Reviving concentrated markets with merger reform

MGA Independent Businesses Australia

Response to the Treasury consultation paper on merger reform

19 January 2024

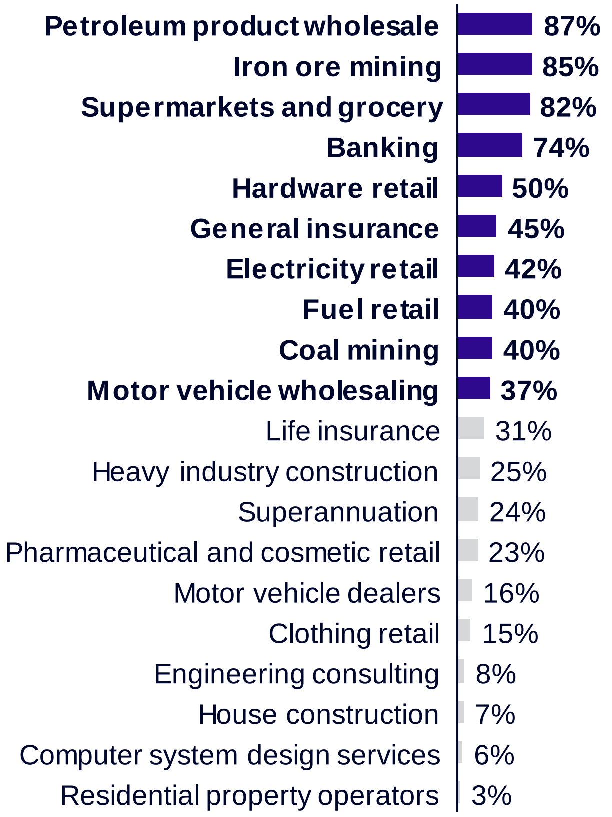
Concentration is high and rising in many Australian industries

- **10 of the 20 largest industry classes in Australia are highly concentrated.** These industries play a large role in the lives of Australians, such as supermarkets, banking and hardware retail. Many of these industries are dominated by the same large conglomerates which use market power in one industry to build market power in additional industries.[1]
- **The Australian economy has become more concentrated over time**, with the average four-firm concentration ratio increasing by 2.2 percentage points from 2001-2 to 2018-9.
- **Increased concentration has failed to deliver on its promise of increased efficiency – in fact, the opposite has happened.** The Chicago School of economic thought from the 1970s predicted that increased concentration would deliver efficiency gains. This has not materialised. Research shows that a 25% increase in concentration results in a 1% fall in productivity.

Four-firm concentration of the 20 largest industry classes (by revenue)

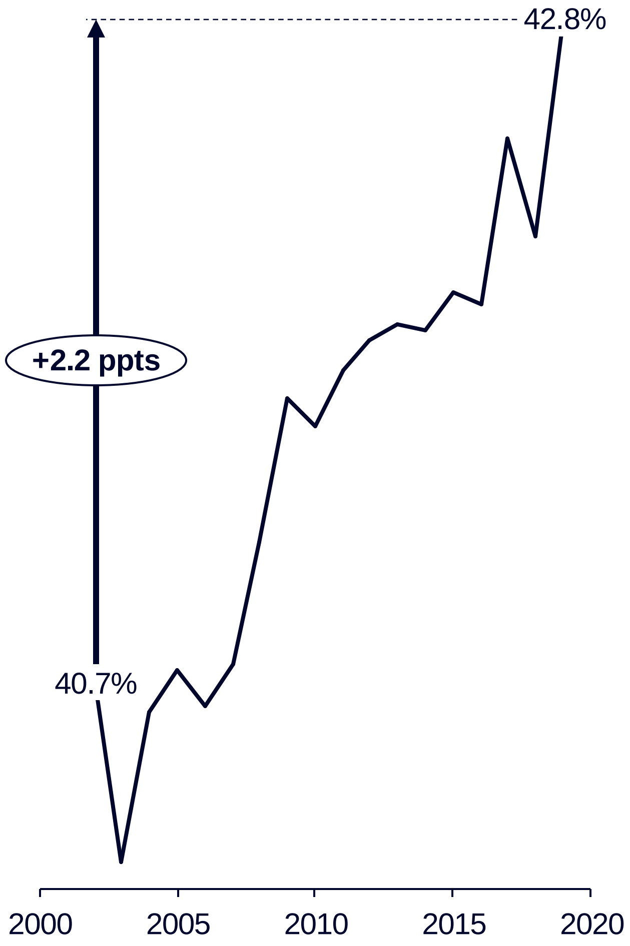
Market share of the four largest firms by industry class, 2023

The highlighted industry classes are considered 'concentrated' with a four-firm concentration above one-third.



Average four-firm concentration ratio

Average market share of the four largest firms by industry



Sources: IbisWorld reports (2024); Leigh (2022); Triggs and Leigh (2019); Leigh and Triggs (2016); Blonigen and Pierce (2016).
Notes: 1. See page 9.

