

Dawson Committee

TRADE PRACTICES ACT REVIEW

**Supplementary Submission No. 1
by the
National Association of Retail Grocers of
Australia**

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**DAWSON COMMITTEE
TRADE PRACTICES ACT REVIEW**

NARGA SUPPLEMENTARY SUBMISSION No. 1

**DEALING WITH ANTI-COMPETITIVE PRICE DISCRIMINATION:
NARGA's RESPONSE TO THE ACCC's GROCERY PRICING REPORT**

EXECUTIVE SUMMARY

The release by the ACCC of its Senate-ordered Report on prices paid to suppliers by the two major supermarket chains and independent wholesalers raises critical issues regarding the level of competition in the Australian grocery industry. Indeed, despite the limitations of a voluntary inquiry – particularly the limited number of responses received from suppliers, the ACCC Report reveals that the two major supermarket chains received favourable prices more often than independent wholesalers during the sample period. This finding represents the first independent, objective assessment of how the two major supermarket chains are favoured in terms of price in a majority of cases in their dealings with suppliers.

Despite the two supermarket chains and independent wholesalers being – in terms of central distribution warehouses - of comparable scale and all being capable of like performance, independent wholesalers are unable to secure comparable prices to the chains on at least the same number of occasions as the chains. This places the independent sector at a competitive price disadvantage and, in turn, reduces their ability to be a vigorous competitive force within the grocery industry.

This, plus other competitive, dangers associated with price discrimination are raised in the ACCC Report. Such dangers include:

- the possibility of the lower prices to the two major supermarket chains being subsidized by the higher prices to other buyers;
- raising barriers to entry, with the reduced likelihood of new entrants;

- prompting independent grocery retailers to exit the industry, thereby pushing the independent sector below the critical mass needed to sustain a viable competitive force; and
- reduced vigor in the competitive process and a greater likelihood of parallel conduct or tacit collusion involving those remaining in the industry.

Such dangers would be of concern to all those seeking to ensure that the competitive process is not distorted by the exercise of power by those major customers who see the ability to extract more favourable prices from suppliers as an obvious way of removing or disciplining rivals.

Within this context, the ACCC Report highlights a number of broader competition issues facing the Australian grocery industry. These include:

- The lack of supplier power and possible intimidation of suppliers;
- The possible reasons behind price differences between like customers having regard to the exercise of buying power;
- The possible reasons behind price differences between like customers having regard to the concept of like terms for like performance;
- The dangers of a 'most favoured customer' or 'meet the competition' clause; and,
- The impact of creeping acquisitions.

Overall, therefore, the ACCC Grocery Pricing Report not only provides varying degrees of support for a number of recommendations offered by NARGA in its main submission to the Committee, but also focuses the spotlight on the importance of greater transparency in supplier and retailer/wholesaler relationship. These original recommendations, together with a new Recommendation 26, are outlined below:

Recommendation 1:

NARGA advocates that a new prohibition against anti-competitive price discrimination be introduced into the *Trade Practices Act* as a way of ensuring that

comparable customers buying comparable volumes and providing comparable services are treated in a comparable manner.

Recommendation 2:

NARGA advocates that a new prohibition be inserted into the *Trade Practices Act* preventing entities having a substantial degree of market power from engaging in coercive or intimidating conduct, or conduct inducing a supplier to discriminate against competitors of the entity.

Recommendation 3:

NARGA proposes that a new prohibition against anti-competitive below cost or unreasonably low pricing be introduced into the *Trade Practices Act*.

Recommendation 4:

NARGA proposes that, subject to certain exceptions, a new prohibition be introduced into the *Trade Practices Act* against entities with a substantial degree of market power strategically targeting smaller competitors by charging lower prices than other markets in the State or Territory.

Recommendation 5:

NARGA proposes that the misuse of market power provision (s 46) expressly identifies the types of anti-competitive conduct that may give rise to a breach of the provision.

Recommendation 6:

NARGA proposes that a new prohibition against anti-competitive creeping acquisitions be introduced into the *Trade Practices Act*.

Recommendation 9:

NARGA proposes that an 'effects' test be inserted into the existing s 46 of the *Trade Practices Act* as an alternative to the purpose element.

Recommendation 26:

Having regard to the ACCC Grocery Pricing Report and in keeping with NARGA's recommendations in its main submission to the Committee, NARGA proposes:

(i) that greater transparency be introduced into the supplier and retailer/wholesaler relationship in the Australian grocery industry as a key element in uncovering and dealing with anti-competitive price discrimination; and

(ii) that other possible examples of anti-competitive conduct within the Australian grocery industry be expressly recognized and dealt with in a clear manner under the *Trade Practices Act*.

