

WOOLWORTHS LIMITED

ACCC inquiry into the
competitiveness of retail prices
for standard groceries

Public submission by Woolworths regarding
“creeping acquisitions”

18 June 2008

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1 Introduction

1.1 There is no creeping acquisitions “strategy”

There has been a considerable amount of special interest group misinformation giving rise to media comment regarding a so-called “creeping acquisition” strategy by the major supermarket chains (MSCs) over the last 10 years since the previous Federal Government’s Joint Parliamentary Inquiry into the Grocery Retailing Industry in 1998.

Woolworths has never had such a strategy and the facts do not support the existence of any such “strategy”. To the contrary, the facts demonstrate that the relatively few acquisitions of independents by Woolworths represent ad hoc, opportunistic acquisitions which have not weakened the independent sector, and which are dwarfed in number by the growth of new independent supermarkets.

Any assumption that the MSCs have a long term, planned approach to their acquisition of stores, as opposed to their preferred new store opening planning process, is in error. It misunderstands the dynamics and financial implications of the store acquisition process. The owners of independent stores determine whether, and if so when, they wish to sell their business. They value and have clearly benefited from the opportunity to seek competing offers to buy their supermarket from independents as well as the MSCs.

The uncertainty as to the timing, location, store format, Local Government Planning requirements and pricing of any independent store acquisition opportunities, contradict a “planned approach”. Nor could such a strategy form the basis of any planned new store growth strategy by the MSCs.

Further, since July 2005, at the initiative of the Commission, Woolworths, Coles and Metcash agreed to a “*Charter for the Acquisition of Independent Supermarkets*” to ensure that there was and continues to be an equal opportunity for an open and transparent independent store acquisition process, to protect the interests of all of the above parties as well as the interests of the independent store owner (as the potential vendor of the business). Woolworths has fully complied with this Charter and understands that it is generally regarded as working well and meeting the concerns and interests of the Commission and other parties.

In addition, Woolworths is a founding signatory to the **Produce and Grocery Industry Code of Conduct (PGICC)**, introduced by the Federal Government in 2000, and is also a founding member of the PGICC Committee that has administered this Code. The Code provides for the notification of all proposed supermarket acquisitions to the Commission.

Set out below are the facts which refute the logic of and basis for any alleged “creeping acquisitions” strategy by the MSCs. They also confirm that any such alleged acquisitions are a part of normal commercial activities which are fully transparent and scrutinised by the Commission.

1.2 Increases in Woolworths and Coles’ store numbers have not been at the expense of independent stores

Woolworths’ first submission to the Inquiry (14 March 2008) noted that the grocery retailing industry is very competitive and that the share of total food and grocery sales held by “*Large supermarkets*” (defined by the ABS) had declined from 66% to 63% over the period 1998- 2007. In that same period, the share held by smaller supermarkets and convenience stores had grown from 13% to 16%. In addition, 48% of the increase in total outlet numbers was attributed to Fresh Food Specialities, while 45% of the net gain in store numbers was attributable to supermarkets and stores other than the MSCs.

Clearly, the growth in stores of Woolworths and Coles has not been at the expense of independents and, despite various assumptions of a strategy of so called "creeping acquisitions", the facts do not support this. Instead, they indicate that the independent sector has increased in size over this period at a greater rate than MSCs, and that only a relatively inconsequential number of independent stores were acquired by Coles or Woolworths.

2 Store acquisitions

2.1 Notification of acquisitions

Aside from the acquisition of the store at Strathalbyn (SA) which Woolworths notified to the Commission (but is not listed by the Commission in Attachment A to the Issues Paper), Woolworths has acquired one independent grocery store in the past 3 years in addition to those listed in Attachment A.

The additional acquisition was of a small IGA store in Coonabarabran which was completed in early 2006. Negotiations commenced in late 2004/early 2005, before the Charter took effect and a number of features distinguished the acquisition from other business purchases. Woolworths did not own any supermarkets in Coonabarabran or the surrounding area at that time. The only other supermarket in Coonabarabran was a Bi-Lo store. The only supermarkets in the nearby towns of Baradine and Coonamble were two IGAs and one Supa IGA.

In its submissions to the Grocery Price Inquiry Metcash has queried whether Woolworths also purchased the Supa IGA at Bathurst. Woolworths has not purchased the IGA store or business that formerly operated in a centre adjoining the Stockland Centre in Bathurst. The IGA store closed and a new shopping centre is being constructed (due to open in March / April 2009) on a site that incorporates the former IGA site. Woolworths has a signed agreement with the landlord for lease for a new store in this centre.

