



Metcash Limited

Public Submission to the ACCC Grocery Inquiry

Summary of Key Issues

28 May 2008



ABN 32 112 073 480
50 Waterloo Road
Macquarie Park
NSW 2113 Australia
PO Box 6226
Silverwater Business Centre
NSW 1811 Australia
Ph: 61 2 9741 3060
Fax: 61 2 9741 3031
Web: www.metcash.com

Mr Graham Samuel
ACCC Grocery Inquiry
Level 35, 360 Elizabeth Street
Melbourne VIC 3000

28 May 2008

Re: ACCC Grocery Inquiry

Dear Mr Samuel

This follow-up to the public submission by Metcash, which was submitted on 11 April 2008, aims to provide a summary of our views on the issues that were raised in this Inquiry by the ACCC and various stakeholders.

These issues include:

- the barriers to entry / expansion due to land restrictions and regulations;
- whether Metcash is providing the independent sector with competitive prices; and
- the impacts of weak competition between retailers including:
 - increases in the margins of retailers
 - the relative rate of food price increases in Australia compared to other countries
 - the bargaining power of large retailers / wholesalers in dealings with suppliers
 - manipulation of fruit and vegetable markets by large retailers / wholesalers

This document provides a succinct summary of our views in relation to these key issues and should be read in conjunction with the main body of our submission which was sent to the ACCC on 11 April 2008.

Kind regards

A handwritten signature in black ink, appearing to read "Andrew", enclosed within a large, loopy oval shape.

Andrew Reitzer

Contents

1	Metcash's core focus is to build a genuine 'third force' that can compete effectively against the major chains	1
2	Lack of access to sites is preventing the independent retail sector from expanding	4
3	Impacts of the 'cosy duopoly' in the retail market	6

1 Metcash's core focus is to build a genuine 'third force' that can compete effectively against the major chains

For more information on the importance of the independent retailer, please see Chapter 6 of our Public Submission to the ACCC Grocery Inquiry made on 11 April 2008

Independent retailers can offer genuine competition by leading prices down through a heavy focus on promotions

Independent retailers offer reasonably competitive 'everyday' shelf prices and deliver strong value promotions comparable to the major chains. At any point in time, IGA banner stores (greater than 1000 square metres in size) are selling around 2,000 – 3,000 items on temporary price reductions (i.e. 'on special'), with these discounted products translating into around 40% of grocery sales volumes.

This focus on promotions creates competitive tension which leads prices down for all items in those areas where the independent retailer has a significant presence, delivering the benefits of competition to consumers in these markets. Research has shown that genuine competition to large, broad range supermarkets like Coles or Woolworths can only come from other large, broad range supermarkets like Supa IGAs.

Independent retailers compete effectively through non-price elements of their retail offer

Price competition is not the only contribution that independent retailers offer consumers. Consumers benefit from improvements in the 'retail offer', which includes a variety of elements such as convenience and service quality as well as price.

Research by the Bureau of Transport, Infrastructure and Regional Economics (BITRE) shows that "clearly, independent grocery stores in some locations are able to compete with the major chains on price, with some even undercutting their competition" and others "may be competing in other areas such as service, variety, opening times, convenient location and delivery."

Independent retailers compete effectively with the major chains through the following non-price elements of their retail offer:

- **Convenient shopping** (quick in, quick out). Many independent retailers are of a smaller size compared to the major chains and are conveniently located with good parking and longer operating hours.
- **Niche ranges**. Independent operators have a strong understanding of the community they operate in and therefore are able to stock ranges that are tailored to the community's tastes.
- **Community focus**. Independent retailers are often local residents who have a strong community focus. For example, under the IGA Community Loyalty Programs (such as "IGA Community Chest"),

independent operators make donations to their community by setting aside a certain amount or percentage of sales from selected lines/products.

- **Personal service.** Compared to the major chains, many independent retailers have an entrepreneurial spirit and make particular effort to provide friendly and personal service to customers.

In areas where an independent retailer has a significant presence, the competitive pressure it adds through these non-price elements poses a significant constraint on a major chain store's ability to raise prices.