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NARGA's RESPONSE TO THE ACCC's GROCERY PRICING REPORT**

NARGA welcomes the first independent, objective assessment of how the independent grocery wholesalers and the two major supermarket chains are treated by suppliers on the critical issue of supply price. Indeed, the Report reveals that, on the limited data received by the ACCC, the major supermarket chains were favoured on price in a majority of instances during the period of the ACCC's Inquiry (1999-2000 & 2000-2001). This price favoritism is demonstrated in Chart 5.3.2 found on page 26 of the Report.

Importantly, Chart 5.3.2 only provides part of the industry picture as it is based on data received by the ACCC from only 19 out of the 50 suppliers surveyed. Thus, on a sample of 38% of grocery industry suppliers surveyed, the price favoritism that the major supermarket chains enjoyed in the period of the Study was expressed in Chart 5.3.2 as a ratio of 10:4 in 1999/2000 and 12:8 in 2000/2001.

Leaving aside for the moment the issue of supplier response to the ACCC Inquiry, these price differences favouring the major supermarket chains place the chains at a competitive advantage over the independent wholesalers thereby reducing the ability of independent wholesalers to offer lower prices to their independent retailer customers. In turn, those independent retailer customers can't offer lower prices to final consumers unless given direct supplier support (with no conclusive evidence in the ACCC Report regarding the level and scope of such support), or jeopardize their ability to reinvest in the business so as to remain a viable competitive force. In short, the competitiveness of independent grocery retailers is inextricably linked to the ability of independent wholesalers to secure comparable prices to those secured by the two major supermarket chains. In summary, the better the prices received by the independent wholesalers, the better the prices they can offer to their independent retailer customers, the better the

prices those retailers can offer consumers and the more competitive tension there is between the two major supermarket chains and the independent sector.

The ACCC recognizes at page 44 that while price discrimination at the wholesale level is the central focus, any discrimination at the wholesale level may have a follow on impact on the retail level:

“Possible price discrimination focuses on the relationship between wholesalers and their suppliers. However, it may affect competitiveness between different retailers thereby substantially lessening competition at the retail level.”

Significantly, the ACCC Report then moves on to identify, on page 49, the following dangers of price discrimination in a highly concentrated market:

- the possibility of the lower prices to the two major supermarket chains being subsidized by the higher prices to other buyers;
- raising barriers to entry, with the reduced likelihood of new entrants in the industry;
- prompting independent grocery retailers to exit the industry, thereby pushing the independent sector below the critical mass needed to sustain a viable competitive force; and
- reduced vigor in the competitive process and a greater likelihood of parallel conduct or tacit collusion involving those remaining in the industry.

In particular, the ACCC makes the following observations:

“From the earlier discussion of market participants it is apparent that, generally, the grocery market is highly concentrated. It could become more so if price discrimination in supplying grocery products caused non-chain retailers to incur higher costs e.g. the lower price given to the major chains is ‘subsidised’ by higher price charged to other buyers. It needs to be considered whether price discrimination could result in heightened barriers to entry, either structural or strategic.

...It is likely that the conduct itself raises entry barriers by establishing over a long period the role of the major retail chains as market leaders. If price discrimination resulted in a further increase in market share for one or both of the chains, this would confer even greater economies of scale and scope. It would make viable entry by independents even more difficult and unattractive. Should one (or both) chains raise prices, smaller retailers would then have every incentive to follow suit. Although all independent retailers will not exit, those remaining are therefore unlikely to be a real constraint on the chains.

If price discrimination does have the effect of preventing or limiting independent retailers from competing and ultimately forces significant numbers from the market, it will have a flow-on effect to independent wholesalers whose customers are the independent retailers. ... A reduction in the number of retailers and in diversity might more easily enable parallel conduct or tacit collusion.”

Having recognized these dangers and, especially, the seriousness of price discrimination as a possible form of anti-competitive conduct, the inevitable question arose as to whether or not those dangers have been realized. On this point, the ACCC acknowledges the limitations of a voluntary inquiry. Indeed, the voluntary nature of the inquiry, together with the specific requirement under the Senate Order to consider whether any conduct identified by the ACCC is likely to be in breach of the *Trade Practices Act*, may have had an inhibiting impact on the level of supplier response – a point suggested by the ACCC at page 40 of the Report. More importantly, the ACCC on the same page notes that despite offering suppliers undertakings of confidentiality, ‘significant players in the grocery industry exercised their right not to provide specific data.’ In the absence of data from ‘significant players,’ the industry is left in the dark as to whether the ACCC findings found throughout the Report represent the industry norm, or whether any conclusions (or other statements) in the Report represent the tip of the iceberg in terms of price favoritism enjoyed by the two major supermarket chains.

