Addressing retail dominance through merger reform

Retail Guild of Australia

Submission response to the Competition Taskforce consultation paper on merger reform

19 January 2024

Executive summary

Industry concentration is high and rising in Australia, leading to poor economic outcomes for citizens

- **6 of the 10 largest industry groups are either oligopolistic or concentrated**. Four-firm concentration has increased by 2.9 ppts from 2007 to 2021.
- **New research links increased concentration to poor outcomes for Australians,** including:
  - Stagnant productivity growth
  - Low real wages growth
  - Higher mark-ups
  - Less market dynamism
  - More frequent competition law infringements (e.g., cartel conduct) and consumer protection infringements

To address industry concentration, merger reform needs to place more scrutiny on mergers in concentrated markets and 'creeping' acquisitions

- **Merger control does not place enough scrutiny on mergers** in highly concentrated markets because:
  - It creates a default position that mergers should proceed, even in concentrated markets
  - It does not place sufficient emphasis on market structure.
- **The merger test allows dominant firms to accumulate market power through 'creeping' acquisitions**
  - The ACCC has focused its attention on high-turnover mergers, but may be missing 'creeping' acquisitions that are driving industry concentration
  - 'Creeping' acquisitions can be observed in supermarkets and hardware.

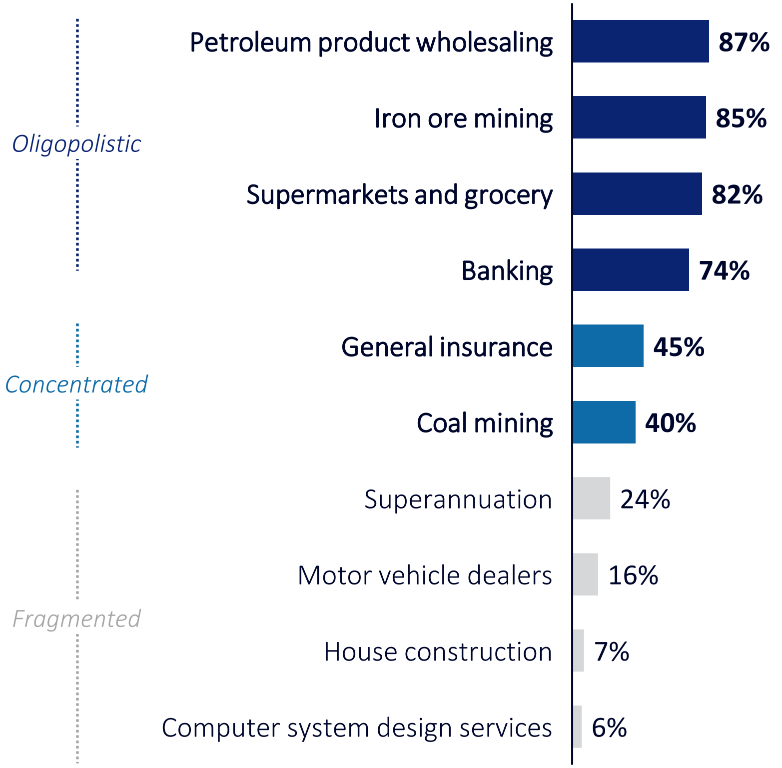
Merger reform can promote productivity, wage growth and lower prices by implementing three priorities

- To ensure that merger law places sufficient scrutiny on mergers in concentrated markets:
  - Priority 1: Shift to a 'clearance' model for mergers in concentrated markets
  - Priority 2: Clarify that a substantial lessening of competition extends to acquisitions that entrench concentrated market structures
- To address 'creeping' acquisitions:
  - Priority 3: Amend the mergers test to prohibit 'creeping' acquisitions that substantially lessen competition

Many of Australia's largest industries are highly concentrated, are becoming more concentrated over time and are more concentrated than comparable countries

