

12 March 2008

By email: grocerypricesinquiry@accc.gov.au

Grocery Prices Inquiry – Submissions
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Dear Commissioners

Public Submission to ACCC Grocery Inquiry

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to provide comment to the Australian Competition and Consumer Commission (**ACCC**) as part of its inquiry into the competitiveness of retail prices for standard groceries (the **Inquiry**).

We welcome the Government's initiation of the Inquiry under Part VIIA of the *Trade Practices Act 1974* (Cth). As the ACCC's Issues Paper makes clear, food inflation has been higher in Australia than in many other industrialised countries. While this is not of itself indicative of a problem with competition, considering the impact of increasing grocery prices on household budgets, we strongly support the wide-ranging inquiry. We note that while the ACCC has undertaken inquiries into the grocery sector in the past, its most recent inquiry of the sector was not able to make use of the strong information-gathering powers of Part VIIA.¹ We would encourage the ACCC to use these powers so as to make possible a more thorough investigation of the state of competition in the grocery market.

We particularly welcome the list of issues highlighted for discussion in the ACCC's Issues Paper of 11 February 2008. Our submission will particularly comment on:

- Consumer behaviour and choice of grocery retailer;
- The pricing practices of grocery retailers and the representation of grocery prices to consumers (and in particular, unit pricing);
- Competition at the supply, wholesale and retail levels of the grocery industry; and
- The role of government and regulators in facilitating effective competition.

¹ Australian Competition and Consumer Commission (**ACCC**), *Report to the Senate by the Australian Competition and Consumer Commission on prices paid to suppliers by retailers in the Australian grocery industry*, September 2002.

About Consumer Action

Consumer Action is a campaign-focused consumer casework and policy organisation, dedicated to advancing the interests of low-income and vulnerable consumers, and of consumers as a whole. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest not for profit specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and throughout the community directly.

Consumers and competition

Fair, effective and competitive markets generally deliver the best price, quality and access to goods and services to the majority of consumers.² In our view, competitive pressure is important for productivity, innovation, access and fair pricing in the marketplace and increased competition can lead to both one-time, and ongoing gains in productivity and efficiency as a response to greater pressures to perform.³

We strongly welcome the Issues Paper's acknowledgment that consumers are not simply passive beneficiaries of competition but play an important role in driving competition in grocery retailing. We agree that the ability of consumers to compare the offers of retailers and their willingness or ability to alter where they shop influence competition between grocery retailers. Nevertheless, as outlined below, there are certain behavioural characteristics of consumers that must be taken into account before any conclusion can be drawn about consumers interface with competition and, in particular, any proposals to improve consumers' ability to promote effective competition.

We note that the grocery sector has certain features that lend it to effective consumer driving of competition. These include the involvement of repeat purchases, a wide range of products, purchases of relatively small value, well understood goods, the opportunity to learn from previous purchasing decisions, etc. The essential nature of groceries (discussed further below) also means that consumers can be important drivers to competition.

We agree with the comments in the Issues Paper that consumers are attracted to grocery retailers for a range of reasons, including the cheapest prices, the range of products or brands offered, the service and friendliness of staff, the freshness of perishable items, the availability of car parking, the convenience of the shopping experience, the type of shopping trip etc. It is our view that these reasons need to be analysed in the context of not only the rational self-interested consumer of classical economics, but also considering the actual behaviour of consumers in markets.

² Consumer Action Law Centre, Submission to the Productivity commission Inquiry into Australia's consumer Policy Framework, June 2007.

³ Organisation for Economic Development, *Product market competition and economic performance*, in OECD Economic Outlook, December 2002, available at www.oecd.org.

Consumer behaviour – lessons from behavioral economics

Developments in behavioural economics challenge traditional economic assumptions regarding *homo economicus* – the notion that consumers in general will act with rational self-interest. This thinking can also help us understand the notions that guide consumer behaviour and therefore make more accurate predictions. Behavioural economics identifies systematic biases and departures by consumers from the perfectly rational model of consumers and highlights variance in consumer behaviour. In our view, these systematic biases or departures need to be considered in determining the nature of consumer behaviour and competition in the grocery sector and any interventions designed to improve competition.