While the industry may be confident that 'on the data provided in response to its survey, the Commission has not identified conduct that is likely to constitute a breach of the [Trade Practices] Act,' how confident can the industry be that this finding also applies with respect to those 62% of grocery suppliers who chose, for whatever reason, not to respond to the ACCC survey? With those non-respondents encompassing 'significant players,' can the ACCC findings be representative of conduct across the industry? Would the ACCC's findings regarding the existence or otherwise of anti-competitive conduct have been different if there had been a higher supplier response level? Clearly, the ACCC findings on page 40 regarding the existence or otherwise of anti-competitive conduct, beg the question of what is the situation in relation to all those suppliers who chose not to respond.

While the industry may be able to accept that the suppliers who chose not to respond may have legitimate interests in protecting their commercial data, the question arises as to whether these non-responding suppliers would accept a Senate inquiry into the level of price favoritism that may be enjoyed by the two major supermarket chains across the whole industry rather than just within the ACCC's limited sample. On this point, it is noteworthy that on page 11 the ACCC readily accepts the limitations of its Inquiry and, in the face of such limitations, raises the possibility that the Senate may wish to further pursue the issue:

"Because of the clear limitations on the collection and use of the data obtained during the inquiry, the Commission regards its report as qualified by the limitations of the amount of data received. The Senate, after its deliberation on the content of this report, may consider that it is appropriate to use the range of questions formulated by the Commission for use in one of the Senate's own committee inquiries."

Again, at page 23, there is clear recognition of the limitations of the ACCC's data:

"The Commission must qualify any assessment of price differences by expressing caution as to how representative the figures are because of the limitations in the voluntary response rate. At best, the data can only be regarded as indicative."

Despite the limitations of the data received by the ACCC, the Report throws light on a number of competition issues facing the grocery industry. These can be summarized as follows:

- The lack of supplier power and possible intimidation of suppliers within the grocery industry;
- The possible reasons behind price differences between like customers having regard to the exercise of buying power;
- The possible reasons behind price differences between like customers having regard to the concept of like terms for like performance;
- The dangers of a 'most favoured customer' or 'meet the competition' clause; and,
- The impact of creeping acquisitions.

The lack of supplier power and possible intimidation of suppliers within the grocery industry

The lack of supplier power over retailer/wholesaler customers has been highlighted by the peak supplier body – the Australian Food and Grocery Council (AFGC) – at page 36 of the Report.

“AFGC offered another view that there ‘... exists a disproportionate distribution of power in favour of the retailer/wholesaler over the supplier in the Australian grocery sector.’ Their view is that the level of retailer/wholesaler concentration within the Australian grocery sector is almost unparalleled in the world, but that all the retailer/wholesaler players are vigorous and effective competitors. They added: ‘With the above as a given market characteristic and regardless of the relevant market being defined on a National, State or other geographical basis, [they] are all customers of significant scale and influence to grocery suppliers.’

The views put by the AFGC are particularly noteworthy given that they demonstrate that suppliers view themselves not only as lacking sufficient power to provide a

countervailing force to `retailer/wholesaler' customers, but also being compelled to operate in a grocery sector that has a level of concentration `almost without parallel in the world.' Importantly, AFGC views the retailer/wholesaler in Australia as major customers, each with a significant scale and influence over suppliers.

These observations appear to suggest that supplier conduct alone may not be the full explanation for price favoritism. Suppliers may be simply responding to `pressure' or other coercive tactics from particular major customers that they be favoured on price. Thus, the existence or otherwise of buying power amongst major customers and the use of that power by those customers becomes a central issue to be addressed. In particular, the question arises as to whether or not suppliers face intimidatory or coercive conduct from major retailer/wholesaler customers.

Significantly, the ACCC notes on page 17 that the issue of undue exercise of buyer power by supermarket chains towards suppliers was identified in the United Kingdom's Competition Commission Inquiry Report as an area where competition is distorted and operates against the public interest in the United Kingdom. Clearly, this is an issue to be considered in the Australian context, especially in view of its almost unparalleled level of retailer/wholesaler level of concentration.

The possible reasons behind price differences between like customers: The exercise of buying power

From an Australian perspective, the issue of the degree and use of buyer power amongst major retailer/wholesaler customers remains to be conclusively resolved, again because of the limited data available to the ACCC. Despite the limitations of the data used by the ACCC, the ACCC was able to make a number of insightful observations regarding the buying power of major customers within the grocery industry. These include:

Observations on page 46 regarding the presence of market power:

“A buyer may have market power relative to its supplier/s if a significant reduction in purchases by that particular buyer would substantially reduce the supplier’s profits.