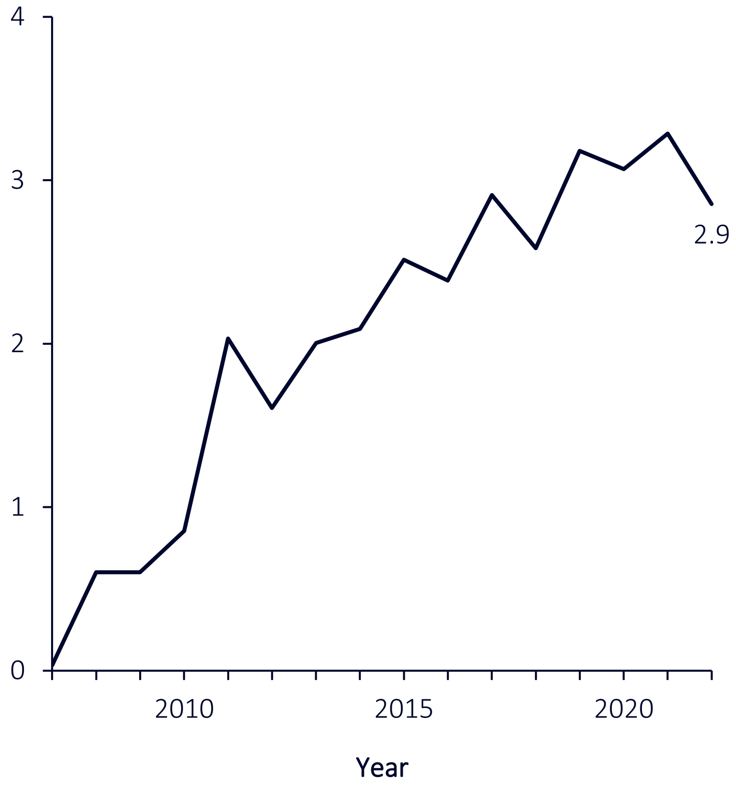
Concentration of the 10 largest industry groups

Market share of the four largest firms per industry (CR4) of the 10 largest industry groups by revenue, 2023



Change in concentration relative to 2006

Ppt point change in market share of the four largest firms (CR4) from 2007 to 2021



Key points

- **6 of the 10 largest industry groups are either oligopolistic** (CR4 > 67%) **or concentrated** (CR4 > 33%). Oligopolistic industries include supermarkets and grocery, and banking.
- **Overall industry concentration has increased** across the Australian economy over the last two decades. The sales-weighted average CR4 across all industries has increased by 2.9 ppts since 2006.
- Many of Australia's industries are more concentrated than comparable countries, such as the United States, including in retail.
- The largest increase in concentration was in **retail trade** (8 ppts), with particularly large increases in concentration in fuel and electronics retail.

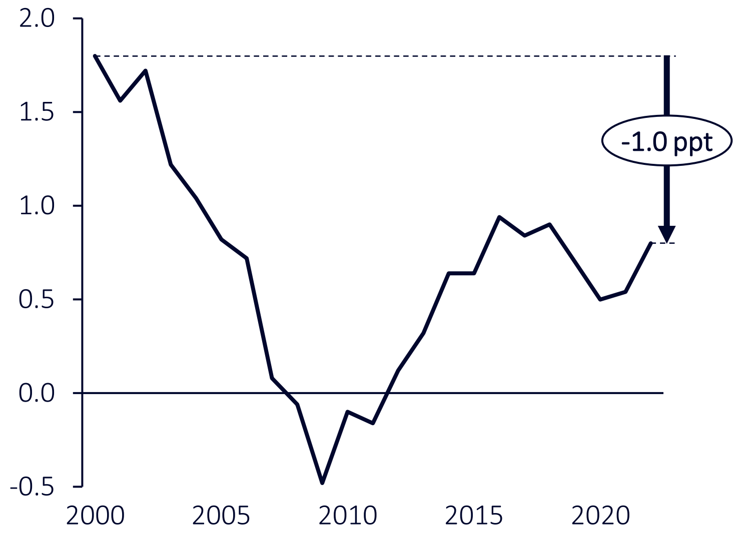
Sources: Australian Bureau of Statistics Cat: Counts of Australian Businesses; Andrews, Dwyer and Triggs (2023); IbisWorld reports (2023).

Evidence shows that increased concentration has contributed to Australia's biggest challenges, including stagnating productivity, low wages growth and higher mark-ups

Multifactor productivity growth

Percentage growth p.a., 5-year rolling average

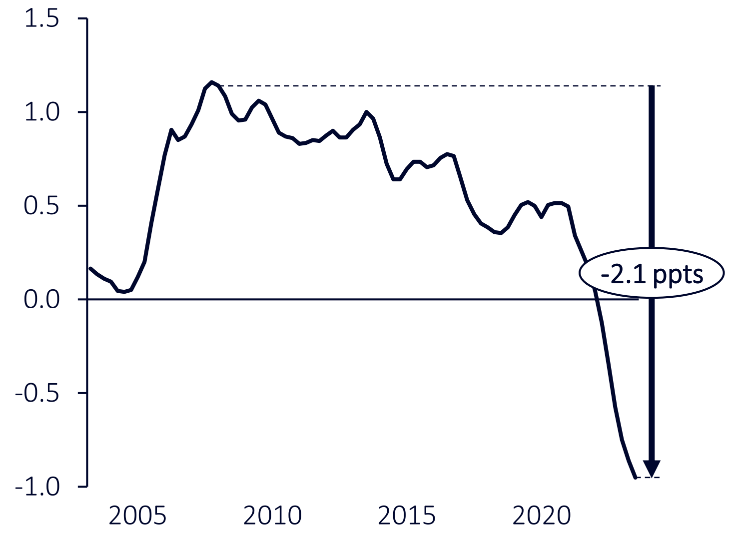
Competition drives productivity by incentivising innovation, while shifting resources toward more productive firms.



