Australian Graduate School of Management School Dinner

Big Business V Small Business – vigorous or vicious competition?

4th November 2004
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In his superb "History of Britain", historian Simon Schama recounts how James the First opened up trade between his newly united kingdoms of Scotland and England.

> "Once a ferocious border policing commission was in place and had started to catch, convict and hang the gangs of rustlers and brigands who had made the Borders their choice territory, cross-frontier trade took off. Fishermen, cattle-drivers and linen-maker all did well. Duty-free English beer became so popular in Scotland that the council in Edinburgh had to lower the price of the home product to make it competitive."

While the methods for dealing with those who seek to restrict competition and erect unfair trade barriers may have been updated, the benefits that come from vigorous and fair competition are just as apparent in Australia today, as they were to Scottish beer drinkers in the early 1600s.

The rewards of more than two decades of economic reform to make Australia more efficient, more flexible, more productive and above all, more competitive are unemployment rates at a 20-year low, interest rates close to the lowest levels in over 30 years and economic growth rates that consistently outstrip those of most other OECD nations.

And while the opening up of the Australian economy to greater competition both internally and from overseas has produced undoubted benefits to the economy, it also provides more direct benefits to consumers.

Vigorous competition provides consumers with:

- choice;
- all the information to make that choice rationally;
- convenience; and
- higher quality and lower prices for goods and services.

Business, too, is a beneficiary of competition policy. Competition – and this includes intense and, at times, incessant price competition – benefits those businesses that are able and motivated to take advantage of the powerful forces driving their particular market.

The corollary, of course, is that businesses that are unable or unwilling to respond to the, often daunting, challenge of competition, will languish and may ultimately fail. But this is the essence of an open market economy.

As the story about the Scottish beer drinkers showed, it has been operating in free enterprise economies in one form or another for hundreds of years. It is just the intensity and speed of change that is different.

I have no doubt that when that duty-free English beer first crossed the border, the local beer makers appealed for some sort of protection but ultimately what was regarded as vicious and unfair by those who benefited from the previously closed beer market, was seen by the consumers who benefited from the end of that monopoly as vigorous and fair.

And they were right, because the purpose of competition policy must be to benefit consumers – not competitors. The question to be asked must always be what is in the long-term interest of consumers.

I'll have more to say about those protections later, but there's no doubt, that in political terms, the most complex area for implementation of competition reform has been in relation to issues affecting small business.

Small business is an important and integral part of the economy. It contributes almost one-third of our Gross Domestic Product and employs over half of the workforce. For the most part, small business is an integral part of vigorous competition and the interests of small business are concomitant with those of consumers. But the principles of competition policy enshrined in both the Trade Practices Act and the National Competition Policy emphasise the primary purposes of a vigorous competitive economy and the protection of the interests of consumers.

Entirely consistent with this objective is that businesses that are able and motivated to take advantage of the competitive environment through innovation, improved efficiencies, keen pricing, quality service standards and other forms of vigorous competition will thrive. And for the most part, small business is able to respond to the competitive environment more quickly and with more flexibility than many of its larger competitors. As stated previously, the corollary is that businesses that are unable or unwilling to respond to the challenge of competition will languish and may ultimately fail.

The difficult task for governments and regulators is to strike the balance – to distinguish between vigorous, lawful competitive behaviour that is likely to lead to significant and sustained benefits for consumers and unlawful inherently anti-competitive behaviour that is likely to disadvantage consumers. This is a task that needs to be undertaken independently, rigorously, transparently and objectively to ensure that the primary focus is on the interests of consumers, that is to say the community at large, and not on insulating certain sectors of business from the normal competitive disciplines.

Now that is the theory and it has been most recently endorsed by both the Dawson Committee Review into the Competition Provisions of the Trade Practices Act and the Senate Committee considering the effectiveness of the Act in relation to small business.

The Dawson Committee Report summed up the issue as follows:

> "The Committee does not favour the introduction of competition measures specifically directed to particular industries to respond to perceived shortcomings in the relevant markets. Often the complaint when analysed is not about reduced competition, but about the structure of the market which competition has produced. Concentrated markets can be highly competitive. It may be possible to object to the structure of such markets for reasons of policy (the disappearance of the corner store, for example), but not on the grounds of lack of competitiveness. Of course, concentrated markets should attract scrutiny to ensure that competition is maintained, but the purpose of the competition provisions of the Act is to promote and protect the competitive process rather than to protect individual competitors. The competition provisions should not be seen as a device to achieve social outcomes unrelated to the encouragement of competition. As a matter of policy those outcomes may be regarded as desirable, but the policy will not be competition policy. Nor should the competition provisions seek the preservation of particular businesses or of a particular class of business that is unable to withstand competitive forces or may fail for other reasons. Those are matters which may legitimately be the subject of an industry policy, but that is not a policy which is to be found in the competition provisions in Part IV of the Act."