There are a number of insights from behavioural economics that are particularly relevant in this context. Firstly, studies in behavioural economics highlight that consumers often have 'bounded rationality'. Accordingly, consumers do not approach each decision or choice with perfect rationality (assessing all available options and prices) but rather use 'rules of thumb'.⁴ This is due to limitations of knowledge, cognitive capacity and computational resources. This means that people are unable to process and compute all the alternatives available to them. Indeed, bounded rationality as a concept encompasses several other biases, which may act as rules of thumb or heuristics to simplify decision making. In the context of a grocery shop, it must be recognised that the reasons consumers are attracted to particular retailers are affected by their 'bounded rationality'.

Another factor which needs to be highlighted is 'habits' of the consumer. Habits explain that people do many things without consciously thinking about them and these habits are hard to change – even though people might want to change their behaviour, it is not easy for them to do so.⁵ Neoclassical economic theory, on the other hand, assumes that people act rationally to maximise their utility (given their particular preferences). Therefore, according to neoclassical economics, a person would not do something out of habit, such as going to the same supermarket each week. Rather, they would undertake a full analysis of all the available grocery retailers in the area, including the range of products available and all the price options offered. Habit helps explain the phenomena of inertia, where consumers make no change even though they know they can obtain a better deal elsewhere. Habits can also result in repeat purchase of particular brands within a supermarket.

Choice overload is an additional behavioural bias that can impact competition in the grocery industry. There is some evidence that only 5-8 pieces of information can be held by a consumer at once, meaning that a consumer is unable to make a rational decision based on the choices in front of them.⁶ In some circumstances, this choice overload means that a

⁴ See for example, Kahneman, D (2002), *Maps of bounded rationality: A perspective on intuitive judgement and choice*. Nobel Prize Lecture.

⁵ New Economics Foundation (2004), *Behavioural Economics: seven principals for policy makers*. NEF: London.

⁶ Prof Lucia Reish, 'The Influence of Behavioural Economics on Consumer Policy', speech to National Consumer Congress, 6 March 2008, Perth.

⁶ Prof Lucia Reish, 'The Influence of Behavioural Economics on Consumer Policy', speech to National Consumer Congress, 6 March 2008, Perth.

consumer might make a decision to make less than optimal purchase. In others, it might mean that a consumer makes a decision not to purchase at all. An example of this involved tastings conducted in an upscale supermarket where the opportunity was given to taste 6 jams in one situation, and to taste 24 jams in the second situation.⁷ Of those who stopped to taste, 30% purchased jam in the 6-jam condition, with only 3% purchasing in the 24-jam condition. It has been argued that firms sometimes deliberately take advantage of this behavioural bias to reduce competition.

Whilst behavioural economics is still a developing field, an emerging body of work is already providing insights about why markets, and regulatory intervention in markets, succeed or fail. This analysis could help inform the ACCC by assisting it form a better understanding of consumer behaviour and the appropriate mechanisms that are more likely to assist consumers drive competition in the grocery market.

Impediments to consumers switching grocery retailers

In the UK, writers such as Waterson, Waddams and Klemperer have discussed the effect of switching and transaction costs – barriers to consumers switching their service provider in markets or reasons for brand loyalty.⁸ In the grocery sector, this analysis could be applied to consumers' brand loyalty to particular grocery items or particular grocery retailers. The research concludes that these barriers have significant effects on competition and efficiency, and can result in sub optimum price outcomes for consumers. The research indicates that there are multiple types of switching costs that vary in degree of importance. Klemperer identifies six key switching costs – that is “a cost [that] results from a consumer's desire for compatibility between his current purchase and a previous investment.” These are:

1. Need for compatibility with existing equipment;
2. Transaction costs of switching suppliers;
3. Costs of learning to use new brands;
4. Uncertainty about the quality of untested brands;
5. Discount coupons and similar devices; and
6. Psychological costs of switching or non-economic “brand loyalty.”⁹

In the grocery market, many of these consumer switching costs are obvious. For example, transaction costs in switching to a new grocery retailer may arise from the extra cost to get to the retailer should they not be located in close proximity. Uncertainty about the quality of untested brands is particularly obvious in relation to the new entrant ALDI, which does not

⁷ Louise Sylvan, ‘The interface between consumer policy and competition policy’, Consumer Affairs Lecture 2006.