Real wages growth

Percentage growth p.a., 5-year rolling average

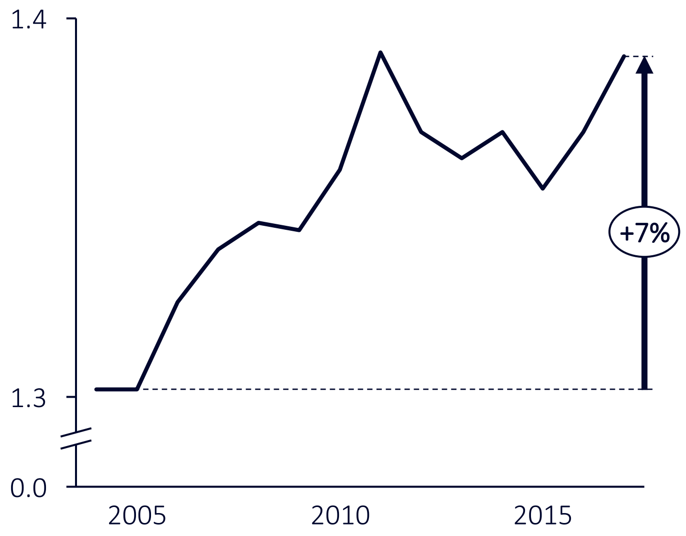
Hambur (2023) finds evidence that local labour market concentration is negatively correlated to real wages growth.



Average firm-level mark-ups

Sales-weighted mark-up

Hambur (2021) finds evidence that the increase in mark-ups is likely due to a decline in competition rather than any reallocation to more productive firms.



There is evidence that weakening competition may also contribute to lower innovation due to the slower adoption of technologies (Andrews et al 2019), a less efficient allocation of resources (Decker et al) and a lower labour share of income (Barkai 2019).

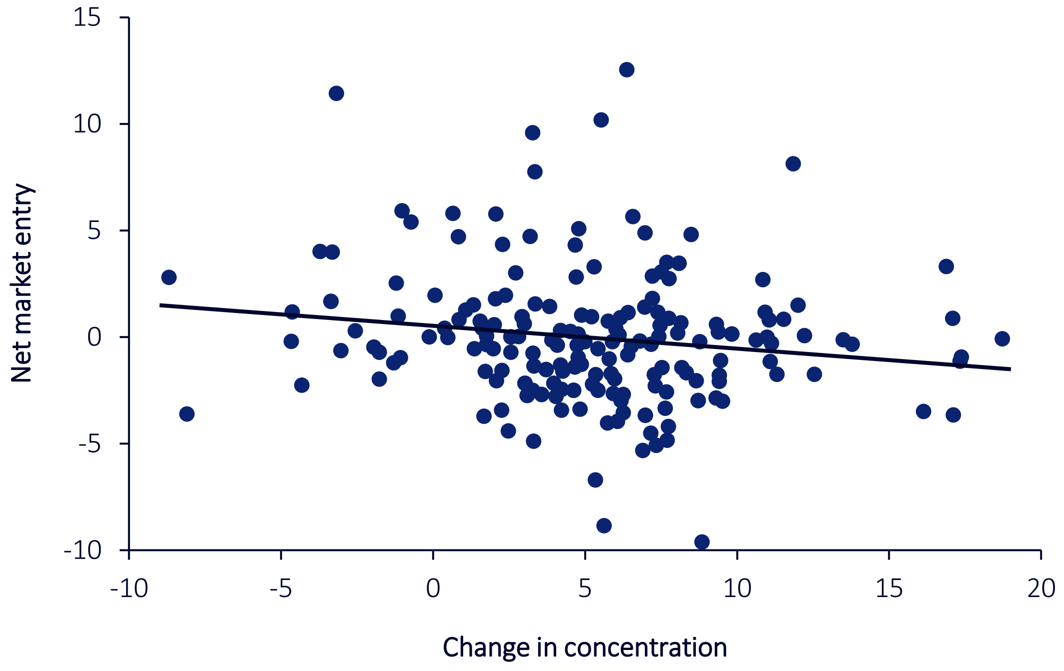
Sources: Australian Bureau of Statistics Cat: 6345.0, 6401.0; Hambur (2021); Hambur (2023); Day et al (2022); Andrews et al (2019); Decker et al (2017); Barakai (2019).