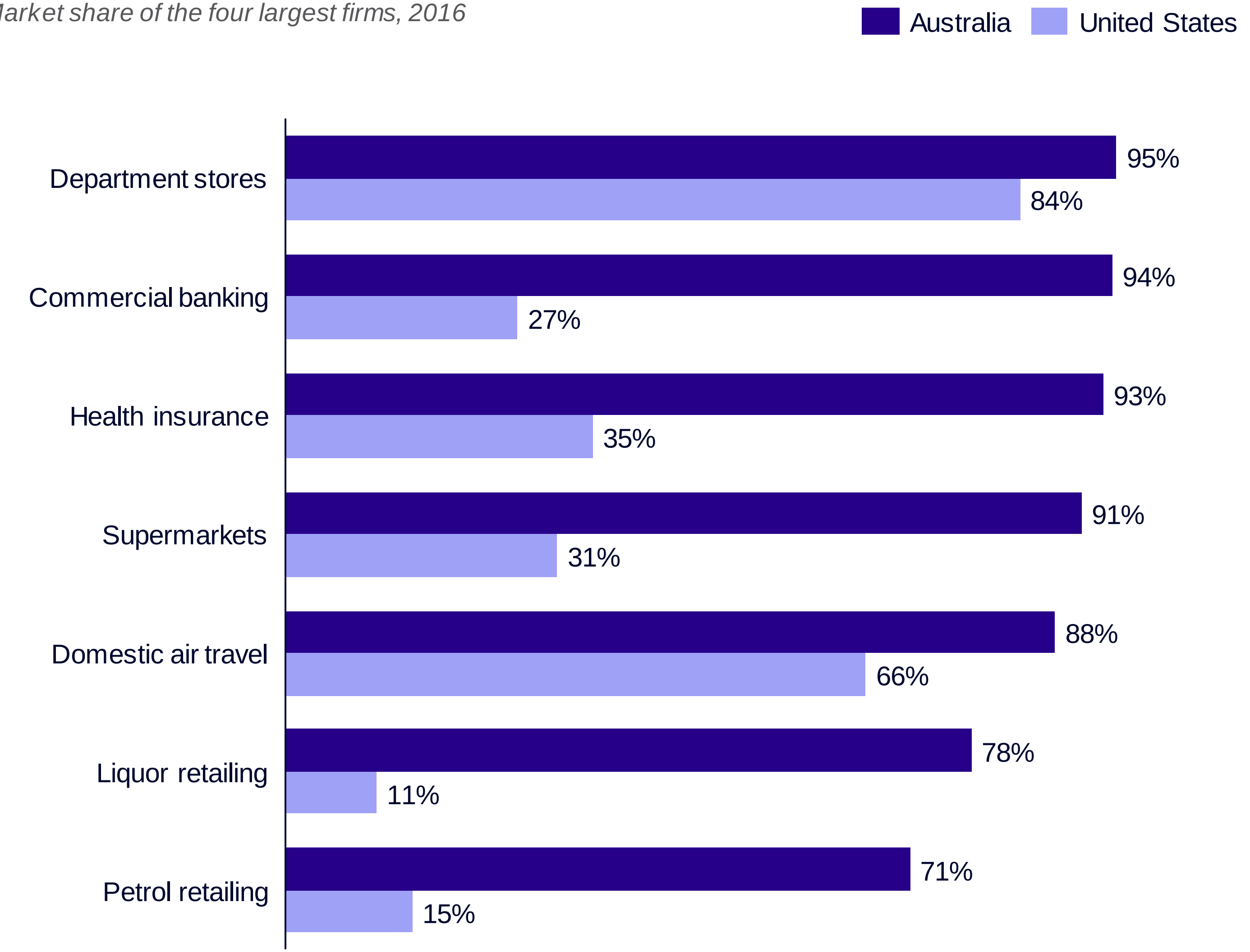
Many industries are more concentrated in Australia than overseas

- **While industries in many developed economies are concentrated, some industries are particularly concentrated in Australia.** There are especially large discrepancies in concentration in commercial banking, health insurance, supermarkets, liquor retailing and petrol retailing.

  While the United States may be an imperfect benchmark for Australia with a much larger population and more opportunities for industry fragmentation, Australia also ranks poorly on international measurements of competition. For example, Australia was ranked 35th for 'extent of market dominance' by the World Economic Forum in 2009, behind peer countries like Canada, United States and United Kingdom.