More recently the Senate Committee considering the effectiveness of the Trade Practices Act in relation to small business noted -

> "…the Committee considers that while the objects of the Act refer to enhancing competition, these objects implicitly require – or at least prefer – the existence of an effective number of competitors.
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> Having stated this, the Committee recognises that there is a significant difference between protecting competitors, and protecting *particular* competitors. The entry and exit of competitors from the market is a normal part of vigorous competition. Market efficiency is often enhanced by driving inefficient competitors from the market
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> To summarise the Committee's views on this issue, the purpose of the Act is to protect competition. This can best be achieved by maintaining a range of competitors, who should rise and fall in accordance with the results of competitive rather than anticompetitive conduct. This means that the Act should protect businesses (large or small) against anticompetitive conduct, and it should not be amended to protect competitors against competitive conduct"

But while the theory is easy to state, it is not so clear that the principles are either well understood or applied in practice. For while it is now widely accepted that the purpose of competition policy is to promote competition in the interests of consumers and not to protect competitors from the rigours of competition, in practice the distinction between these objectives is confused

and blurred — sometimes leading to conclusions that are inherently anti-competitive in nature.

Competition policy regulators are required to deal with two issues. The first is to analyse whether in the context of any particular market, there exists a course of behaviour which would have the effect or be likely to have the effect of substantially lessening competition in that market. This requires a rigorous, independent, factual economic analysis of the market and the likely impact of behaviour of competitors in that market. If that analysis reveals a likely anti-competitive consequence, competition policy requires competition regulators to intervene to prevent that anti-competitive consequence.

It may or may not be the case that to protect and nurture competition in that market, it is necessary to take steps to protect competitors or a class of competitors in that market from substantial damage or indeed elimination as a result of a course of behaviour by another competitor. The provisions of Part IV of the Trade Practices Act are designed to permit that intervention by competition regulators to take place.

What is not clear however, in the claims and counter-claims that are made by small and big business respectively in relation to these matters, is whether the primary case has been made for regulatory intervention. That is to say, it is not apparent that any rigorous independent analysis has been undertaken of the relevant market or markets to determine that a course of behaviour by one or more competitors in those markets will lead to a substantially anti-competitive (and thus anti-consumer) impact.

If such an analysis leads to the conclusion that there is likely to be a substantial lessening of competition in the relevant market, then of course the competition regulator should intervene. But if the analysis merely leads to the conclusion that some competitors in the market might suffer damage or indeed be eliminated, but that competition in the market will still be vigorous with attendant consumer benefits, then there is a dubious case for intervention by the competition regulator.

The difficulty in this area is that so often those who seek regulatory intervention have failed to first demonstrate the case for intervention. Indeed, in some cases, they have been reluctant to have the relevant market, and the course of behaviour complained of, subjected to an independent rigorous analysis to determine whether there is a case for intervention.

The point is, if we intervene too soon and without transparent, open and independent analysis, we may be acting to protect competitors, at the expense of vigorous, lawful competitive behaviour, and as a consequence, disadvantage the consumer.

Having spent eight, at times difficult, years undertaking an independent and rigorous process of examination and reform of anti-competitive regulations which have not been in the public interest, pursuant to National Competition Policy, policy makers need to be continually on the alert that they are not

drawn back by powerful private interest groups to protect specific sectors of business from the competitive environment.

Nowhere has this dilemma been more starkly illustrated than in the case of the retail grocery market (and more recently, the linkage with the retail petrol market) in Australia where many of the small retailers (and their wholesale suppliers) maintain that if they are not protected from competition by the major retailers, a market duopoly of Coles and Woolworths will result. This necessitates, it is claimed, policy and regulatory intervention for example to retain discriminatory shop trading hours, to limit the acquisition of additional market share by the major retailers and to prevent price discrimination by suppliers to, and price discounting (claimed to be predatory pricing) by, the major retailers.

