Statement of Issues

8 October 2020

Alsco – proposed acquisition of Spotless Laundries' garment business

Purpose

1. Alsco Pty Limited (**Alsco**) proposes to acquire Spotless Group Holdings Limited's (**Spotless**) garment laundry services business (**Spotless Garments**) (Alsco and Spotless Garments together, the **Parties**) (the **proposed acquisition**). Spotless Garments is part of Spotless' commercial laundry services business, which incorporates both linen and garment laundering (**Spotless Laundries**).

2. This Statement of Issues:

   - gives the Australian Competition and Consumer Commission's (**ACCC**) preliminary views on competition issues arising from the proposed acquisition;
   - identifies areas of further inquiry; and
   - invites interested parties to submit comments and information to assist our assessment of the issues.

3. Statements of Issues do not refer to confidential information provided by the parties or other market participants and therefore may not fully articulate the ACCC's preliminary position.

Overview of ACCC's preliminary views

4. In considering the proposed acquisition, the ACCC applies the legal test set out in section 50 of the *Competition and Consumer Act 2010* (the **CCA**). In general terms, section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.

5. The ACCC divides its preliminary views into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise concerns'. In this Statement of Issues there are multiple 'issues of concern'.

Issues of concern

6. The ACCC’s preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of commercial laundry services for garments:

   - in the geographic areas where the parties overlap, namely New South Wales, South Australia, Queensland, Tasmania, Victoria and Western Australia; and

   - multi-state markets.[1]

7. The proposed acquisition will combine the two largest commercial laundry suppliers for garments in most states and the only two commercial laundry suppliers for garments with a comprehensive multi-state presence.

Making a submission

8. The ACCC invites submissions from interested parties.

9. Interested parties should provide submissions by 5pm **Friday 30 October 2020**. Responses may be emailed to mergers@accc.gov.au with the title: Submission re: *“Alsco/Spotless Laundries - attention Jonathan Koay/Tess Macrae”*. If you would like to discuss the matter with ACCC staff or have any questions about this Statement of Issues, please contact Jonathan Koay on (03) 9658 6436 or Tess Macrae on (03) 9290 1835.

10. The ACCC anticipates making a final decision on **Thursday 17 December 2020**, however, this timeline can change. To keep up with possible timing changes and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at https://www.accc.gov.au/public-registers/mergers-registers/public-informal-merger-reviews.

Confidentiality of submissions

11. The ACCC will not publish submissions regarding the proposed acquisition. We will not disclose submissions to third parties (except our advisors/consultants) unless compelled by law (for example, under freedom of information legislation or during court proceedings) or in accordance with s155AAA of the CCA. Where the ACCC is required to disclose confidential information, the ACCC will notify you in advance where possible so that you may have an opportunity to be heard. Therefore, please identify any confidential information that is provided to the ACCC. Our *Informal Merger Review Process Guidelines* contain more information on confidentiality.

About ACCC ‘Statements of Issues’

12. A Statement of Issues is not a final decision about a proposed acquisition. A Statement of Issues outlines the ACCC’s preliminary views and identifies further lines of inquiry.

[1] That is, for customers that seek a contract with a supplier that covers two or more states.

13. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

The parties

The acquirer: Alsco

14. Alsco is wholly owned by Alsco Inc., a company based in Utah in the United States.

15. Alsco provides commercial laundry services focusing on garments, but also provides linen laundry services specialising in food and beverage customers. It operates thirteen processing plants and two distribution centres throughout Australia.

16. Commercial laundry services for garments commonly include the pickup, cleaning and delivery of items such as uniforms and other workwear used in manufacturing, industrial and food services industries.

Spotless Laundries

17. Spotless Laundries, a division of Spotless, is a supplier of commercial laundry services in Australia. Its services include the hire, cleaning and delivery of linen and garments.

18. Spotless Laundries primarily supplies laundry services for both linen and garments to healthcare and industrial customers in metropolitan and regional areas, but also services accommodation customers in some areas. It operates ten processing plants and four depots across Australia.