Four-firm concentration in Australia and the United States

Market share of the four largest firms, 2016



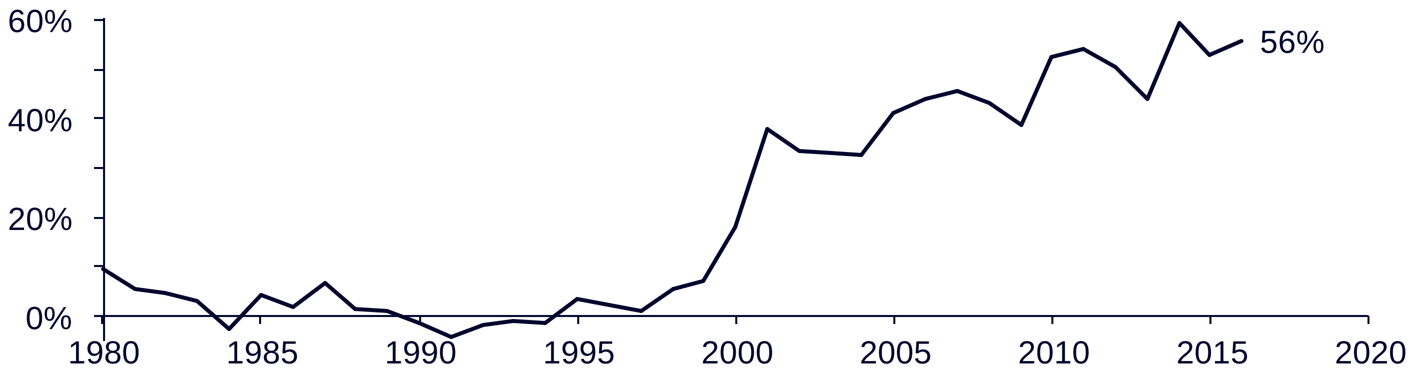
Sources: Leigh and Triggs (2016); World Economic Forum (2019). Note that this chart uses a different data source to that used for the chart on page 2.

Growing economic evidence links increasing concentration with higher mark-ups and lower wage growth

- **Increasing economic concentration has been linked to increased prices**, with average mark-ups increasing from close to 0% above marginal cost in 1980, to above 50% after 2010.
- **There is also emerging evidence that increased concentration leads to lower wages.** The wage share of GDP has fallen from 84% to 69% over the last four decades. Leigh and Triggs (2016) find that more concentrated industries tend to deliver lower wages to employees. Hambur (2023) finds evidence that more concentrated local labour markets leads to lower wage growth.