⁸ See for example Waterson, M. *The Role of Consumers in Competition and Competition Policy*. University of Warwick Economic Research paper no.607; Klemperer, P. 1995. Competition when Consumers have switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics, and International Trade”. *Review of Economic Studies*. 62: 515–539; and Waddams, C., Giulietti, M. & Waterson, M. 2005. Consumer Choice and Industrial Policy: a study of UK Energy Markets. *The Economic Journal*. 115: 949- 968. See also from the United States: Camerer, C., Issacharoff, S., Lowenstein, G., O'Donoghue, T. & Rabin M. *Regulation for Conservatives and the Case for “Asymmetric Paternalism”*. 2003. University of Pennsylvania Law Review. 151: 1211-1254.

⁹ Klemperer, as above, pp 517-18.

stock brands that are familiar to many Australian consumers. Our concerns about discount coupons such as shopper dockets are detailed further below.

In considering the state of competition in the grocery industry, the ACCC needs to consider the costs imposed on consumers should they want to switch. We are concerned about market developments that mean that consumers bear more of these costs. There are some measures, however, that can reduce switching costs. One in particular, which we outline further below, is unit pricing.

Impact of high grocery prices on disadvantaged consumers

In undertaking the review, it must be acknowledged that food and other grocery items are essential items. The effectiveness of competition in the supermarkets sector, therefore, is an issue of particular importance because of the impact grocery prices have on low-income consumers. When food prices rise, this affects the standard of living of the poor exponentially more than it does the standard of living of the rich.

The lowest income earners in Australia pay, proportionately, four times as much for food compared with the highest income earners.¹⁰ In Tasmania, the lowest income earners spend approximately 98% of their income on essential items, a substantial proportion of which includes food.¹¹ Clearly then, changes in food prices that may have limited impact on the overall financial situation of most Australians have a profound impact on low income earners.

The wages of low income earners have not kept pace with food price inflation. Real wages for full-time male wage earners were stagnant for the 30 years to 2005.¹² For many low-income earners, real income levels have declined over an equivalent period. Even where real wages of some sectors of the Australian population have risen faster than supermarket prices is of little consolation to low income wage earners.

The lowest income earners in Australia spend virtually the entirety of their income on essential items. Their income levels, in real terms, have stagnated and declined, and they have no budgetary margin out of which to pay for the grocery price rises that have occurred in supermarkets. We ask that the ACCC consider the essentialness of food and other grocery items to Australian households in making any recommendations in relation to this Inquiry.

Pricing practices and representation of prices – unit pricing

One tool that consumers can use to better manage their spending on grocery items is unit pricing. Consumer Action recently made recommendations to the National Trade and Measurement System consultation that mandatory unit pricing be introduced in

¹⁰ Quiggin, John, *Equity and Efficiency Effects of Food Taxes*, Submission to Senate Committee of Inquiry into a New Tax System, 1998.

¹¹ Tasmania Together 2020, *Snapshot of Progress for 2007*.

¹² Frijters, Paul & Gregory, Robert, *From Golden Age to Golden Age: Australia's "Great Leap Forward"?*, IZA Discussion Paper No. 206, 8 April 2006, p 8.

supermarkets Australia- wide. We substantially repeat the content of our recommendations below.

Background on unit pricing

Unit pricing involves displaying a price per unit of measure (eg. kilo and litre) for items in addition to the items' actual price. Unit pricing is standard in a number of overseas jurisdictions, including parts of the United States and European Union (**the EU**).¹³ Unit pricing became an issue in the United States in the late 1960s, and since approximately 1970, increasing numbers of states have legislated to require supermarkets to display unit prices. Unit pricing up-take in the United States is widespread, and it is rare to find a supermarket that does not display unit prices in some format. Likewise, the nations comprising the EU were required by a 1998 directive¹⁴ to ensure unit prices are displayed in supermarkets.