Increased market concentration has coincided with fewer start-ups and more competition infringements, suggesting that competition has deteriorated

Net market entry is lower when industry concentration is higher

Ppt change in concentration CR10 (2007-17) and net market entry for ANZSIC groups[1]

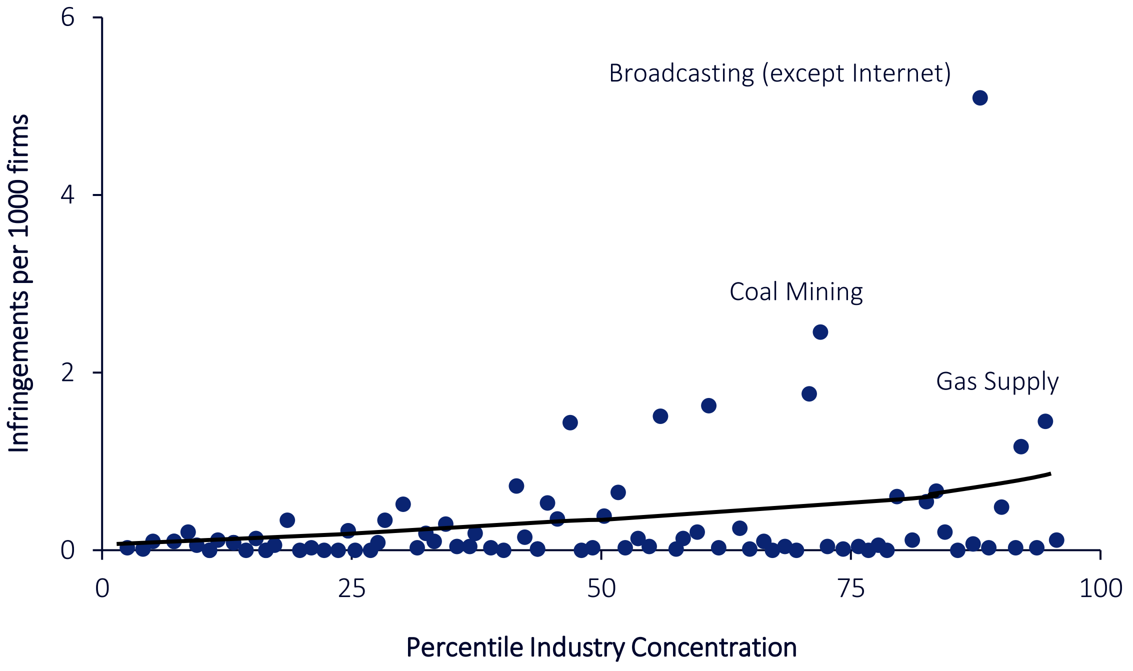
An increase in concentration is linked to less market dynamism, with lower net market entry.



Competition law infringements increase with industry concentration

Percentile industry concentration CR10 (2007-21) and competition infringements per 1000 firms (1993-2023)

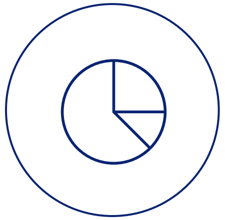
Firms in more concentrated industries have been observed to contravene competition provisions more frequently.



Notes: 1. Change in concentration refers to the change in the market share of the top 10 firms in an industry group between 2007 and 2017. Net market entry measures the percentage change in employing firms per annum in 2015-21 regressed on the percentage change in employing firms in 2007-14. 2. Number of infringements count total infringements for 1993-2023 per 1000 firms in 2007. Industry concentration is defined as average sales concentration of top 10 firms (CR10) over 2007-2021. Sources: Australian Bureau of Statistics Cat: 8155.0; Australian Competition and Consumer Commission; Andrews, Dwyer and Triggs (2023).

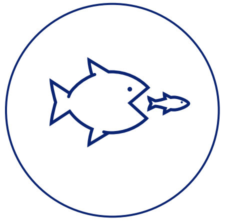
The current mergers regime is making competition and concentration worse in important retail markets

Key problems for merger reform to address



1. Merger control does not place enough scrutiny on mergers in highly concentrated markets

- While competition law decision-makers can consider the impact of market structure in determining whether there is a substantial lessening of competition (SLC), the sustained increase in concentration over time suggests that decision-makers are not placing sufficient weight on the long-term competitive impacts of changes in concentration and market structure on competition.
- By requiring the ACCC to prove an SLC to injunct a merger in Federal Court, merger law imports a presumption that even mergers that lead to or entrench concentrated market structures are benign. This is contrary to empirical economic evidence.