19. Spotless is majority-owned by Australian listed company Downer EDI Limited.

The target: Spotless Garments, a part of Spotless Laundries

20. Alsco is proposing to acquire certain garment business assets of Spotless Laundries (**Spotless Garments**) and is participating in a competitive bid process. Alsco would not acquire the Spotless Laundries linen laundering business, which could either be retained by Spotless or purchased by another bidder.[2]

Sale of Spotless Laundries

21. The ACCC is also assessing the proposed acquisition of the entire Spotless Laundries business by South Pacific Laundry. This includes both linen and garments assets (refer to the ACCC's Merger Register).

[2] This includes food and beverage linen and other item volumes (e.g. mats) connected with garments customers.

Industry background

The supply chain

22. There are two main classes of laundered items: linen and garments.

23. Laundered garments are generally uniforms, such as chefs' jackets, aprons, coats, pants, tops and industrial overalls. In terms of laundering requirements:

    - Certain customers require sterile garment cleaning, such as those used in medical, pharmaceutical, hazardous materials or food processing environments (reputation of the laundry supplier is particularly important for these customers). While these items may have to be washed in dedicated loads, the equipment used is mostly the same as for non-sterile loads.

    - Other customers may have medium to large volume requirements, such as those in manufacturing or food processing. At this stage, the ACCC is primarily interested in these types of customers, which are typically serviced by suppliers of significant scale. While the Parties also have a number of customers with small garments volumes, these customers are likely to have available alternative suppliers, including small regional suppliers, and therefore these customers are not the focus of the ACCC's review.

    - Certain garments customers may purchase their own garments rather than hiring (known as 'customer owned goods') and only outsource the laundering services. This appears to be limited and is not currently a significant area of focus for the ACCC.

    - Some customers also require a full service supplier, which includes garment delivery to specific employee lockers.

24. Linen refers to fabric goods including bedding, towels and tablecloths. Within linen, there are different customer categories with varying linen needs: accommodation;[3] food and beverage;[4] and healthcare and aged care.[5]

25. The basic laundering process and the equipment typically used can be summarised as follows:

    Pickup soiled laundry → Sorting by item / size by hand → Washing in large 'tunnel' washing machines or washer extractors → Drying in tumble driers → steam finishing (for garments) / ironers (for linen) → Allocation of linen or garments by customer → Laundry folded manually or by machine (garments can be hung on storage rails) → Delivery to customer (for garments, this may include delivery to specific lockers)

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[3] E.g. hotels, motels, bed and breakfasts. Items include pillowcases, flat sheets, doona covers, bedspreads, bath towels, etc.

[4] E.g. restaurants, stadiums, convention centres. Items include tablecloths, napkins, tea towels, etc.

[5] E.g. hospitals, retirement villages. Items include flat sheets, scrubs, sterile theatre packs, patient gowns.

26. Linen and garments share a similar washing and drying process. However, the finishing equipment, rail system and operational process for large-scale garments processing are distinctly different to linen. Individual garments are placed on clothes hangers attached to a rail system that proceed through a steam tunnel machine. The steam jet removes fabric wrinkles and garments are ready for customer delivery. In contrast, linen items are processed through a series of ironing, folding and stacking machines. Garments also require distinctly different rail conveyor infrastructure.

27. The ACCC understands that certain smaller garments suppliers may use tumble driers as an alternative to steam tunnels. However, this may only be viable for limited volumes and is likely to require additional labour. Market feedback suggests that steam tunnel machines are required to capture additional scale efficiencies above certain volume thresholds. The ACCC is continuing to explore the extent to which suppliers can utilise tumble driers as an alternative to steam tunnel machines.

28. From a delivery perspective, industrial customers often assign garments, such as overalls with nametags, to specific employees. This requires the laundry service supplier to track and re-stock individual lockers. In contrast, linen customers generally have specific drop-off areas at their site and re-distribute the linen internally.

Tender and contract processes

29. Most commercial customers purchase laundry services via tendering or competitive quote processes. Contracts are typically two to three years, often with an option to extend.

30. Many customers opt for a 'full rental model' where the laundry supplier purchases linen/garments for the customer at the start of the contract and the customer hires the items back from the laundry supplier.

31. Contracts often do not have contractual penalties for early termination. However, many customers rent their linen and garments from the laundry suppliers and may have to pay an exit payment for the residual / depreciated value of the linen or garments purchased by the supplier.