One reason for the adoption of unit pricing in these jurisdictions was the move away from standard measurements for grocery items. For example, while many consumers may have little difficulty in determining themselves the lowest unit price comparing one and two kilograms of flour, modern grocery products are now sold in a vast array of variable sizes (eg. 175grams, 680 grams, 1.25 litres etc.). Determining the best value buy when faced with such an array of non-standard measurements is impossible for most consumers.¹⁵ Where the measures in which similar or identical products are sold differ widely, price competition is eroded.

Benefits of unit pricing

A number of benefits from unit pricing have been identified:¹⁶

- Unit pricing promotes price competition, reduces prices and is anti-inflationary;
- Unit pricing enhances consumer sovereignty and welfare; and
- Unit pricing reduces consumer confusion and increases consumer confidence.

Unit pricing makes it easier for consumers to perform price comparisons between products. It can enable consumers to switch container size within brands and to switch brands (to the lowest unit price container size). Unit pricing can also result in consumers paying less for the same quantity of groceries.

For example, investigations by Queensland Consumers Association¹⁷ showed that the cost of 25 typical products of well-known national brands products was \$93.51. But by choosing

¹³ Ian Jarratt, 2006 Churchill Fellow, "To investigate unit pricing of prepackaged grocery items in the European Union and the USA", available at www.churchilltrust.org.au under business section.

¹⁴ European Community Directive 98/6/EC on consumer protection in the indication of the prices of products offered to consumers, 16 February 1998.

¹⁵ Monroe, Kent B. & LaPlaca, Peter J., 'What are the Benefits of Unit Pricing?' *Journal of Marketing*, Vol.36 No.3 July 1972, p 20. (A 1970 study showed college educated women, asked to identify the most economical package for 20 different product types, erred 43% of the time).

¹⁶ Ian Jarratt, above n 13.

the lowest unit priced packages, the cost of the same amount of total product for 25 items was only \$49.28 (a massive saving of 47%). Also, because most of the savings came from switching brand not package size, the total bill was only \$61.14, yet the basket still contained 13% more of the products sold by weight.

Recognising that consumer may not want to change their brand of all, or some, of the products in the basket, an investigation by the Queensland Consumers Association revealed that for 19 items buying the lowest unit priced size within a brand reduced the cost of the same total amount of product by almost 20%. We believe that similar experiments should be undertaken on a larger scale at a larger range of outlets to determine real price benefits of unit pricing to consumers.

There is also evidence that unit pricing makes demand more price-elastic.¹⁷ This is to be expected as unit pricing makes price comparison easier, therefore increasing price competition.

Even where unit pricing does not result in consumers paying less, it does allow them to better assess 'value for money'. Some consumers use unit pricing systems to help them determine the likely quality (rather than always buying the lowest unit priced product, brand or size).

National system

Any unit pricing system that is introduced should be national, uniform and compulsory. A federal uniform system would be consistent with State and Federal policy in relation to trade measurements. While voluntary unit pricing systems may provide some consumer and market benefits, a national compulsory unit pricing system is required to realise the fullest possible benefits of unit pricing.

An effective unit pricing system requires clear and consistent unit price display – such consistency and clarity is not possible in a voluntary system. Under a voluntary system, there would emerge a series of different formats for displaying unit price, and the different formats of display would confuse consumers, reducing consumer awareness and understanding of unit price. As research discussed below has demonstrated, consumer benefit from unit pricing systems depends on the prominence of the display of the unit price.¹⁹ It is only possible to ensure that unit prices are displayed in a prominent way if there is compulsion to display them in a specified manner.

There may be general concerns with increasing the volume of regulation with which business must comply. In relation to unit pricing, this concern is misplaced. Unit pricing requirements would be situated in the relevant Commonwealth national trade measurement system instrument. There would thus be no need for separate legislation. In addition, unit

¹⁷ The following is taken from QCA's Public Submission to the ACCC Inquiry into the Competitiveness of Retail Prices for Standard Groceries.

¹⁸ Isakson, Hans R. & Maurizi, Alex R., 'The Consumer Economics of Unit Pricing', *Journal of Marketing Research*, Vol.10 No.3 August 1973, p 284.