2. The merger test continues to allow dominant firms to accumulate market power through ‘creeping’ acquisitions

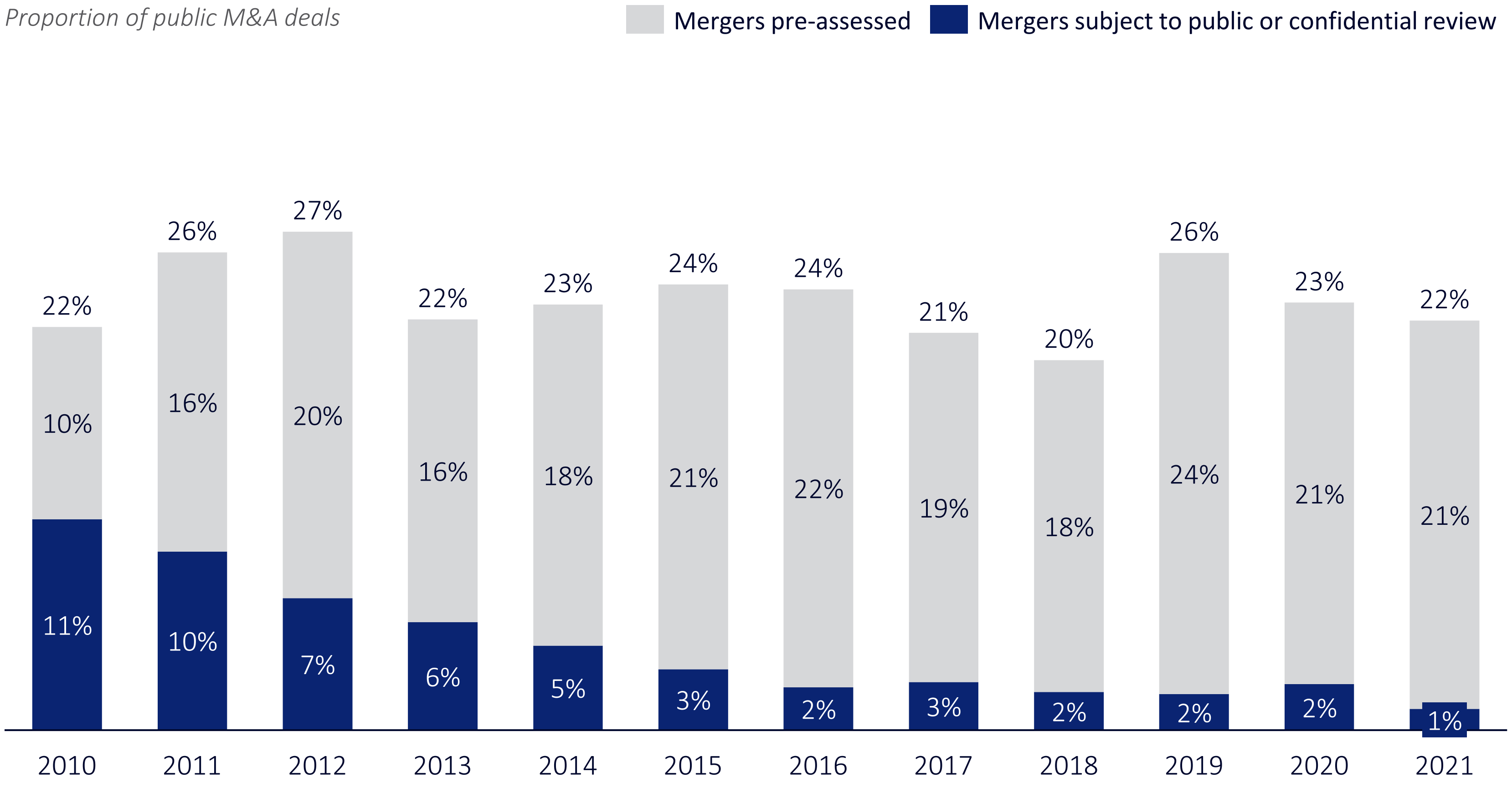
- Competition decision-makers are restricted to considering the incremental competitive effects of individual acquisitions.
- However, there have been a series of acquisitions in key sectors including supermarkets, hardware and liquor which cumulatively have the impact of substantially lessening competition by entrenching market structures that limit competition.

Merger control does not place enough scrutiny on mergers in highly concentrated retail markets due to two interrelated design flaws

Design flaw	Description	Key challenges
1 Merger control creates a default position that mergers should proceed, even in concentrated markets where there is a great risk of competitive harm.	To prevent a merger, the ACCC is currently required to positively persuade the Federal Court that the merger substantially lessens competition. The starting position is that the merger should proceed, even in markets where there is a great risk of competitive harm if a problematic merger proceeds.	• **This default position is contrary to economic evidence**, which suggests that in general, mergers that create or entrench concentrated market structures lead to higher mark-ups, less consumer choice and lower quality products. It places the risk of a decision-making error on consumers. • **This starting position may allow too many mergers to proceed** in highly complex markets where the effects of the merger are uncertain. The starting position may be determinative in these cases as the ACCC requires cogent evidence of how the market will evolve both with and without the merger, which may not be available in complex commercial settings. • **Merger parties may not have incentives to disclose key information** because they do not bear the onus of proof. This means that complex mergers in concentrated markets do not receive an appropriate level of scrutiny.
2 The test does not place sufficient emphasis on market structure.	While the Federal Court must, and the ACCC may, consider aspects of market structure (e.g., the level of concentration in the market), competition decision-makers tend to focus their attention on interrogating the likelihood of predictions of future conduct.	• **Mergers may be allowed based on potentially self-serving evidence of future conduct** even if the market's structure suggests that the merger is at high risk of substantially lessening competition.