Areas of overlap

32. The Parties overlap in the supply of commercial laundry services for garments nationally and in multiple states.

33. Alsco will also be acquiring some of Spotless Laundries' laundering volumes for the following items because they form part of Spotless Laundries' contracts with its garments customers (Spotless Laundries will retain the volumes of these items for its other customers):

    - floor mats laundering;
    - continuous towel rolls, mops, tea towels, microfiber cloths laundering;
    - table linen laundering (e.g. napkins and tablecloths); and

- customers who purchase garments via one of the Parties but who do not use the ongoing laundering services of that Party.

34. However the additional volume of these items to be acquired by Alsco appears to be relatively small. In addition, the ACCC considers there are likely to be a number of competing suppliers of these services in the relevant geographic areas, including Spotless Laundries post-acquisition. The ACCC does not consider these are significant overlaps and has not considered them further in its analysis.

Market definition

35. The ACCC's starting point for defining relevant markets to assess the proposed acquisition is to identify the areas of overlap between the products and geographic regions actually or potentially supplied by the merger parties. The ACCC then considers other actual or potential suppliers of those products, and whether other products and geographic regions constitute sufficiently close substitutes to provide a constraint on the merged entity.[6]

36. Here, as Alsco only proposes to acquire Spotless Laundries' garments business, the primary areas of overlap are the supply of commercial laundry services for garments on a single state and multi-state basis.

37. Issues relating to customer and supplier substitution, and the geographic scope of the relevant markets, are explored below.

Product dimension

38. The ACCC's preliminary view is that the relevant product dimension is likely to be the supply of commercial laundry services for garments.

39. As stated in the ACCC's *Merger Guidelines*,[7] market definition is purposive. It should be tailored to the potential contravention in issue. The ACCC's starting point is the overlap between Alsco and Spotless Garments in commercial laundry services for garments,[8] being the relevant area of rivalry between the Parties that would be lost as a result of the proposed acquisition.

<u>Garment and linen laundry suppliers</u>

40. The ACCC is considering whether linen laundry suppliers are relevant substitutes for garment laundry suppliers, which might suggest a broader commercial laundry services market. From a customer perspective, garments and linen are used for distinctly different purposes and cannot be substituted. From a supplier perspective, the ACCC is considering the extent to which linen laundry suppliers could reallocate capacity or install new equipment for laundering garments in response to a price rise or reduction in service quality by the merged entity. This involves considering whether a supplier's capacity to

[6] See ACCC, *Merger Guidelines 2008* (updated 2017), paragraphs 4.10 – 4.13.

[7] See ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 4.9.

[8] Including mats that form part of a customers' garment laundering contract.

provide one service can profitably be switched to supply another service quickly and without significant investment.[9]

41. In the SPL-Spotless SOI, the ACCC considered that from a supplier perspective, there were no significant technical or equipment cost impediments to laundries specialising in linen moving into or switching between laundering linen and garments.[10] However, the ACCC also noted that some market feedback indicated that for a linen supplier, switching from linen to garments would be more difficult than switching between linen customer types, with a greater need to invest in specialised equipment.[11] The ACCC has received further information that reinforced this market feedback, and strengthened the reasons why garment laundering may be a separate market to linen laundering.

42. As discussed further in paragraphs 62 to 66 below, the ACCC considers there are some distinct features of garment laundering compared to linen laundering that limit whether a linen supplier can and would switch to supply garments quickly, and without significant investment.

43. The ACCC will continue to examine the incremental costs of – and any other barriers to – laundries moving from linen to garments, before finalising its view on the scope of the relevant product dimension.

44. Within garment laundering, the ACCC has also considered:

- whether disposable garments are a sufficiently close substitute; and
- whether there is segmentation by customer industry.

<u>Disposable garments</u>

45. Some suppliers have identified disposable, single use garments as an alternative to reusable textile items, particularly for healthcare customers that require sterile theatre packs. They consider that disposable garments are increasing in availability, quality and cost effectiveness, and remove the administrative burden of customers arranging laundering. Disposable garments are therefore potentially a viable alternative for certain laundered products now and in the future.

46. Market inquiries indicate that certain customers who currently use reusable garments do not see disposable garments as an alternative (relevantly, while there may be increasing use of disposable items in healthcare, scrubs and hospital gowns are usually contracted under linen laundering rather than garments). Reasons may include the environmental impact or longer term costs compared to reusable garments, or that a non-textile alternative is not suitable for some uses. Some suppliers have submitted that they do not see disposable garments as a threat to their garment laundering volumes.