¹⁹ Miyazaki, Anthony D. et al, 'Unit Prices on Retail Shelf Labels: An Assessment of Information Prominence', (2000) 76 *Journal of Retailing* 1.

pricing for a very limited number of products (see below) is already required for certain products, so a universal system of unit pricing would expand an existing system, rather than introduce a new and untried system.

Like all new regulation, the benefits of unit pricing must outweigh its costs. Supermarkets may be concerned about the cost of implementing a unit pricing system. Such costs will be minimal because most supermarkets have electronic scanning and computerised labeling systems and therefore already have the foundations of the technology required to print and display unit prices. In fact, the display of a unit price is already required under state law for certain fresh foods (eg. meat, cheese) sold in random packages. Supermarkets already implement this selective unit pricing system (the difference being that the unit price is typically attached on individual items, not to the shelf). Thus most supermarkets already have the basic technology and system required to implement broader unit pricing, and therefore the cost of regulation would be minimal.

The national supermarket chain Aldi has recently introduced unit pricing across all its stores. The fact that Aldi has adopted unit pricing demonstrates that it can be implemented without significant costs to the business. Aldi has also said that a consistent, national approach would serve to benefit consumers and has called on other supermarket chains to adopt unit pricing.²⁰

Format of display of unit price

The prominence of the display of unit price is critical to the effectiveness of a unit pricing system. A recent study tested the impact of different label formats on which unit prices were displayed.²¹ It showed that the labels with more prominent, larger displays of unit price were more effective than the less prominent displays. That is, where unit price was more prominently displayed, shoppers were more likely to select lower unit priced items.²² This was particularly so for consumers with low levels of price consciousness.²³

Because of the importance of the format of display of unit price, we believe it is critically important for a national system to detail the required dimensions of unit price displays. While general requirements that displays be 'unambiguous, easily identifiable and clearly legible'²⁴ are useful, more specific detail is necessary for unit pricing. For instance, New Jersey requires the font of the unit price to be 'not less than 50 percent than that of the retail price.'²⁵ We recommend that the size of the text displaying the unit price be regulated. From the research done thus far, we believe a large, easily readable display of unit price will bring more consumer benefit than a unit price displayed in small font. We believe that further consumer testing may be necessary to determine the optimal display characteristics.

²⁰ Aldi, Media Release – New Aldi price system helps shoppers see true value, 8 November 2007.

²¹ Miyazaki, above n 19.

²² Ibid, page 107.

²³ Ibid, page 104.

²⁴ *The Price Marking Order 2004*, section 7 (1) (a), UK.

²⁵ *New Jersey Administrative Code, Administrative Rules of the Division of Consumer Affairs*, Subchapter 14 §13:45A-14.7 (1), New Jersey.

To give some indication of a possible minimum unit price display, in Queensland a shelf-label setting out the unit price of pre-packed random weight meat²⁶ must display the unit price in text at least 10mm high.²⁷ There is a need for regulation to specify both the general minimum unit price font size and the minimum size of the unit price in relation to the size of the actual item price. We believe the determination of such sizes is key to the success of a unit pricing system.

Advertising and on-line purchasing

There are clearly benefits from requiring the unit price to be published whenever the item price is published in advertising material. Unit pricing in advertising allows consumers to easily compare prices not only between items within a store, but between retailers. The UK and Irish approach, based on an EC Directive, requires the unit price to be quoted in most advertisements.²⁸

There is also benefit from requiring the unit price to be published on websites used for on-line purchasing. The consumer benefit from the use of unit prices in these circumstances is clear, particularly considering the number of individuals who now purchase on-line. As Coles' online shopping website²⁹ displays unit prices when customers add products to their 'shopping cart', it is obviously not too great a technical hurdle to implement unit pricing for on-line shopping.

Consumer education

To best achieve its objectives, a unit pricing system should be accompanied by a consumer education strategy. This strategy should increase awareness, knowledge of how to use and actual use of unit prices. Given that Australian consumers have no or limited prior experience with unit pricing, special effort is needed to educate consumers. We believe that ongoing consumer education would be of significant value and should involve retailers, governments and community organisations.