This will occur if:

- there are inadequate alternative buyers to compensate for the loss of the particular buyer;
- there are significant switching costs in changing to supply other buyers; and/or
- the supplier depends on the firm with buyer power to ‘underwrite’ its cost of production by facilitating economies of scale.”

Such observations should not only ring alarm bells given the observations by AFGC about the level of retailer/wholesaler concentration in Australia, but are reinforced by the further ACCC observations on page 46 that ‘as retailers (especially grocery retailers) typically carry a broad range of products, they could refuse to stock one particular brand with little impact on sales.’ In short, the ACCC observes on page 48 that:

“Most suppliers could not afford to lose access to retail outlets of Woolworths and Coles. On a national basis Woolworths and Coles combined have over 1200 retail outlets. ... The buying power of those major retail chains is significant.”

The ACCC goes on to state that ‘it might be expected that the major retail chains would invariably get the best price,’ but on the limited data available to the ACCC the major chains did not always get the best price. In reality, the industry would not expect the major chains to ‘always’ get the best price for the simple reason that with the emergence of recognizable independent banner and retailer groups, the independent sector can now not only buy comparable quantities deliverable to central distribution warehouses as do the two major supermarket chains, but can perform in terms of sales and being able to deliver on buyer/supplier expectations in a like manner as the two major supermarket chains. After all, the industry would accept that buyer/supplier relationships are not just about questions of scale, but also depend on the buyer’s ability to deliver on a pre-conceived marketing or business plan as agreed between buyer and supplier. Nevertheless, the ACCC’s Inquiry of price differences at the wholesale level provides an extremely valuable point of comparison at a level in the industry where the central

distribution warehouses of the two major supermarket chains and the independent wholesalers are of comparable size and efficiency. At this level, there can be a like for like comparison between the two supermarket chains and the independent wholesalers.

The possible reasons behind price differences between like customers: The impact of and adherence to the concept like terms for like performers

Where buyer and suppliers agree, however, on the level of performance to be delivered within the relationship, it would be expected that if the same or comparable level of performance is achieved by different customers, then those different customers should receive the same or comparable treatment in terms of price. Where a major customer performs at a comparable level to another major customer, but is treated differently, questions arise as to why that pricing difference occurs. Is it a case of suppliers not treating like performers in a like manner, or is it a case of the exercise of buyer power. Based on the limited sample available to the ACCC, and their clear disclaimers throughout the Report, it is clear that the ACCC finding that 'the major retail chains do not always get the best price' leaves unresolved the central question as to why, on the limited data available to the ACCC, the major retail chains received - as shown in Chart 5.3.2 - a better price than the independent wholesalers in a majority of instances.

Given the absence of data from 62% of suppliers surveyed, the issue arises as to how (if at all) the buyer power of the two supermarket chains is exercised throughout the rest of the industry and whether the level of price favoritism shown in Chart 5.3.2 of the ACCC Report differs (if at all) throughout the rest of industry. Such issues become critical ones, particularly given the independent sector's ability to perform in a like manner to that of the two major supermarket chains. Indeed, the ability of the independent wholesalers to get the best price on some occasions as shown in Chart 5.3.2 provides ready evidence of their ability to perform in a like manner to the two major supermarket chains. Clearly, independent wholesalers are - in the words of AFGC on page 36 - able to collaborate with suppliers to utilize their respective trading relationships to provide offerings most desired by the customers.

The ability of independent wholesalers to get on occasion a better price than the two major supermarket chains reflects their ability to meet with suppliers and, in the words of the ACCC on page 20, agree that they can both have a common understanding of what is the best way to present the supplier's product or accommodate the supplier's production plan. After all, if independent wholesalers did not perform to a level required by suppliers for a better price, then they would not get that better price. That independents are capable of a better performance than the chains, thereby securing a better price, is demonstrated in Chart 5.3.2. Thus, given that independent wholesalers can perform in a like manner on a significant number of times, the question arises as to why they cannot get a better price at least 50% of the time. Like performance as suggested by AFGC would suggest like terms. Where like performance leads to unlike terms, the questions arises as to whether the difference in terms can be explained by an exercise of buying power, a lack adherence by suppliers to their publicly claimed principle of 'like terms for like performance,' or whether there is some other reason for the dissimilar treatment.