Now clearly if these claims are borne out by an independent rigorous analysis of the relevant markets, both product and geographic - if the fundamental claim of a likely duopoly between the two major retailers can be demonstrated, and that can be shown to be substantially anti-competitive, and therefore disadvantageous to the consumer, that is to say the community at large, competition law should operate to prevent such an outcome.

But these claims, and this prognosis, have not to date been demonstrated in any independent rigorous analysis of the relevant markets – and consequently there does not appear, at this stage, to be a valid case for intervention by competition regulator.

Some of these claims come from smaller independent outlets or their representatives who are concerned at their ability to compete in an increasingly competitive environment.

But some are being made by powerful, vested interests who are seeking to preserve or enhance their own special position in the market to the disadvantage of consumers.

For example it is claimed there is a duopoly in retail grocers in Australia. This seems to ignore the reality of the existence of the Metcash group, with some 4200 stores supplied by its wholesale operations (and repeatedly announcing rosy profits results and outlooks to the stock exchange), the Foodland group with its extensive interests in Western Australia and now expanding into Queensland and New South Wales, the German based Aldi group with its own form of home brand discounting, which has just in the past few days advertised for sites to enable a significant expansion of its presence along the eastern seaboard and finally the prospective entry into the Australian market of the Costco Group with its large warehouse style hypermarkets.

And then we have the recent independent analysis of the grocery market in Australia undertaken by Whitehall Associates for the Commonwealth Department of Agriculture, Fisheries and Forestry. Their Report provides some instructive reading.

> "There is a highly competitive and contested retail food market for the consumer dollar. ….the intense competition for market share between the grocery retail majors, and between majors and independents and over 30,000 specialty food businesses is a major benefit to Australian consumers in terms of price, convenience, range and choice.
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> Future trends in retail will continue to see extensions of the retail format into new areas where synergies are available…
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> Food retailers are increasingly using loyalty strategies to shape and entrench buyer shopping habits (store cards, fuel discounts, in-store banking services, loyalty reward schemes and so on). This drives repeat store visitations thereby encouraging high sales turnover"

The Report notes that a "highly competitive retail sector combined with the strong presence of national and international brands has resulted in a low margin, by world standards, grocery sector" – hardly the sign of a rampant duopoly extracting monopoly profits.

And if we turn to the petrol market, what becomes clear is that far from the existence of a "cartel" between the four oil majors, as is often claimed, or the encroaching and supposedly inevitable duopoly of the two major supermarket chains, what we are seeing is, in the words of one major player who has publicly indicated it won't be participating in the new wave of shopper docket schemes, "a culture of discounting" with competitive responses being made by competitors in order to attract and retain custom.

The reality is that the linkage of petrol discounting to retail grocery sales is no more than a loyalty or marketing program like Fly Buys. While these schemes initially focussed on the two major supermarket chains they have now extended to include the Metcash/IGA group, major hardware chains, Dimmeys Department stores and finance brokers.

We should not be surprised if retailers of other consumer products were to follow suit with similar marketing or loyalty schemes in the future.

And why has petrol been chosen? Fundamentally because it is the most consumer-price sensitive commodity in Australia today. In what other market will people drive from suburb to suburb checking prices?

While independent retailers and their representatives and suppliers would urge the competition regulator to outlaw these schemes claiming that they will lead to the demise of all independent outlets as the Coles/Woolworths juggernaut rolls on, all the evidence points to a vigorous competitive retail grocery and petrol sector involving many major players including Coles, Woolworths, Metcash, Foodland, Aldi, Dimmeys, Shell, BP, Caltex, Mobil and potentially other significant retailers establishing their own alliances.

Both retail groceries and petroleum have been, and are continuing to, undergo rapid change. Gone are the small stand alone supermarkets and the tiny corner service stations. Now supermarkets are four to five times their

previous size, service stations are now fewer in number but significantly larger, located on major highways and directly linked with substantial convenience stores, carwashes, fast food outlets and even hotels.

These changes are driven by consumer preferences and businesses operating in these markets will undergo rapid change. But those that do adapt will survive, indeed thrive, while those which are unable to adapt, or rest on the belief that governments or regulators will step in to protect them, will languish and may ultimately fail.

I repeat, it is not the job of the Trade Practices Act or the Australian Competition and Consumer Commission to protect competitors – but to protect competition.

This is not to say that small business has no protection under competition policy. For competition policy is about encouraging lawful, vigorous, competitive behaviour to benefit consumers, that is to say the public interest. Small businesses that are subjected to anti-competitive or oppressive and unconscionable business behaviour that disadvantages small businesses are entitled to protection.