For more information on the level of competition in the wholesale market, please see Chapter 5.4 and 5.5 of our Public Submission to the ACCC Grocery Inquiry made on 11 April 2008

Metcash offers independent retailers the ability to obtain a lower cost of supplies than otherwise possible

Over the past decade, Metcash has built up a substantial wholesale customer base in the independent sector, and has pooled the purchasing volumes of independent retailers to accumulate the scale required to help them to compete against the major chains (which already hold significant economies of scale due to their retail market dominance).

Some retailers have commented that the wholesale prices that Metcash offers are 'uncompetitive'. The purchasing power of the major chains (given their market share of 75-80%), their ability to guarantee a certain volume of sales plus retail level compliance means that they are able to achieve a lower cost of supply. Anecdotal evidence suggests that this is in the order of some 2% of the 'confidential' terms offered by suppliers.

Independent retailers are still able to compete effectively against the major chains, despite this difference in wholesale costs, through their strong focus on promotional deals, their lower cost of doing business and their advantages in convenience and other non-price elements of the retail offer.

"The success of our customers is fundamental to our success"

Metcash's motto to be the "Champion of the Independent Retailer" reflects its recognition of its ongoing viability is dependent on the viability of independent retailers.

To only consider the non-vertically integrated wholesalers would be an overly simplistic approach to examining the wholesale market. Vertically integrated chains (including Woolworths and Coles) also carry out all major wholesaling functions, including negotiating with suppliers, providing storage and arranging distribution of products to stores.

These supply chain costs are all factored in to retail prices. Competitive pressure at the retail end means that Metcash must compete vigorously with the major chains in achieving low supply chain costs, so that independent retailers can compete effectively with the major chains.

Metcash's significant size in the non-vertically integrated wholesaling market should not be confused with a monopoly presence. Its ability to maintain a sustained increase in prices is severely constrained by the need to maintain a competitive cost of supplies to the retailers who buy

from Metcash. In order to maintain a viable customer base made up of independent retailers who are able to compete with the major chains, Metcash must share the benefits of scale and innovation efficiencies with independent retailers through maintaining low wholesale prices. This fact was recognised by the Trade Practices Tribunal when, in examining a dispute between wholesalers and retailers, it considered that the interest of retailers are protected because “[there] is, fundamentally, a community of interest between retailers and wholesalers.”¹

It is unlikely that an increase in ‘choice’ of wholesaler to independent retailers would yield any benefits to them. Unless the market shares of the major chains decline significantly, no wholesaler would be able to negotiate better terms of supply than the major chains.

On the contrary, any significant reduction in the volume of products purchased through a wholesaler would reduce its ability to maintain low supply costs. An example of this can be seen in 2002 when Australian Independent Wholesalers (AIW) was forced to exit the market after losing a significant customer that represented a significant volume of purchases.

The importance of maintaining economies of scale is also highlighted by the impact of creeping acquisitions. For example, the proposed acquisition of Karabar Supabarn by Woolworths will undermine Metcash’s ability to buy at competitive prices and reduce per unit costs. This reduction in Metcash’s ability to compete effectively with the major chains at the wholesale level will reduce the ability of independent retailers to offer competitive prices.

¹ Trade Practices Tribunal, QIW Retailers v Davids Holdings Ltd (BC9502743 at 136-137)

2 Lack of access to sites is preventing the independent retail sector from expanding

For more information on the impediments to effective competition, please see Chapter 5.3 of our Public Submission to the ACCC Grocery Inquiry made on 11 April 2008

Independent retailers can and would expand if suitable sites become available

Large, broad range supermarkets operated by independent retailers are successfully competing against Woolworths and Coles supermarkets. In recent years, the IGA network has demonstrated this fact through both the high number of new store openings and an average growth rate in store sales that is comparable to the major chains.

The major factor that is preventing independent retailers from expanding their presence in the market, in particular the opening of more Supa IGAs which compete vigorously with Coles and Woolworths supermarkets, is a lack of suitable sites. The major difficulties in obtaining suitable sites for independent retailers are:

- the major chains already occupy the majority of existing suitable sites, with long term leases which offer landlords little incentive to make additional sites available to competitors;
- difficulty gaining access to shopping centre sites due to their preference in dealing with the major chains, which already lease multiple sites from the landlord; and
- the ability of Coles and Woolworths to set up multiple duplicate presences to lock out competitors.

Reforms to planning regulations / zoning laws should consider the impact on competition between retailers

The Government's recent changes to foreign investment policy, which now allows foreign firms to 'land bank' for up to 5 years, shows that the Government recognises site availability as a critical issue in the grocery retailing market.