47. The ACCC's preliminary view is that disposable garments provide a limited constraint on laundered garments. It appears there are some customers who

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[9] ACCC, *Merger Guidelines 2008* (updated 2017), paragraphs 4.12 – 4.26.

[10] ACCC, *South Pacific Laundry – proposed acquisition of Spotless Laundries, Statement of Issues*, 27 August 2020 (SPL-Spotless SOI) available here, paragraph 38.

[11] SPL-Spotless SOI, paragraph 39.

have or can switch partly or fully to disposable garments. However there are other customers who, for practical or other reasons, do not consider disposable garments as a suitable alternative to laundered garments.

Segmentation by customer industry

48. Both Alsco and Spotless Garments service garments customers in the industrial and hospitality industries (as noted, healthcare items such as scrubs and hospital gowns are considered linen items). As described at paragraph 23, some customer items may require special cleaning, however the laundering uses the same equipment and processes.

49. Some customers may choose not to outsource garment laundering. For example, customers who do not have special cleaning requirements might leave employees to launder their own uniforms.

50. The ACCC's preliminary view is that there is no apparent segmentation by customer industry in commercial laundry services for garments.

Preliminary conclusion on product dimension

51. The ACCC's preliminary view is the appropriate market to assess the proposed acquisition is the supply of commercial laundry services for garments. This reflects the purposive nature of market definition, Alsco and Spotless Garments' specialisation in garments and the rivalry that would be lost as a result of the proposed acquisition. The ACCC has also taken into account the distinct customer demand for garment laundering and the specialised nature of garment laundering, as distinct from linen laundering. The ACCC invites submissions from market participants about whether there is a broader commercial laundry services market.

Geographic dimension

52. The ACCC has explored whether the relevant geographic dimensions involve:

- state-based markets (New South Wales, South Australia, Queensland, Tasmania, Victoria and Western Australia); and/or
- multi-state markets.[12]

53. The ACCC understands that certain customers use, and seek tender proposals from, garment laundry providers with facilities or depots close to their location. In addition, market feedback suggests that certain garments customers, particularly those in industrial sectors, may have operations outside of metropolitan regions which broadly supports state-based markets.

54. There also appears to be a proportion of customers that contract for garments on a multi-state basis with a requirement or strong preference to contract with a single supplier. The ACCC understands this may be motivated by reducing contracting and administration costs, access to a single point of contact,

[12] That is, for customers that seek a contract with a supplier that covers two or more states.

operational consistency, and the potential to leverage volumes for pricing benefits.

55. The ACCC is considering the impact of the proposed acquisition at the state-based and multi-state levels, noting that the Parties are large suppliers, and the two largest commercial laundry suppliers for garments, in both broader and narrower geographic dimensions.

The ACCC invites comments from market participants on:

- The extent to which laundry facilities, equipment and logistics capabilities are transferrable between linen and garment laundering.
- What specialised equipment and/or services are required for laundering garment or linen items.
- Whether switching to disposables would be a viable alternative to using outsourced garment laundry services and if so, in what circumstances.
- The products other than garments that you consider are relevant to this transaction.
- Whether segmentation by customer industry is appropriate in garment laundering, and why.
- If you are a commercial laundry services customer and have operations nationally or across multiple states, whether:
  - it is important to use a laundry supplier with a national presence, especially for garments, including the reasons why (or why not).
  - there are benefits to using a single supplier nationally or in multiple states – e.g. reducing transaction costs, more attractive volume-based pricing benefits or negotiating power.

Issues of concern: reduced competition in garment laundry services

56. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in the supply of commercial laundry services for garments in both state-based geographic markets in New South Wales[13], South Australia, Queensland, Tasmania, Victoria and Western Australia, and multi-state geographic markets.

57. The proposed acquisition combines the two largest suppliers of garment laundry services in most states, and combines the only two large-scale garment laundry suppliers with a comprehensive multi-state presence. The ACCC considers that

[13] The ACCC is currently considering the competitive dynamics in the Australian Capital Territory (ACT) as part of its analysis of New South Wales, and will continue to investigate whether there is a standalone geographic market in the ACT.

the Parties are often each other's closest garment laundry competitor, and appear to frequently compete with each other in high value tenders. The Parties provide a similar breadth of garment services at a comparable scale and capacity, and with a similar reputation. They also appear to service similar customers in both size and range of industries.