Let me now illustrate briefly how the Trade Practices Act and the ACCC does operate to protect the interests of small business consistent with its fundamental objective, which is to promote competition in the interests of consumers.

Small business and Section 46

There has been a lot of discussion about how the misuse of market power provisions of the Trade Practices Act protect small business.

Following some recent High Court decisions the Commission has expressed the view that there is a need to clarify the interpretation of the section to bring it back to what was intended by Parliament when it was first enacted and then subsequently amended in 1986.

Effective misuse of market power provisions are an important part of any competition law. They deal with situations where a firm has substantial market power and uses that power to damage its competitors or to prevent new firms from competing with it. These provisions are an important adjunct to the other main pillars of an effective competition law – the restrictions on the accumulation of market power through mergers and acquisitions and anti-competitive agreements between competitors.

Effective misuse of market power provisions are important to small business because smaller businesses could be the potential targets of a misuse of market power by a larger business. In this situation the Commission will act to protect the small businesses involved.

We do this not to protect a particular business merely because it is a small business, but to protect competition where small businesses are being targeted for anti-competitive reasons by a more powerful firm.

So, while the Commission believes it would be helpful for the misuse of market power provisions in the Trade Practices Act to be clarified, we still stand ready to act against any business that seeks to abuse its market power. Contrary to some recent claims, the Commission has not turned its back on this section of the Act even though, as the law currently stands, it has placed some high hurdles in our way before we can take action under this section.

Small business needs to be careful, however, not to place undue reliance on the misuse of market power provisions.

Firstly, it needs to be understood that the misuse of market power provisions require both conduct which is damaging, or potentially so, to competitors, and for this conduct to be intended to, or to have the purpose of, damaging specific competitors. It is not enough to point to the fact that competitors, even small competitors, are being damaged by the actions of a larger, more powerful business. Normal, even aggressive competition is not on its own a misuse of market power. The conduct of the larger business needs to be targeted or intended to damage particular competitors.

This is where the Commission requires the assistance of small business. The Commission will investigate properly alleged instances of abuse of market power and use its statutory powers to do so if necessary. However, it needs small business to draw to its attention instances of market behaviour by larger businesses which is both targeted at a particular business and is detrimental or potentially detrimental in its impact.

The second reason why small business should not place undue reliance on the misuse of market power provisions is that they are concerned with a particular form of market conduct - that is, so called horizontal behaviour. This is where a business with substantial market power is seeking to damage one or more of its competitors.

The abuse of market power provisions are not relevant in so called vertical behaviour - that is, where a small business is a customer of, or supplier to, a larger more powerful business. There are other provisions in the Trade Practices Act which are relevant to these situations which I will come to shortly.

The misuse of market power provisions are therefore not a panacea for all the concerns of small business. They deal with one important source of concern for small business - anti-competitive behaviour by a larger competitor. However, they do not deal with other legitimate concerns that small businesses may have.

Unconscionable conduct

Many of the complaints received at the ACCC from small businesses do not relate to concerns about direct competition with a larger business. The majority of complaints from small business are about their commercial relationships with larger business. Often this relationship involves the supply of goods or services.

In these situations the more relevant provisions that apply to the situation are the unconscionable conduct laws, particularly the statutory unconscionability provision, Section 51AC.

Big business cannot use its power or influence over a small business for unfair purposes. A business in a position of power threatening to withhold the supply of products, especially where those products cannot be sourced elsewhere, in order to impose harsh and oppressive conditions will likely breach the unconscionable conduct provisions of the Act.

One leading case taken by the ACCC under s.51AC made it clear to franchisors that they cannot hold their franchisees to ransom with unreasonable terms and conditions.

The franchisor in this case withheld essential supplies unless the franchisees bowed to a range of unreasonable conditions, including making them pay for advertising that did not even include their stores details, and forcing them to buy many years worth of product at a time.

At one point, the franchisor demanded the surrender of diaries containing details of current customers, while setting up his own businesses which competed directly with his franchisees.

The franchisor demanded unreasonable conditions, such as refusing to consider meetings unless the request was received by mail, and refusing joint meetings, when the franchisees tried to discuss their concerns with him.

The court declared that the conduct of the franchisor was unconscionable, in breach of the Act, and that the managing director of the franchise was involved in the contraventions.

The conduct of this franchisor beggared belief and the franchisees in this case had no way forward in running their businesses.