A risk of simplistically reducing the level of planning regulation or relaxing zoning laws is that the major chains, which have significant capital reserves, would then be able to exploit this opportunity to secure large masses of sites and further lock out competition. In many instances, the opening of a large Coles or Woolworths store in an area can have devastating impacts on existing local businesses, and the actual level of local competition is ultimately reduced in the long run.

Changes to planning regulation / zoning laws should foster healthy competition. For example, the UK Competition Commission recently recommended the inclusion of a 'competition test' in planning decisions on larger grocery stores, which considers the level of competition in the local area in approving new development or extensions. An applicant would pass the test if, in the area bounded by a 10 minute drive time:

- the new store was a new entrant; or
- there were already four or more different stores in the area; or
- there were three or fewer stores in the area and the new store's operator would operate less than 60% of grocery sales areas.

3 Impacts of the ‘cosy duopoly’ in the retail market

For more information on the level of competition in the retail market, please see Chapter 5 of our Public Submission to the ACCC Grocery Inquiry made on 11 April 2008

The ‘cosy duopoly’ between Woolworths and Coles has led to weaker competition in the retail market

Continued consolidation in the grocery retail market has allowed the major chains (i.e. Woolworths and Coles) to reach a combined market share of between 75-80%.

On a local level, many consumers have little choice but to accept the retail offer of a major chain outlet in their area. The major chains often point to the availability of food from retailers such as butchers and fruit and vegetable shops as evidence of their smaller ‘share of stomach’, but consumers remain heavily dependent on the traditional supermarket for dry and packaged groceries.

The entry of the discount retailer Aldi has had little effect on the major players. Most consumers do not view Aldi (which only stocks a limited range and offers mainly private label products) as a genuine alternative to a traditional supermarket. Independent retailers remain the only true ‘third force’ in the market.

Where other large, broad range supermarkets (such as a Supa IGA) do not have a presence, the level of competition between the two major chains has been weak. On a local level, many Australian consumers face a situation where there are no suitable alternatives to a Woolworths or Coles store. These consumers are vulnerable to price increases or a decline in service quality by the major chains, since they have no access to an alternate large, broad range supermarket. BITRE research shows that “consumers in towns with access to both [major chains and independents] have the advantage of choice, prices and associated services.”

For more information on the factors behind rising food prices, please see Chapter 8 of our Public Submission to the ACC Grocery Inquiry made on 11 April 2008

Increasing food prices in Australia

The recent rise in food prices has been a focus of this inquiry. There are some claims that the price increase in Australia has been higher than that of overseas markets, and that this is due to an increase in the margins of retailers.

Metcash is aware that there are many factors which have contributed to rising food prices. Metcash, as a wholesaler, does not have extensive data on the margins of retailers and is not in a position to comment on the margins of retailers. Hence, it cannot assess the validity of this claim.

Manipulation of fruit and vegetable markets

Over the course of this inquiry, Metcash has become aware of complaints by fresh produce suppliers that the fruit and vegetables markets are being manipulated by large players with excessive bargaining power.

Metcash has only recently began focusing on fresh produce (through the establishment of IGA>Fresh) and has not traditionally been a significant player in the fresh produce market. Therefore, it is not in a position to comment on the validity of this claim.

Metcash believes that the establishment of IGA>Fresh will give suppliers more options on who they sell their produce to and reduce the monopsonist power of the major chains.

For more information on the importance of independent retailers to suppliers, please see Chapter 6.5 of our Public Submission to the ACCC Grocery Inquiry made on 11 April 2008

Weak bargaining power of suppliers

Metcash has long been aware that most suppliers have little bargaining power in their dealings with the major chains. The dominance of the major chains means there are too few alternative distribution outlets for suppliers and growers. Delisting of a supplier's products by a major chain can seriously impair the supplier's viability. In the long run, the concentration of market power within the two major chains will hurt Australian consumers.

In general, Metcash is viewed as a 'third force' that in the market that dilutes the bargaining power of the major chains and strengthens the bargaining position of suppliers in the market. This is confirmed by quotes from suppliers, including:

- "We would like to see an active, progressive Metcash as a viable 3rd player in the Australian grocery market"
- "Having a strong 3rd force in the market is a good thing...we would like to see an even stronger Metcash / Independent network".