Exemptions

While the cost and burden of implementation of unit pricing will be small for most supermarkets, we recognise that for some small businesses the burden may be higher. We support consideration of possible exemptions for small businesses so that these are not subject to undue costs because of new regulation. Such exemptions, however, should be kept to a minimum.

Exemptions could be given based on a number of factors, including size of business. We believe an examination of overseas jurisdictions would provide a useful common-sense checklist of necessary exemptions.

²⁶ One of a few products in all Australian jurisdictions that, currently, must be unit priced.

²⁷ *Trade Measurement (Prepacked Articles) Regulation 1991 (Qld)*, regulation 28(2)(a)(i).

²⁸ *European Communities (Requirements to Indicate Product Prices) Regulations 2002*, section 5(4), Ireland; *The Price Marking Order 2004*, section 5(4), UK.

²⁹ <http://www.coles.com.au>.

Shopper dockets and loyalty

We continue to be concerned about the bundling of unrelated products in markets, and the impact of such bundling for competition and consumer outcomes. Bundling can have consumer benefits when they reduce transaction costs on related products. For example, bundling electricity and water may have benefits if they involve economies in billing, metering and checking credit references. However, bundling of unrelated products may actually result in high transaction costs (for example, the costs of developing and maintaining the relationship between petrol and grocery retailers). With linking grocery retailing with petrol, we wonder whether it wouldn't be more efficient overall for each to be a stand alone service.

We note that the ACCC has previously investigated shopper docket petrol discounts and acquisitions in the petrol and grocery sectors.³⁰ We also note that the ACCC considered this issue again in the context of its recent petrol inquiry.³¹ In both cases, the ACCC concluded that it sees no competition problem with the arrangements and that there are significant benefits to consumers from shopper docket petrol discount schemes. However, as suggested above, we are concerned that petrol shopper dockets create a barrier to switching, tying consumers to particular retailers where it might not be cheap or efficient for them to do so. We note a recent development from Woolworths to introduce a card to replace shopper dockets – this appears to be a way of locking customers more tightly to the retailer.

We note that recent changes to the *Trade Practices Act 1974* (Cth) (**TPA**) means that the ACCC will have a lesser ongoing role in examining shopper docket arrangements. Amendments to the third line forcing provisions of the TPA, which exempts related parties from being conduct that breaches sections 46(6) and 46(7)³², means that petrol and grocery retailers that structure themselves as related parties will no longer have to seek notification of third line forcing. In this context, we ask the ACCC to closely investigate the extent to which these arrangements are a barrier to switching and an impediment to competition.

Competition at the supply, wholesale and retail levels of grocery industry

The Issues Paper asks for comment in relation to competition at the supply, wholesale and retail levels of the grocery market. It is difficult for us to comment in any detail on this, however, we would note that the long and complex supply chain means inefficiencies that would prevent cost savings flowing through the supply chain to consumers may be difficult to identify. We do comment on our concerns with the increasing duopolistic nature of the supermarket industry below.

We are concerned about the potential competition problems that result from 'creeping acquisitions', that is, continued acquisitions (and the subsequent increased concentration)

³⁰ ACCC, *Assessing shopper docket petrol discounts and acquisitions in the petrol and grocery sectors*, February 2004.

³¹ ACCC, *Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol*, December 2007.

³² *Trade Practices Legislation Amendment Act (No 1) 2006*.

may result in an increased likelihood of collusion, price rises and margin increases without collusion, loss of volume for independent wholesalers and reduced negotiating power for suppliers.

We note that the ACCC has become concerned about creeping acquisitions, which led to the creation of the Charter for Competitive Sale of Independent Supermarkets. However, as Appendix A to the Issues Paper makes clear, there have been continued acquisitions of independent supermarkets by the large chains since the creation of the Charter. We continue to be concerned that section 50 may not be sufficient to deal with this issue, as that section requires the particular (usually individually small) acquisition being considered to substantially lessen competition. While an individual acquisition might not do so, a number of acquisitions over a period of time may substantially lessen competition.