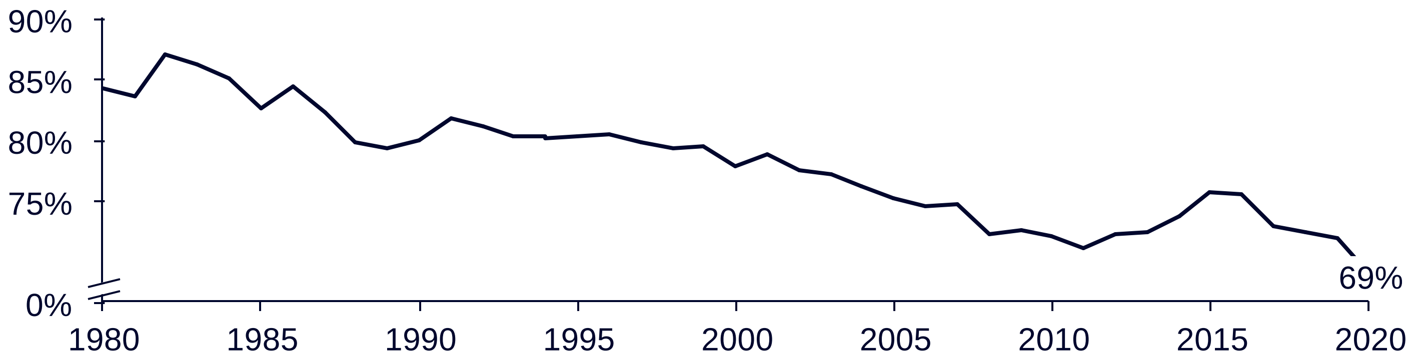
Average firm mark-ups

Percentage of prices above marginal cost



Wage share of GDP

Percentage of GDP



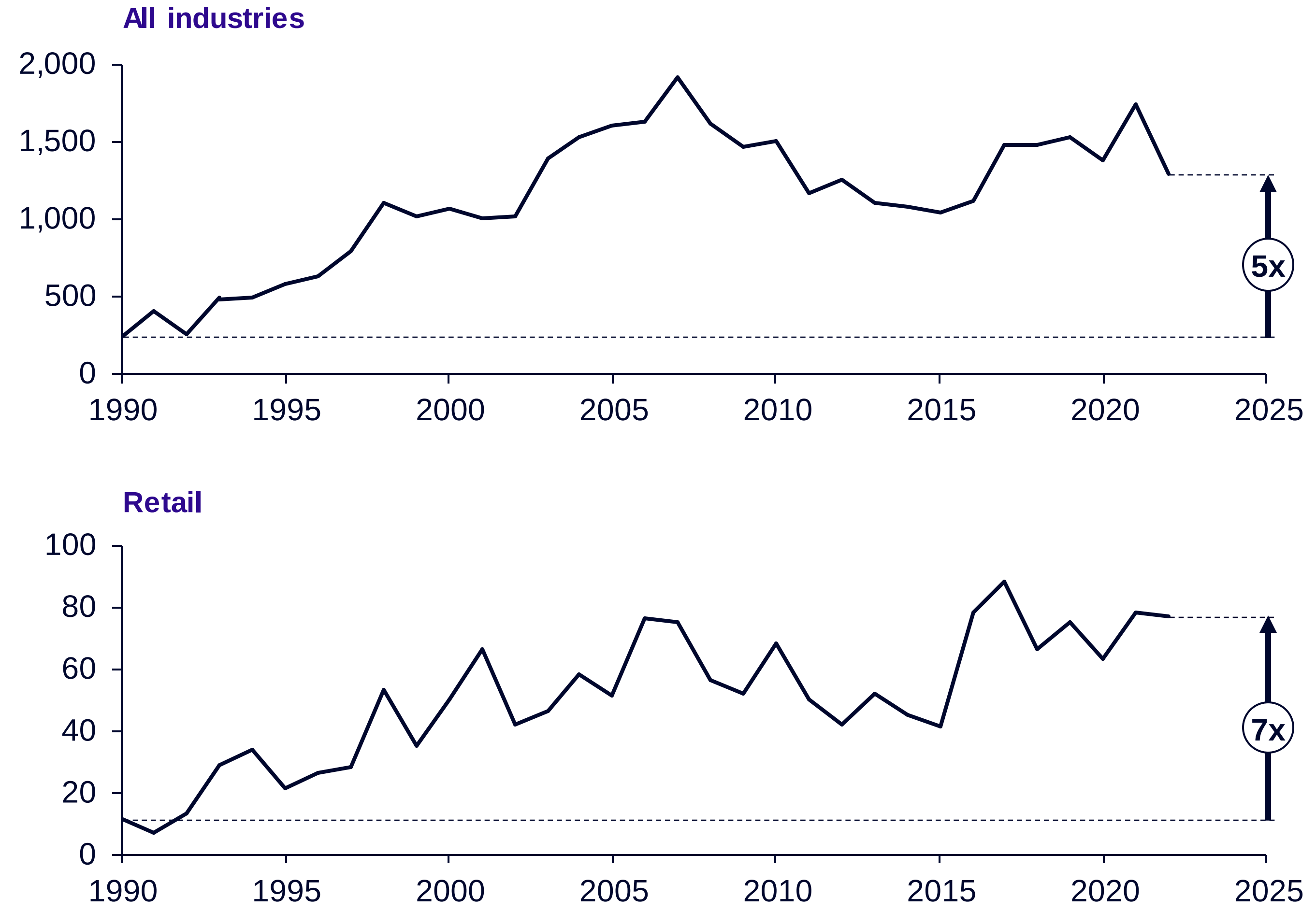
Sources: Hambur (2023); Madsen and Robertson (2022); De Loecker and Eeckhout (2018); Leigh and Triggs (2016).

Merger activity in Australia has increased five-fold since 1990 and is a major driver of concentration

- **Since 1990, merger activity has increased five-fold across all industries, and seven-fold in retail.** From the early 2000s, there were consistently over 1,000 public merger deals per year, indicating that merger activity is a primary driver of concentration.
- **Economic evidence suggests that an increase in concentration is self-reinforcing and leads to further increases in concentration.** Andrews, Dwyer and Triggs (2023) find evidence that more concentrated industries have lower rates of net entry – which itself contributes to greater concentration.
- **Firm entry rates declined** from 13% in 2005-06 to 10% in 2019-20 (before the introduction of temporary government pandemic support) alongside an increase in concentration over the same period.

Public M&A deals

Number of transactions



Sources: Australian Bureau of Statistics: Counts of Australian Businesses; Refinitiv (2023); Andrews, Triggs and Dwyer (2023).

The ACCC has focused on a handful of larger M&As, but it may be overlooking smaller 'serial' acquisitions that are driving market concentration

