty Limited Woolworths Group Limited - PFD Food Services Pty Limited | ACCC

Concerns persist among businesses in the sector that the current system has not been able to deal effectively with creeping acquisitions. This unease has endured since the 2008 ACCC report on the inquiry into grocery prices, with the inquiry receiving a number of submissions alleging that Coles and Woolworths were expanding through a strategy of creeping acquisition of independent supermarkets[2]. While individual transactions may not trigger immediate concerns, the cumulative impact of a merged entity with significant market power leveraging the same supply chains and shared suppliers poses a potential threat to fair competition.

A prominent case highlighted by the ACCC in their *preliminary views on options for merger control processes*[3] revolves around Petstock Pty Ltd (Petstock). This company became the second-largest pet retailer in Australia through a series of unnotified and unscrutinised acquisitions.

Heightened concerns escalated within the sector in 2023 when Petstock was then acquired by the largest supermarket chain in the country. Merged entities with significant market power can leverage shared supply chains, leading to increased concentration and potential anti-competitive practices. In the supermarket retail sector, there is a documented history of extracting listing fees, shelf fees, margin support and promotional support from suppliers. The incentive for a merged entity to exploit its market power and engage in similar behaviours is a genuine concern that should be addressed in the reform process.

Therefore, the merger reform should tackle concerns regarding creeping acquisitions and their potential impact on the market. Additionally, the government should contemplate conducting ad hoc post-merger analyses for accountability purposes and to enhance understanding of markets susceptible to competition concerns.

> **Recommendation 3:** Reforms on merger assessment should consider the cumulative impact of acquisitions by a party with significant market power, especially in related or adjacent markets to address the potential impact of creeping acquisitions.
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> **Recommendation 4:** Undertake post-merger market studies to assess the competitive landscape, identify potential areas of concern, and enhance insights for future mergers and acquisitions, particularly in highly concentrated markets.

[2] ACCC (2008). *Report of the ACCC Inquiry into the competitiveness of retail process for standard groceries*

[3] ACCC (2023). *Preliminary views on options for merger control process*