Duopolistic nature of supermarket industry and problems that arise from this

The Australian supermarket sector is largely a duopoly, and two businesses, Coles and Woolworths, dominate market share. When a market is dominated by a few very large businesses, there is inevitably considerable risk that the market power of these businesses will be used in a way that undermines competition. We are concerned that the Australian supermarket sector lacks effective competition due to its duopolistic structure, and this results in high profits for Coles and Woolworth at the expense of other stakeholders such as consumers.

Surprisingly, even researchers who have denied that consumers have suffered a detriment from the duopolistic nature of the Australian supermarket sector admit that larger a business becomes 'the greater become its opportunities to work with (or even coerce) rivals in a coordinated use of horizontal market power...'.³³ Such an admission appears inconsistent with the notion that the in Australia supermarkets operate in a competitive market.

There are a number of negative consequences of market concentration. As the number of businesses in a market declines, the remaining businesses' demand curves become less elastic allowing businesses to unilaterally elevate price.³⁴ Disturbingly, this occurs without any tacit collusion, so anti-cartel laws are not able to target such anti-competitive outcomes.

Businesses in more highly concentrated markets typically have higher profit margins than businesses in less concentrated markets. This is certainly true in the supermarket sector.³⁵ It should be noted that by their nature, supermarkets are high volume/low margin businesses. The margins of Australian supermarkets are high in comparison with other countries and in comparison with what one might expect from a competitive market. Contrary to claims that higher margins are due to increased efficiency, it may be higher retail prices, rather than efficiency, that is the primary source of higher profits of large businesses in concentrated markets.³⁶ If supply-chain efficiency has led to reduced costs for

³³ Round, David K., *The power of two: squaring off with Australia's large supermarket chains*, The Australian Journal of Agricultural and Resource Economics, 2006, page 54.

³⁴ Cotterill, Ronald W, *Antitrust analysis of supermarkets: global concerns playing out in local markets*, The Australian Journal of Agricultural Research and Resource Economics, 2006, page 20.

³⁵ Competition Commission (UK), *Groceries market investigation: Provisional findings report*, 31 October 2007.

³⁶ Cotterill, above n 34, p 21.

supermarket chains (which it has) this ought to result in reduced prices paid by consumers. In the United Kingdom, where there has been concern about the level of competition in the supermarket industry, this has been the case – real supermarket prices have reduced by more than 7% in the five years to 2005.³⁷ That similar reductions have not been seen in Australia, but that real prices have actually increased, is of great concern.

This is of particular concern in the Australian context, given that we have one of the most concentrated retail food markets in the world,³⁸ and far less competition than the UK³⁹ (a country in which market concentration has been identified as a serious competition problem).⁴⁰

By contrast to the high profit margins that result from excessively concentrated markets, more competitive markets lower the profit margins of supermarket chains.⁴¹ For instance, it was found in the UK every extra large competing supermarket in a geographic area reduces rival supermarket profit margins by more than 4%.⁴² This is despite the fact that most large supermarket chains set prices nationally.⁴³

It has been suggested that power at one level of a vertical supply chain (eg. supermarket buyer power) is balanced out by power at another level of a vertical supply chain (eg. the power of very large food processors). Evidence suggests that this is not the case. Where power exists at two or more levels in a vertical supply chain, this power will coalesce and be used to the detriment of less powerful participants at other levels of the supply chain. In the case of grocery products, the less powerful participants who will suffer the brunt of this coalescing power are consumers.⁴⁴

Examples of the outcome of the market power supermarkets wield in Australia are numerous. One example is the dairy industry, where the gap between farmgate and retail milk prices rose quickly between 1998 and 2003.⁴⁵ The fact that supermarket prices have met or outpaced inflation in recent years (combined with the fact that farm prices have been largely stagnant and supply chain efficiency has dramatically increased) also demonstrates the detrimental impact on consumers of the power of supermarkets.

³⁷ Office of Fair Trading (UK), *The grocery market: The OFT's reason for making a reference to the Competition Commission*, May 2006, page 24.

³⁸ Cotterill, above n 34, p 15.