2.2 Effect of acquisitions

(a) General comments

Most of Woolworths' growth is "organic". That is, its growth in supermarket store numbers is due to reasons other than the acquisition by Woolworths of another supermarket business and the subsequent opening of a Woolworths supermarket on that site. Over the period from 2001 to 2007, 121 of a total 139 store openings were due to organic reasons, such as where Woolworths converted a non-supermarket retail site to a supermarket site, developed a greenfields site or simply moved from one location to another nearby location.

Given that the "block acquisitions" by Woolworths of part of the Franklins chain in 2000 and 2001, and part of the Foodland (**FAL**) store chain in 2005 cannot be alleged to be "creeping acquisitions", these have been excluded from this calculation of store openings. The Franklins and FAL acquisitions have been described in more detail in section 2.2(b) below.

(b) Acquisitions of stores from the Franklins and Foodland chains

The acquisition and conversion of 71 stores from the previous Franklins chain in 2000 and 2001, and the acquisition of 20 Action stores from the FAL chain in 2005, were notified to, scrutinised at length and informally cleared by the Commission. In each case the transaction involved a larger number of stores being acquired by the independent sector than that acquired by Woolworths. These large transactions, prompted by the

decision to exit by an owner of a supermarket chain, are not acquisitions which could ever be alleged to constitute "creeping acquisitions".

The Action stores and development sites acquired in 2005 by Woolworths were part of and facilitated the wider acquisition of the FAL group by Metcash. Woolworths acquired the New Zealand operations of FAL at the same time.

Woolworths' involvement in the FAL transaction was the catalyst which enabled the overall Metcash transaction to proceed. Woolworths acquired the FAL operations in New Zealand (which trade under the "Woolworths" and other banners). As a result, Metcash acquired a total of 60 Action stores in Western Australia and Queensland (which became part of the IGA group) and increased its wholesale turnover by over \$1 billion.

Woolworths' reasons for acquiring the particular selected Action stores were to extend its retail network into areas where Woolworths was not competitively represented. At the time of seeking clearance, Woolworths presented comprehensive data to the Commission indicating that, for each of the Action stores to be acquired by Woolworths, the closest competing supermarket to each Action store was either a Coles or another independent supermarket.

At the time, Woolworths believed that its acquisition of the Action stores was likely to increase the intensity of retail competition in the relevant local areas for those stores.

In 2007, Metcash reported that the FAL/Action assets that it had acquired had generated \$87 million in incremental earnings.¹ Metcash reported that it sold the Action supermarkets to Metcash-supported purchasers in order to continue as a wholesale supplier to those operations, and that sales for the acquired FAL stores had increased by 17.2% "as a consequence of the conversion and IGA marketing".²

To the limited extent that Woolworths' growth is through the acquisition of independent supermarkets, these acquisitions are disclosed to the Commission in accordance with the PGICC and the Charter for the Acquisition of Independent Supermarkets (which, in Woolworths' view, achieves the aims of the Charter). The Commission then reviews the acquisition pursuant to section 50 of the *Trade Practices Act*.

- (c) Woolworths' few acquisitions of separate independent stores have not reduced competition in retail markets or at the wholesale level

Apart from the Action stores acquisition in 2005 (discussed above), to date, Woolworths has only acquired 6 independent stores after 2005. Of these 6 sites, 4 had no local existing Woolworths stores within the local trade area, while 2 had existing Woolworths stores within different shopping centres within the local trade area.

Prior to each acquisition, Woolworths notified the Commission and the Commission received significant market data and reviewed each individual store acquisition under s.50 of the *Trade Practices Act*, examining both impacts on retail competition as well as competition at the wholesale acquisition level. Woolworths notes that each of those individual acquisitions was cleared by the Commission after carefully considering these factors.

¹ Metcash Ltd 2007 Annual Report, p.3.

² Metcash Ltd 2007 Annual Report, p.4.

(d) Potential repercussions arising from limiting the range of potential buyers

Regulatory reform that leads to a limitation on the range of potential buyers of independent supermarkets through reducing the ability of Woolworths and other major supermarket chains to bid for such businesses would detrimentally affect the competitive process that currently exists under the Charter for the Acquisition of Independent Supermarkets. In particular, two outcomes are likely to result:

- Metcash may become a monopsonist in the market for the acquisition of existing and future IGAs, an outcome which will not likely increase the welfare of independent grocery retailers or their customers; and
- the value that independent grocery retailers could obtain upon exiting the business would diminish (because of the smaller number of potential bidders), which would ultimately discourage entry into independent grocery retailing because of a perceived inability to adequately execute a financially viable “exit strategy” should the retailer choose to cease trading.