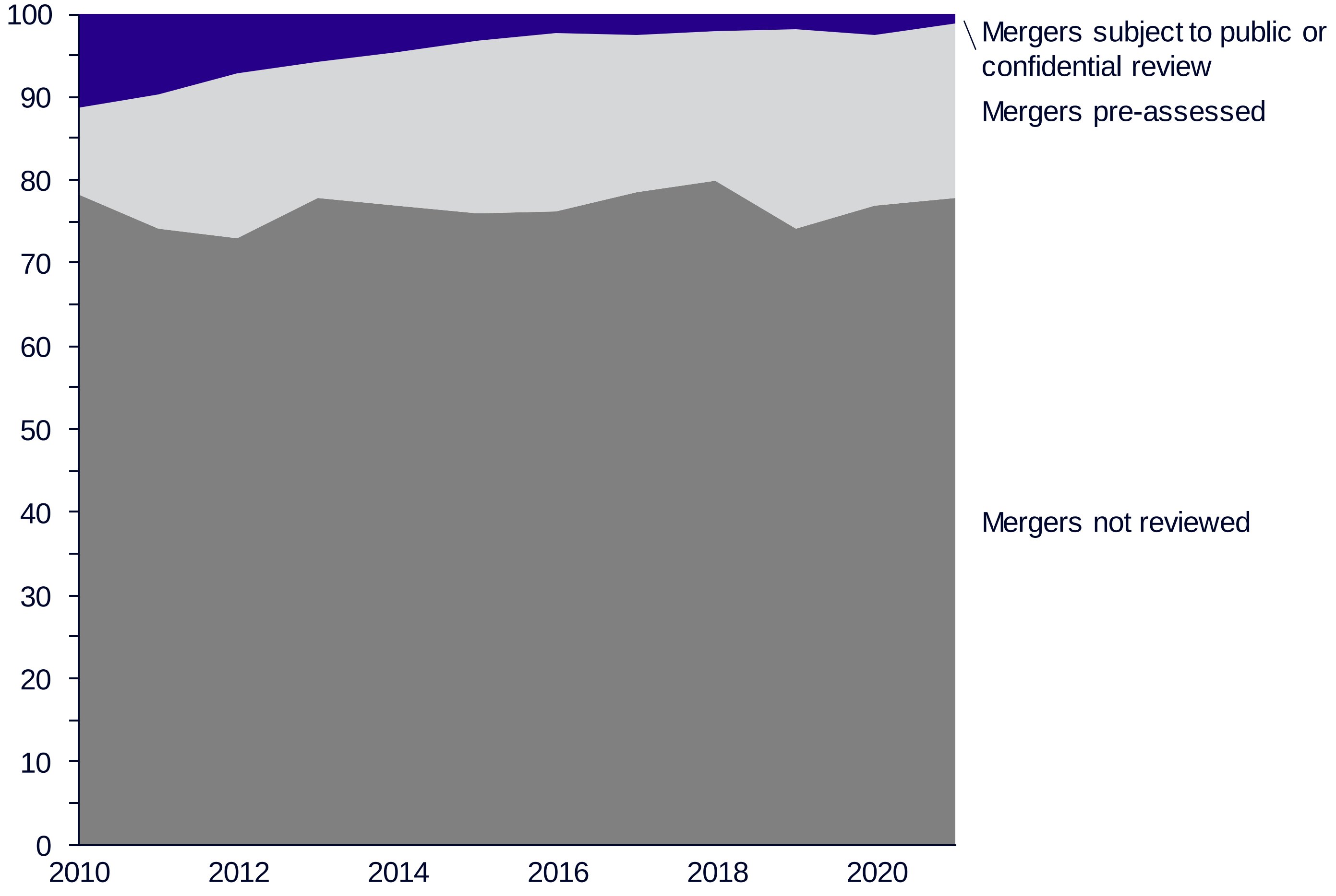
- In each year from 2010 to 2021, **over 70% of deals are not subject to any form of merger review**. This could include acquisitions by dominant ASX-listed firms of non-listed targets.
- **The ACCC has increasingly focused on a smaller number of large deals**, with the proportion of public deals subject to public review declining from 11% in 2010 to 1% in 2021.
- **The ACCC has paid less attention to smaller acquisitions – but smaller 'serial' acquisitions can have a significant impact on competition.** In the US, small mergers that do not trigger mandatory disclosure thresholds are estimated to account for 28-47% of the increase in four-firm market share from 2002 to 2016.

Relevant recommendations:

- Amend the mergers test to prohibit 'serial' acquisitions that substantially lessen competition.
- Clarify that a substantial lessening of competition extends to acquisitions that entrench concentrated market structures.

Proportion of M&A deals that are assessed by the ACCC in its informal process

Proportion of public M&A deals



Sources: Financial Times (2021); Barrios and Wollmann (2022); ACCC/AER annual reports.