The ACCC has increasingly focused on larger mergers, but it may be missing small ‘creeping’ acquisitions that could be driving increased concentration over time

Proportion of M&A deals that are assessed by the ACCC in its informal process



Key points

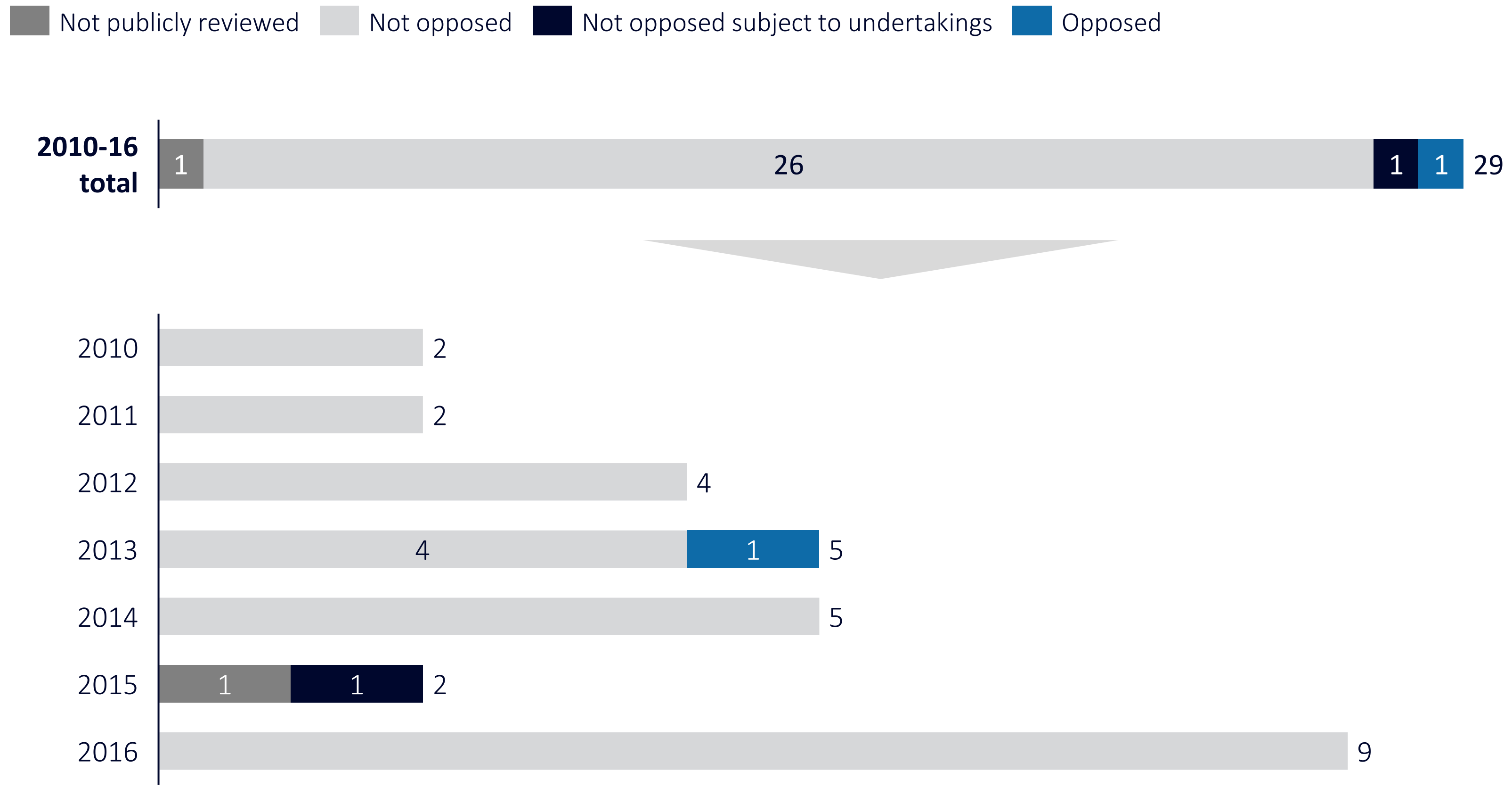
- In 2010-21, the ACCC assessed 20-27% of M&A deals each year. This suggests that the **ACCC is not being notified of over 70% of deals**, potentially including acquisitions by ASX-listed firms of small targets that are not ASX-listed.
- **The ACCC has increasingly focused its resources on larger mergers**, with an increasing proportion of assessed mergers being pre-assessed as a low-risk merger. It has paid less attention to smaller mergers which may individually have a limited impact on competition.
- **Small ‘creeping’ acquisitions can have a significant cumulative effect on concentration**. In the US, small mergers that do not trigger mandatory disclosure thresholds are estimated to account for 28-47% of the increase in four-firm market share from 2002 to 2016.