The impact of creeping acquisitions

The issue of creeping acquisitions or strategic acquisitions undertaken in a small, piecemeal fashion making them difficult to challenge under s 50 - the merger provision – of the Act was raised in the ACCC's Report. On page 50, the ACCC identifies creeping acquisitions as a possibly relevant factor in determining whether price discrimination is competitive or anti-competitive in the long run. Clearly, the ability of the independent sector to maintain a critical mass is related to its ability to be vigorously competitive, particularly in the face of price discrimination.

The dangers of a 'most favoured customer' or 'meet the competition' clause

'Most favoured customer' or 'meet the competition' clauses entitling the buyer to terms that are at least as good as those offered to other buyers have been raised as a possible problem area. On page 50, the ACCC notes that while such clauses may be to protect the buyer's competitiveness, they may result in reduced price flexibility or even price fixing depending on the circumstances.

Identifying and dealing with anti-competitive conduct within the grocery industry: Some broader issues

Despite throwing light on a number of key issues, the ACCC Report raises many more issues regarding the identification and stamping out of anti-competitive conduct within the grocery industry. These unresolved issues include:

- Making justifiable assessments on the competitive well-being of the grocery sector given the lack of data from `significant' suppliers;
- The importance of a post-Franklins break-up Inquiry;
- Limitations with the present s 46;
- Intimidatory conduct by retailer/wholesaler customers aimed at securing more favorable prices to those of competitors;
- Below cost selling; and
- Strategic targeting.

Lack of data from `significant' suppliers

The lack of data from significant suppliers is an obvious source of concern. In the face of a non-response rate of 62% in relation to useable data, the ACCC findings are necessarily limited in scope and cannot be extrapolated across the industry. Nevertheless, there are sufficient areas of competitive concern highlighted in the Report to support a more thorough investigation by the Senate, particularly as this should provide considerable comfort to those suppliers who did not respond comprehensively to the ACCC Inquiry for confidentiality reasons.

A post-Franklins Inquiry

The importance of a follow-up Senate Inquiry is highlighted by the changed industry conditions following the Franklins break-up. The Franklins break-up has increased the market shares of all the remaining industry participants with an inevitable increase in the buying power of major customers. Whether or not this increase in buyer power has led to an increase in price favoritism enjoyed by either the independent wholesalers or the two major supermarket chains is a question needing to be answered. The ongoing competitive

wellbeing of the grocery sector should be of concern to all Australian consumers, particularly given the almost unparalleled level of retailer/wholesaler concentration in Australia, a view long held by NARGA and which is also now expressed by the AFGC as demonstrated on page 36 of the Report.

Limitations with the present s 46

The present difficulties in establishing breaches of s 46 and, in particular, the purpose element, are reiterated on pages 50 -51. These difficulties limit the effectiveness of s 46 in dealing with conduct that has the effect of damaging competition.

Intimidatory conduct by retailer/wholesaler customers aimed at securing more favorable prices to those of competitors

In view of what the AFGC describes on page 36 as the disproportionate distribution of power in favour of the retailer/wholesaler over the supplier in the Australian grocery sector, it is imperative that such power is not used in an intimidatory manner against suppliers. Whether or not suppliers face intimidatory conduct by a customer seeking to secure more favourable prices to those of competitors should be considered, particularly in the light of whether or not such conduct has an anti-competitive purpose or effect.

Below cost selling

Although not within the scope of the ACCC Inquiry, the ACCC's reference on page 17 to the findings of the United Kingdom's Competition Commission Inquiry of 'persistent selling by supermarkets below cost,' should be of concern in an Australian context, with its almost unparalleled level of retailer/wholesaler concentration. The purpose and effect of persistent below cost selling by those having a substantial degree of market power in the grocery industry should be placed under the spotlight to ensure that it is not anti-competitive.

Strategic targeting

Again, although not within the scope of the ACCC Inquiry, the ACCC's reference on page 17 to the findings of the United Kingdom's Competition Commission Inquiry of

price flexing (varying prices in different geographical areas in the light of local competition) should also be of concern in Australia. The purpose and effect of price flexing or what NARGA describes as 'strategic targeting' of competitors must also be placed under the spotlight to prevent its use in an anti-competitive manner.

In view of the ACCC Grocery Pricing Report NARGA makes the following additional recommendation to the Committee:

Recommendation 26:

Having regard to the ACCC Grocery Pricing Report and in keeping with NARGA recommendations in its main submission to the Committee, NARGA proposes:

- (i) that greater transparency be introduced into the supplier and retailer/wholesaler relationship in the Australian grocery industry as a key element in uncovering and dealing with anti-competitive price discrimination; and**
- (ii) that other possible examples of anti-competitive conduct within the Australian grocery industry be expressly recognized and dealt with in a clear manner under the *Trade Practices Act*.**