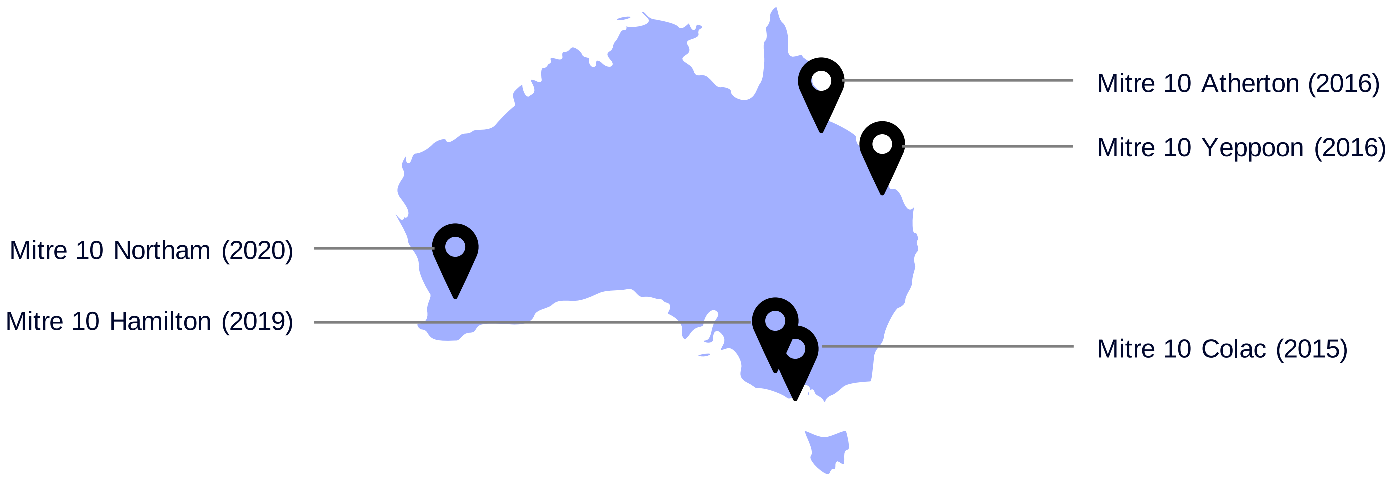
‘Serial’ acquisitions can be seen in hardware, where Bunnings’ market share has ‘crept up’ through a series of acquisitions

- **Since 2015, Bunnings has acquired at least five independent hardware businesses, none of which were subject to public review from the ACCC.** It has also approached at least seven other Mitre 10 businesses asking them to consider selling their stores to Bunnings.
- **While each of these acquisitions may individually be small, they have cumulatively allowed Bunnings to increase its dominance in hardware retailing.** Bunnings’ market share in this industry increased by 12 ppts between 2017 and 2024, and is now 8 times larger than its nearest competitor. Its dominance is even greater in DIY hardware retailing, where it has over 50% market share.

Relevant recommendations:

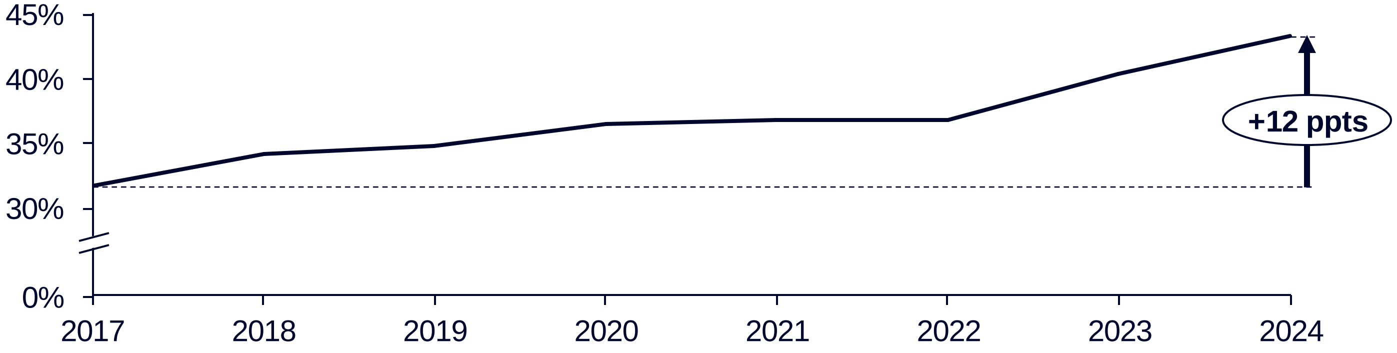
- To ensure that acquisitions by dominant firms or small targets are not ‘slipping through the cracks’, introduce mandatory notification of all mergers where the merger parties have a combined market share of over 40%.

Selected Bunnings’ recent acquisitions of independent hardware businesses



Bunnings’ market share in hardware retailing

Proportion of industry revenue



Sources: IbisWorld (2023); Metcash submission to the Select Committee on Cost of Living (2023); Crawford (2017); MGA interviews.

Dominant incumbents in supermarkets and hardware have made strategic land acquisitions to foreclose competition

- **Large supermarkets and hardware stores have made acquisitions of land that heighten strategic barriers to entry and may entrench market power by causing rivals to exit.** There are also examples of large incumbents that have acquired land to discourage entry by rivals.

Relevant recommendations:

- Amend Section 50(3)(b) to make reference to 'strategic barriers to entry' to encourage due consideration of theories of harm that involve the exit of existing rivals or that discourage potential entry.

Examples of strategic land acquisitions that may substantially lessen competition

Coles' strategic acquisition of land near Foodworks Estella

- Foodworks opened in Estella in late 2023.
- Soon before Foodworks' opening, Coles announced a purchase of land less than 1km away with an intention to open a Coles store.
- **This acquisition heightens strategic barriers to entry in both the local geography and in other similar locations.** Given Coles' economies of scale and scope, the acquisition may have the purpose or effect of causing Foodworks to exit the local market, and may discourage independent grocers from establishing in other locations due to the potential threat of being driven out by the entry of a large supermarket.