Sources: Financial Times (2021); Barrios and Wollmann (2022); ACCC/AER annual reports. Notes: CR4 is the market share of the top four firms in an industry.

‘Creeping’ acquisitions can be seen in the grocery sector, with the ACCC publicly assessing 29 proposed acquisitions of individual groceries or sites in 2010-16

Proposed supermarket site acquisitions from the two largest firms in the supermarket and grocery sector

Number of sites from known acquisitions

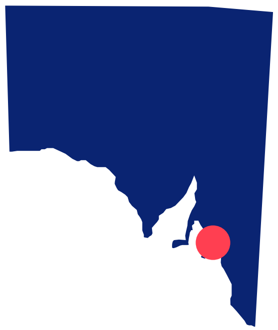


Key points

- In 2010-16, the ACCC publicly reviewed 29 proposed acquisitions by the two largest supermarkets of individual supermarket stores or sites (25), or of individual shopping centres (4). There were other supermarket or supermarket acquisitions that were not publicly assessed.[2]
- Only 1 of these 29 acquisitions was opposed. The 28 acquisitions that were allowed to proceed have the potential to entrench market power of the two largest supermarkets at a regional or national level.
- In addition, the two largest supermarkets acquired at least 39 independent retail stores between 2001 and 2009.

Sources: ACCC informal merger register; Hon Dr Craig Emerson MP response to the ACCC grocery inquiry (2009); Metcash submission to the Select Committee on Cost of Living. Notes: 1. Excludes speciality stores, such as The Shop @ Coolum, which are unlikely to impose significant competitive restraint on Coles. 2. For example, Coles acquired Rochedale Town Centre in 2020, and Woolworths acquired Miranda Mall in 2022. Neither of these transactions are recorded on the ACCC informal merger register.

Recent examples of creeping acquisitions in grocery and hardware retail highlight that the current merger regime is not fit for purpose



Case study: Coles' proposed acquisition of Brighton Foodland

- In 2023, Coles offered to acquire Foodland in Brighton, a local grocery market where Coles already had 30% market share. If Coles acquired Brighton Foodland, its market share would grow to 40%.
- Coles' offer was well above market rates to discourage alternative buyers from acquiring Brighton Foodland.
- It is understood that the Coles' proposed acquisition was notified to the ACCC, but the ACCC did not intervene. This led to Metcash being forced to match the Coles offer to protect the independent network. This meant Metcash's ability to compete against the chains is reduced, because it has had to spend significant resources simply to stop Coles grow larger through creeping acquisition, when the law should be doing this.

Case study: Bunnings' acquisition of land adjacent to Mitre 10 Jimboomba

- In 2019, Bunnings bought land next to the Mitre 10 in Jimboomba announcing their intention to build a new store on that land.
- Bunnings' existing market share in the local Jimboomba DIY hardware market was almost 90% due to the presence of three large format Bunnings stores north of Jimboomba (at Springfield Lakes, Browns Plains and Bethania).
- The ACCC was advised that Mitre 10 Jimboomba would close when the Bunnings opened. This would mean that the only other DIY hardware competitor to Bunnings in the area would be Mitre 10 Beaudesert.
- The Mitre 10 Beaudesert would plainly impose no competitive constraint on a large format Bunnings at Jimboomba because it is a 45-minute drive for Jimboomba residents and not on a road they would otherwise use to access jobs and other services.
- The ACCC did not intervene in the acquisition, which when the Bunnings opens will likely substantially lessen competition in the local DIY hardware market.

Sources: Bannister (2021); Retail Guild of Australia interviews.

Merger reform can address these challenges and promote productivity, wage growth and lower prices by implementing three priorities

Merger reform priorities to address concentrated markets and creeping acquisitions

Priority 1: Shift to a ‘clearance’ model for certain mergers in concentrated retail markets

- Merger control currently relies on the ACCC to bring Federal Court proceedings as a litigant to injunct potentially problematic mergers. This incentivises the ACCC to only block mergers where it is confident that it can gather sufficient evidence to prove a substantial lessening of competition.
- A shift to a ‘clearance’ model for certain mergers in concentrated markets requires merger parties to produce evidence that the merger would not substantially lessen competition, and ensure a greater level of scrutiny for mergers in these markets.

Priority 2: Clarify that a substantial lessening of competition extends to acquisitions that entrench concentrated market structures

- The current test places too much emphasis on interrogating the likelihood of predictions of future conduct, and too little emphasis on the impact of a merger on market structure given its close link to market outcomes.
- The test should be amended to place greater focus on market structure by making explicit that a substantial lessening of competition includes entrenching or materially increasing a position of substantial market power.

