P U B L I C   S U B M I S S I O N

National Association of Retail Grocers of Australia

ACCC inquiry into the competitiveness of retail prices for standard groceries

(Part D)

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RETAIL GROCERY SECTOR MARKET SHARE

Introduction

The ACCC has been given conflicting evidence on the level of concentration in the retail grocery market. The market share of the two major supermarket chains has been variously expressed as either around 50% or around 80% of the market in which these stores operate.

It is clear that the interpretation of market share is entirely dependent on the definition of the market, with the 50% estimate coming from a market definition that, as well as packaged groceries and the goods commonly sold in supermarkets, includes fast food outlets, restaurants and other food outlets in the market definition. This reflects the approach taken by the ABS in its definition of the 'food' market.

Another approach involves the analysis of industry scan data for packaged groceries and other goods sold through supermarkets – such as the data collected by A C Neilsen. From this perspective the two major chains have about 80% of the ***market for groceries (fresh and packaged)***.

The chart below, taken from the 2006 AC Neilsen Grocery Report, demonstrates how these two approaches are linked. The data is sourced from the food sales statistics collected by the Australian Bureau of Statistics (ABS), and includes the following categories:

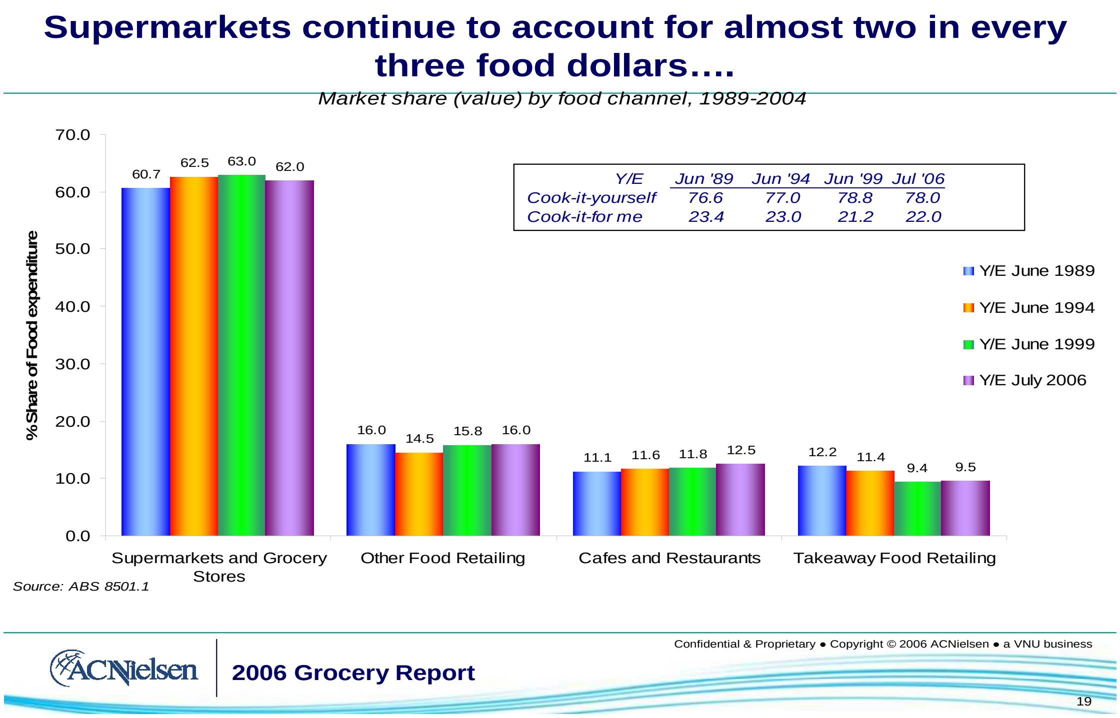
- Supermarkets and Grocery Stores (Includes Woolworths and Coles)
- Other Food Retailing (does not include the two majors)
- Cafes and Restaurants (does not include the two majors)
- Takeaway food retailing (does not include the two majors)

The comment "Supermarkets continue to account for almost two in every three food dollars" is pertinent.

The claim made by and on behalf of the two major supermarket chains – that they collectively represent only 50% of the retail food market is not inconsistent with the claim that these chains represent 80% of the groceries market.

The figures in the chart below confirm this fact.

50% of the total food market translates to (50 / 62) % - or 80.6% of the groceries market – using the 2006 figures from the chart below.



Terms of Reference

It is clear from the terms of reference given to the ACCC for the current grocery inquiry that the inquiry is about groceries – not fast food outlets, restaurants and other food stores.