Bunnings' strategic acquisition of a lease in Loganholme

- Bunnings opened in Loganholme Hyperdome Home Centre in 2017, which also housed an existing Mitre 10. There were three other Bunnings stores within an 8km radius.
- Bunnings undercut Mitre 10's prices and led to Mitre 10 exiting in 2021. With four Bunnings within close proximity, and the next closest Mitre 10 store being over 5km away, Bunning's acquisition of a lease at Loganholme **lessened competitive tension in the local area**.
- In 2021, Bunnings was granted approval to open a large store next to Mitre 10 Jimboomba. This acquisition may have a similar effect of causing Mitre 10 to exit the local market and reducing local competition.

Sources: Mangelsdorf (2023); Bannister (2021); Kerr (2017); MGA interviews

‘Serial’ conglomerate mergers have allowed large firms to leverage market power in existing sectors to adjacent markets

- **Wesfarmers and Woolworths Group have a strong presence across a portfolio of sectors.** For example, Wesfarmers is one of the four largest firms across 11 different industry classes, spanning retail, wholesale and manufacturing. Woolworths has a strong presence in supermarkets and department stores, and has business interests in other sectors such as food services and insurance.
- **A presence across a portfolio of sectors allows large conglomerates to leverage their market power in existing sectors to adjacent markets.** Wesfarmers and Woolworths have recently made conglomerate acquisitions in several sectors, including health, apparel and pet retail. While they currently have limited market share in these adjacent sectors, these acquisitions allow them to potentially dominate adjacent markets by:
  - Combining data sets from adjacent markets to strengthen market power
  - Foreclosing rivals in adjacent markets by bundling or typing products across markets
  - Foreclosing rivals’ access to suppliers in adjacent markets

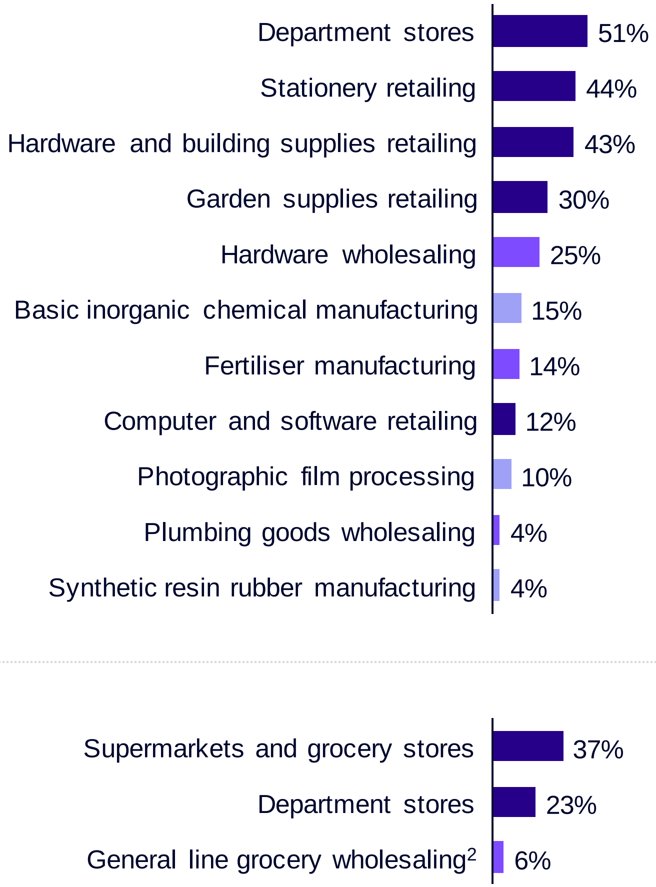
Market share and recent acquisitions of conglomerates

Retail | Wholesale | Other

Market share in industry classes where the firm is one of the four largest[1]

Wesfarmers

Woolworths Group



Recent conglomerate or adjacent market acquisitions

Wesfarmers

Health
- API
- InstantScripts
- Silk Laser Clinics

Trade or specialty tools
- Beaumont Tiles
- Adelaide Tools

Apparel
- Workwear Group

Woolworths Group

Health
- Healthylife

Data
- Quantium (75%)

Pet retail
- Petstock

Sources: Ibisworld reports (2024); Wesfarmers (2023); Woolworths Group (2023).
Notes: 1. Latest available data (either 2023 or 2024). 2. Reflects 65% of PFD’s market share in general line grocery wholesaling.

Some acquisitions have entrenched an incumbent's market power through the expansion of data and market intelligence capabilities

- **Decision-makers are not placing sufficient scrutiny on potential harms that could arise from acquisitions involving data assets**, as illustrated by Woolworths' acquisition of a majority share of PFD.
- Access to rival data is also of concern when retailers purchase shopping centres, which may provide them access to the sales data of tenants (including competitors).