Priority 3: Amend the mergers test to prohibit ‘creeping’ acquisitions that substantially lessen competition

- The current test should be amended to allow competition decision-makers to prohibit a merger if, when combined with other acquisitions made by a corporation within a specified period, the acquisition would substantially lessen competition.

Priority 1:

Merger law should shift to a ‘clearance’ model for certain mergers in concentrated retail markets

How a ‘clearance’ model for certain mergers in concentrated retail markets would work

- The designated Minister (e.g., the Treasurer) would declare a market as a ‘concentrated market of concern’ (i.e., retail grocery markets). A merger involving a firm with a market share above a defined threshold in a concentrated market of concern would be **prohibited unless the ACCC is positively satisfied** that the merger would not substantially lessen competition. To address concerns with creeping acquisitions, the designation would apply irrespective of local market share.
- **Limited merits and/or judicial review** should be available to merger parties.
- A similar system of ‘declarations’ is already used in the Act. For example, Section 44H allows the designated Minister to declare a service to be subject to the access regime under Part IIIA. This use of ‘declarations’ would also align with the ACCC’s proposal to introduce service-specific codes of conduct for ‘designated digital platforms’.

Benefits of shifting to a ‘clearance’ model

- **A ‘clearance’ model would appropriately apply greater scrutiny to mergers in relevant concentrated markets** where the risk of irreversible harm to market structure and competition is the greatest. This applies a ‘precautionary principle’ by placing the risk of error on merger parties. This effectively reverses the onus of proof for mergers in concentrated markets.
- **Merger parties are incentivised to disclose key information** in order to demonstrate that the merger would not substantially lessen competition. As merger parties are often unique custodians of key evidence, a ‘clearance’ model ensures that merger decisions are based on the best available evidence.
- **A ‘clearance’ model is consistent with international merger regimes** including those used in the European Union, United Kingdom and New Zealand.

Sources: ACCC (2022).

Priority 2:

The merger test should clarify that a substantial lessening of competition extends to acquisitions that entrench concentrated market structures

How the merger test should be clarified

- A merger that entrenches a concentrated market structure could theoretically be characterised as one that substantially lessens competition by reducing competitive restraints on dominant incumbents. However, this impact of competition **may be missed by many conventional tools of competition analysis** (e.g., diversion ratios) it may result in only small changes in prices or market behaviour, in absolute terms.
- The merger test could, as the ACCC has suggested, expressly state "that a substantial lessening of competition includes **entrenching**, materially increasing or materially extending a position of substantial market power."
- The current merger factors only require competition decision-makers to consider market features (e.g., the level of concentration in the market). The merger factors could be refined to require decision-makers to engage directly with how the merger might **change or entrench market structure** (e.g., whether the merger increases or entrenches concentration in the market).[1]

Benefits of clarifying the test

- Clarifying the test would ensure that competition decision-makers give **due consideration to market structure**, given its close link with the long-term level of competition in a market.
- Explicit reference to **entrenchment** will ensure that competition decision-makers are appropriately cautious about accepting claims that reduced competition is short-term and readily corrected by market forces.[2] This aligns with contemporary empirical evidence that suggests that increases in market concentration are linked with lower rates of future market entry.

Sources: ACCC's proposals for merger reform (2023); Andrews, Dwyer and Triggs (2023). Notes: 1. See *Competition and Consumer Act 2010* (Cth) s 50(3). 2. Explicit reference to 'entrenchment' will countervail the perspective that market power is readily corrected by market forces, as suggested by courts on several occasions. For example, in *Vodafone Hutchinson Australia v ACCC* [2020] FCA 117 at [49], citing an earlier case with approval: "A short term effect readily corrected by market processes is not substantial." Such thinking can lead decision-makers to error. For example, in the ACCC's informal clearance of Coles' acquisition of Coolum Village, the ACCC included in its reasoning that "a new entrant intends to enter the local market in Coolum, enhancing competition". However, there is currently no such competitor near Coles or Woolworths in Coolum that places a substantial competitive constraint on these supermarkets.

Priority 3:

Amend the mergers test to prohibit 'creeping' acquisitions that substantially lessen competition

How the test could better address creeping acquisitions

- The current test only allows competition decision-makers to assess whether a single merger transaction is likely to substantially lessen competition in any market. This prevents them from assessing the **cumulative impact of successive acquisitions**, especially where individual targets are small and individual acquisitions are unlikely to substantially lessen competition.
- The current test should be amended to allow competition decision-makers to prohibit a merger if, **when combined with other acquisitions** made by a corporation within a specified period, the acquisition would substantially lessen competition.

Benefits of addressing 'creeping' acquisitions

- By addressing 'creeping' acquisitions, competition regulators can **prevent the accretion of market power and concentration over time**, which would otherwise reduce long-term competitive tension in a market.