The unconscionable conduct provisions seek to protect all parties from unfair dealing such as this, but particularly where one of the parties is especially vulnerable. Businesses should not take unfair advantage of a person in a vulnerable position by entering into commercial arrangements without ensuring that the person has full knowledge of its terms and effects.

In another recent case, a company leased farmland to farmers in South Australia. Most of these farmers lacked formal education, spoke little English and had very limited commercial experience, whereas their landlord was highly educated and experienced.

The initial lease agreements placed no limit on the water that the farmers could obtain from a bore on the land. The lessor then requested that the farmers sign new agreements, which significantly reduced the amount of water available and placed steep charges for excess water use. The lessor continued to tell the farmers that the agreements had not changed. However,

unbeknownst to the farmers, the company sold a substantial proportion of the water allocated to the bore.

These new agreements resulted in the farmers incurring huge excess water charges. The company demanded the farmers pay more than $67,000 in total for excess water use.

Following action by the ACCC, the court granted injunctions restraining the company from demanding payment for excess water, and requiring them to indemnify the farmers for any excess water charges until their leases expired.

The cases that the ACCC has pursued with regard to unconscionable conduct all have an unscrupulous factor. It is more than tough negotiating. For a matter to be regarded as unconscionable by the courts a business must have crossed the line and engaged in conduct that is not tolerated in a normal commercial relationship.

It is important to recognise that the law does not exist to inhibit businesses from advancing their own legitimate commercial interests. The law will not apply to situations where a business has merely driven a hard bargain, nor does it require one business to put the interests of another party ahead of its own.

Collective Bargaining

An area where changes are to be made to assist small business is in the area of collective bargaining.

Normally, where groups of competing businesses come together to collectively negotiate terms and conditions and, in particular, prices, this is likely to raise concerns under the Trade Practices Act.

Indeed, in recent months we have had great success in prosecuting a number of companies and their executives for illegal cartel arrangements to fix prices, including a record $35 million in total penalties for companies and executives involved in a power transformer and transformer distribution cartel.

However, the ACCC and the Trade Practices Act have long recognised that when it comes to negotiating with big business the playing field is far from level for small business.

The ACCC and the Act therefore explicitly acknowledge that it is sometimes fairer to enable this relative mismatch in bargaining power to be evened up, by enabling small business to come together to bargain collectively under a process known as authorisation.

Under this process, the ACCC has the power to authorise protection from court action for otherwise anti-competitive conduct where those proposing to engage in that conduct can demonstrate that there is a net public benefit.

Refinements to this process to further benefit small business are likely in coming months as a result of amendments to the Trade Practices Act which have bipartisan political support.

While having many of the same characteristics as authorisation, the proposed new notification process will provide automatic immunity within a statutory period unless the ACCC is satisfied that the proposed collective bargaining arrangements are not in the public interest.

It is anticipated that this process will be a low cost, simple and timely way to obtain protection under the Act to allow a group of small independent businesses to negotiate with a bigger party where it is in the public interest.

Summary

To sum up, it is not the role of competition policy to favour one sector over another - competition policy is not about preserving competitors, it is about promoting competition.

The benchmark test for competition regulators is whether a course of conduct is likely to lead to a substantial lessening of competition in a specific market for goods or services.

One of the difficulties is that there is not a wide understanding of the difference between protecting competitors and promotion of competition. And while small business will seek for the focus of competition policy to tend more towards a philosophy of the protection of competitors, ostensibly in the interests of the promotion of competition, the voice of the consumer will be constantly heard urging that the focus remain on the promotion of competition with its attendant consumer benefits.

The voice of consumers rests with consumer groups, governments and regulators to ensure that competition is vigorous and lawful, even if this implies that it be aggressive and potentially damaging to some competitors within a market. For this is the way for consumers to get the advantages of choice, quality and price to which they are entitled and to ensure that our economy is best able to adapt itself to maximise productivity and growth.

The Commission can not interpret its responsibility to promote competition to mean the protection of individual companies and the outlawing of vigorous, legitimate competition – even where that competition causes difficulties for individual firms.

Vigorous competition is not market failure and it is not the job of the Commission to preserve competitors or protect any sectors of the economy from competition.

The role of the ACCC and the Trade Practices Act 1974 is fundamentally to enhance the interests of Australian consumers by promoting fair, vigorous and lawful competition, whether it be between businesses big, medium and/or small.