This would suggest that, the appropriate approach to defining the market, market share and market concentration, is the latter.

Markets in Competition Law

Competition law practitioners need a clear definition of a market for a range of purposes – i.e. in order to determine market concentration, market dominance and other matters relating to their regulatory function.

It is therefore appropriate for the ACCC to use the accepted approaches to defining the grocery market, not only for this inquiry but for determining market shares and market concentrations when it comes to rulings relating to mergers and acquisitions.

The ACCC approach to market definition is clearly outlined in the recently released draft Merger Guidelines 2008 (the Guidelines). Substitution is seen as key to market definition.

The question then arises whether, say, a restaurant is a substitute for, or close substitute for a supermarket. Clearly it is not. The product offer is quite different.

Geographic Markets

Competition regulators are very much aware of the fact that markets exists at various levels, local, regional, state and national.

In fact Section 50 of the *Trade Practices Act 1974* requires that the potential impact of mergers and acquisitions are assessed at various levels of the geographic market.

It is therefore possible for markets to be seen as more or less concentrated in differing localities, regions or states, apart from the level of concentration seen at the national level. This is certainly the case in the retail grocery market.

The Guidelines issued by the ACCC propose the application of the HHI test to determine the level of market concentration – and suggest that a HHI of 2000 or more would be indicative of a market that is too concentrated.[1]

In this context it is evident that it is very important to determine the true market share of the two major grocery chains. A combined share of around 80% for the two majors would see the HHI threshold exceeded, whereas a perceived combined market share of 50% may not.

The assessment also has significance in terms of deciding whether the grocery market as a whole is competitive or whether, because of the degree of concentration, it suffers from the market failings associated with non-competitive markets, which include higher average prices.

[1] Other jurisdiction use different, and in many cases lower values of the HHI index as indicative of high concentration.

The Hypothetical Monopolist Test

The Guidelines go on to describe the *Hypothetical Monopolist Test* (otherwise known as the SSNIP test) as a means of determining whether an entity can exercise market power in a market, including a geographic market.

The SSNIP test revolves around an assessment of whether the entity can institute a 'small but significant non-transitory increase in price' in the market within which it operates.

Under such conditions, the entity can charge higher prices and make greater profits in that market or in that area than would be the case if the market was more competitive.

Evidence made available to the ACCC to date, including by the majors themselves, would suggest that the major chains have a pricing policy through which they set prices in accordance with local conditions. This would suggest that, in general, lower prices would be available to consumers in areas where a number of competing stores were co-located and in areas where one or both majors dominated the grocery scene, higher prices would apply.

We would suggest that the fact that these pricing practices exist demonstrates that there is a problem with market concentration in the retail grocery sector and that in the many locations where the majors dominate, consumers are not getting their groceries at the lowest possible price.

It is clear that the issue of market concentration in the retail grocery sector needs to be addressed.

The link to food price inflation – and the CPI

If the two major supermarket chains account for 50% of all food sales (equating to 80% of sales through the grocery sector) it could be assumed that the price increases taking place in these stores account for 50% of food price inflation – unless evidence is presented to show that the price increases in these stores have trended well below the food price inflation curve. This could be the case if the chains involved were prepared to pass the benefits of their buying power and / or efficiency gains on to the consumer.

However, we have seen that, at least in the case of Woolworths, there has been a steady and consistent increase in EBIT derived from grocery sales – i.e. the shareholders are benefiting from the price increases obtained.

So, are prices going up because costs are increasing, or because margins are increasing – or both?

Given the impact of food prices on the CPI as a whole, what is the impact on the CPI (and interest rates) of the steady increase in grocery prices?

Conclusion

The questions of market share and market concentration are critical to this inquiry. A concentrated market in the grocery sector underpins the growth of grocery prices, as the lack of effective competition allows incumbents to increase margins to a greater extent than would be the case in a competitive market, and reduces their need to drive internal efficiencies[2].

Consumers are the losers from both of these effects.

ABS statistics clearly demonstrate the link between a claimed 50% share of the ***food*** market and a measured 80% share of the ***groceries*** market.

They show that these measures of market share are simply two ways of looking at the same numbers.

It is, however, the practice of competition regulators to narrow down the definition of a market in order to determine in what part of the market concentration may be a problem.

If a two party share of 50% ***of all food*** sold in Australia is not of concern to the regulator, a two party 80% share ***of all groceries*** should be.

[2] It is often assumed that, because of their size, larger chains are more efficient and are therefore capable of passing on to consumers an efficiency benefit. However, the tendency of larger organizations towards size induced inefficiency also needs to be considered. At what point does size become a disadvantage?