Relevant recommendations:
- Add a Section 50(3) merger factor: 'the nature and significance of assets, including data and technology, being acquired directly or through the body corporate'.

Case study: Woolworths' acquisition of PFD

Summary

- In 2021, the ACCC granted informal clearance for Woolworths to acquire 65% of the shares in PFD Food Services. PFD is a wholesale food service distributor that supplies many independent retailers.
- Woolworths offered behavioural undertakings to the ACCC, but the ACCC determined that the acquisition would not be likely to substantially lessen competition, and concluded on this basis that there was no need to accept the undertaking.

Negative impact of the merger on competition

- While Woolworths and PFD stated that they intend to keep the businesses separate and implement information barriers between them, the transaction would give Woolworths the capability to view the purchasing patterns of its retail competitors, and would be able to calculate revenues and demand in the local area of its competitors. This information would allow Woolworths to gain an unfair strategic advantage over its competitors.
- Even though the ACCC assessed the competitive impact of the acquisition 'on the assumption that Woolworths and PFD will operate as a combined entity', it did not place sufficient weight on the anti-competitive effect that the acquisition could have by enabling Woolworths to access competitors' data.
- MGA member data suggests that in some local markets, PFD distribution prices increased by more than its competitors, suggesting that the merger resulted in a substantial increase in Woolworths-PFD's market power.

Sources: ACCC (2021); Ferguson and Vedelago (2013); MGA interviews.

Merger reform should implement four recommendations to revive competition in concentrated markets

1. Amend the mergers test to prohibit **‘serial’ acquisitions** that substantially lessen competition.

2. Clarify that a substantial lessening of competition extends to acquisitions that **entrench concentrated market structures**.

3. To ensure that acquisitions by dominant firms or small targets are not ‘slipping through the cracks’, introduce **mandatory notification** of all mergers where the merger parties have a combined market share of over a defined threshold (e.g., 40%).

4. Amend the Section 50(3) merger factors in the following ways:
   i. Amend Section 50(3)(b) to make reference to ‘**strategic barriers to entry**’ to encourage due consideration of theories of harm that involve the exit of existing rivals or that discourage potential entry.
   ii. Add a Section 50(3) merger factor: ‘the nature and significance of assets, **including data and technology**, being acquired directly or through the body corporate’.

Recommendation 1:

Amend the mergers test to prohibit ‘serial’ acquisitions that substantially lessen competition

The problem

- The existing Section 50 test restricts competition decision-makers to assessing the competitive effects of the individual merger transaction in question. This prevents them from assessing the **cumulative impact of successive acquisitions**, which is important when the acquirer strategically purchases a series of small targets which are individually unlikely to substantially lessen competition.

The solution

- Amend the Section 50 test to allow competition decision-makers to prohibit a merger if, **in conjunction with other acquisitions** made by a corporation within a specified period, the acquisition would substantially lessen competition.

Recommendation 2:

Clarify that a substantial lessening of competition extends to acquisitions that entrench concentrated market structures

The problem

- While acquisitions that entrench market structures could be caught under the current Section 50 test, they are often **missed by conventional tools of economic analysis**, like diversion ratios and critical loss analysis.

The solution

- Section 50 could expressly clarify “that a substantial lessening of competition **includes entrenching, materially increasing or materially extending a position of substantial market power**.”
- This ensures that competition decision-makers give due consideration to market structure, given strong empirical evidence that links concentrated market structure to weakening competition in a market.

Recommendation 3:

Introduce mandatory notification of all mergers where the merger parties have a combined market share over a defined threshold (e.g., 40%)

The problem

- The current system of informal merger review relies on voluntary notification of mergers to the ACCC. This means that **many mergers may not be considered by the ACCC**, including acquisitions by ASX-listed firms of non-ASX listed targets. For example, many small acquisitions involving land may not be notified to the ACCC.

The solution

- To ensure that small acquisitions that may form part of a 'serial' acquisitions strategy are not being missed, **introduce mandatory notification of proposed mergers to the ACCC where the merger parties have a combined market share of over a defined threshold** (e.g., 40%), regardless of the size of the transaction.

Recommendation 4:

Amend the merger factors to place greater weight emphasis on strategic barriers to entry and the impact of data assets on competition

The problem

- Competition authorities are **not placing sufficient weight on strategic barriers to entry**, as shown by the non-opposition of the acquisition by dominant retail firms of land or leases.
- Competition authorities are also **not placing enough weight on the impact of the acquisition of data assets** on competition, as shown by the clearance (free from undertakings) of Woolworths' acquisition of a majority share of PFD Food Services.

The solution

- Amend the Section 50(3) merger factors in the following ways:
  i. Amend Section 50(3)(b) to make reference to '**strategic barriers to entry**' to encourage due consideration of theories of harm that involve the exit of existing rivals or that discourage potential entry.
  ii. Add a Section 50(3) merger factor: 'the nature and significance of assets, **including data and technology**, being acquired directly or through the body corporate'.

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