³⁹ Mills, Gordon, *Buyer Power of Supermarkets*, Agenda, Vol. 10 No. 2, 2003, p 161.

⁴⁰ Competition Commission (UK), above n 35..

⁴¹ Ibid.

⁴² Ibid.

⁴³ Often, supermarket chains have a number of set price points – the lower price point will be used if there is a proximate competitor, or discounting practices (such as sales and coupons) will be used to significantly lower the average price of products.

⁴⁴ Cotterill, above n 34, p 15

⁴⁵ Spencer, S., *Price Determination in the Australian Food Industry: A Report*, Commonwealth Department of Agriculture, Fisheries and Forestry, Canberra, 2004, pages 23024. (Note that the impact of the deregulation of the dairy industry during this period must be considered as a factor in these price changes).

Market monitoring

While we welcome the initiation of this inquiry from the Government, we do believe that the ACCC should have an ongoing role in monitoring competition in the grocery market. As outlined above, food is a significant cost in household budgets. And while the ACCC will have a role when it examines acquisitions in the context of section 50, we believe consideration should be given to a more concrete ongoing role of market monitoring.

We note that a particular outcome of the ACCC inquiry into petrol prices was for the provision of formal monitoring powers over petrol pricing, including an annual report to Government on its monitoring.⁴⁶ It is our view that such monitoring powers are appropriate in markets that have a high impact on consumers. In this way, regulators can play an ongoing role in promoting competition in particular markets and consumers can be assured that competition concerns will be highlighted and acted upon in a timely way.

Market inquiries

We note that this inquiry is being undertaken as a reference from the Minister for Competition and Consumer Policy. At present, there is no mechanism by which the ACCC can undertake a in-depth assessment of the market or requesting another body to do so, on its own volition. This in comparison to the UK, which provides the leading example of incorporating market analysis mechanisms into its consumer protection laws, by providing for both market studies and market investigations in its *Enterprise Act 2002*.

The Office of Fair Trading (**OFT**) refers to the market studies and investigations powers under UK competition and consumer protection laws as “diagnostic tools”. They complement its preventative tools (such as guidance and consumer education), advocacy tools (such as government advice and encouragement to business and consumers to use private redress mechanisms) and enforcement tools (such as undertakings and court action).⁴⁷ These tools, including market studies and investigations, sit within an overall framework of promoting markets that work well for consumers by dealing with both the supply and demand side.⁴⁸ Market studies and investigations strengthen the commitment to analysing or “diagnosing” market outcomes from both angles before taking action.

The OFT (and other industry regulators) may also make a market investigation reference to the United Kingdom Competition Commission (**UKCC**) to investigate any feature of a market that it suspects restricts or distorts competition in connection with the supply or acquisition of any goods or services. Such features may include supply and demand side features of a market

The practical experience of the use of market studies and investigations powers in the UK has been of a wide variety of important investigations in areas where consumer detriment

⁴⁶ Media Release – Minister for Competition and Consumer Affairs Chris Bowen, *Petrol Prices and Australian Consumers: Release of the ACCC Report Into Unleaded Petrol Prices*, 18 December 2007.

⁴⁷ Office of Fair Trading, *Annual Plan 2007–08*, March 2007, p 8.

⁴⁸ Office of Fair Trading, *Annual Plan 2007–08*, March 2007, p 8-9; see especially the diagram at 9.

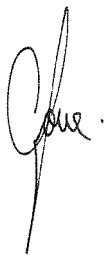
has been observed. This has resulted in a large range of different and considered actions to address problems.

We believe that appropriate market inquiry powers should be inserted into the TPA to enable the ACCC undertake in-depth investigations of particular markets should they raise competition and consumer concerns. Should ongoing market monitoring raise concerns about the grocery sector in the future, such market inquiry powers could be used to investigate competition and consumer problems, without having to wait for a reference from Government.

Should you have any questions in relation to this submission please contact Gerard Brody on (03) 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE

A handwritten signature in black ink, appearing to read 'C. Lowe'.

Catriona Lowe
Co-CEO

A handwritten signature in black ink, appearing to read 'Gerard Brody'.

Gerard Brody
Director – Policy & Campaigns