58. The ACCC is concerned that removing this competitive tension is likely to result in Alsco possessing the ability to raise prices or reduce service levels to the merged entity's customers. There appears to be a limited number of existing alternative suppliers of similar scale to the Parties and with the ability to constrain the Parties' conduct. Further, given the need to incur significant sunk capital costs, barriers to entry appear to be moderate, although somewhat lower for existing suppliers of linen laundry services. Given the merged entity would possess high shares of garments customers in any relevant geographic market, the proposed acquisition is likely to result in Alsco possessing the ability to raise prices or reduce service levels to customers.

High concentration in garment laundry services

59. As stated in the ACCC's *Merger Guidelines*, market concentration refers to the number and size of participants in the market. It provides a snapshot of market structure as well as an estimate of the size of the Parties, which can assist when considering the other merger factors.[14]

60. Market feedback suggests that the garment laundry services industry has gradually consolidated over a period of time, in part, through acquisitions by both Alsco and Spotless.

61. Alsco or Spotless Garments are the largest and only two commercial laundry suppliers for garments with a comprehensive multi-state presence, and the largest two suppliers in most states. Based on the ACCC's estimates and market feedback, the merged entity is likely to have over 50% share of garments volumes in each overlapping market and in some cases well over a 50% share.

Constraint from existing linen suppliers

62. As discussed under Market Definition above, given the nature of the overlap and the closeness of rivalry between Alsco and Spotless Garments in garments, the ACCC is continuing to consider the extent to which other commercial laundry suppliers are likely to constrain the merged entity. This involves considering barriers to mobility and factors relevant to barriers to expansion.[15]

63. In particular, the ACCC is examining whether commercial laundries that currently specialise in linen services can switch or move into garment laundering without incurring significant additional costs or taking significant risks. If these costs and risks appear likely to limit the willingness of linen suppliers to compete with the merged entity, such suppliers would offer little in the way of competitive discipline. The ACCC considers there are some distinct features of garment services compared to linen services which may limit the ability of existing linen

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[14] ACCC, *Merger Guidelines 2008* (updated 2017), paragraphs 7.6 – 7.16.
[15] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.42.

suppliers to effectively constrain the merged entity in respect of garments customers. Information received suggests the following:

- **Some garment equipment appears specialised and different compared to linen.** As noted in the SPL-Spotless SOI, front-end washing and drying equipment are largely transferrable between linen and garments and the costs of this equipment represent a relatively high share of the capital costs that a laundry supplying garment services needs to incur. However, the sorting and rail conveyance system, back-end finishing and storage equipment used by large-scale efficient garment laundering operations are highly specialised, substantially different to linen, and can involve considerable sunk capital costs. While smaller garment laundries do not need to incur all of these costs, at this stage the ACCC considers that the incremental costs faced by linen laundries seeking to offer competitive garment services are large enough to limit the constraint from linen laundries on the merged entity.

- **Distinct variations in operational processes between linen and garments.** For large suppliers of garment services, operators typically hang garments individually on clothes hangers attached to a large rail conveyor system. This is distinctly different to linen suppliers where operators feed linen through an ironing line. In addition, many industrial customers assign garments to specific individuals to suit their role, size and name. This requires garment suppliers to undertake a more involved end-sorting process to track and deliver garments to specific lockers, which may involve purchasing technology such as RFID tags[16] and tracking software. Conversely, linen is typically delivered to a customer's drop-off area and can be distributed by the customer's staff. Laundries may also require a dedicated sales team for garments customers distinct from linen customers.

- **Outsourced garment values and volumes appear considerably smaller than outsourced linen.** Market feedback suggests that outsourced linen laundry demand is considerably larger by volume and in value than outsourced garments demand (in part, due to a wider range of customers and industries requiring linen laundry services). This may also be due to some garments customers choosing the option for staff to launder their allocated garment(s) themselves (that is, the customer purchases the garments but does not arrange the laundering for its staff). Therefore, suppliers considering offering garment laundering services are likely to face greater difficulties in extracting the necessary scale benefits to compete profitably with larger suppliers than do suppliers seeking to offer linen services. This may explain the relatively small number of significant suppliers of garment laundry services.

64. In market inquiries, linen laundries have expressed a reluctance to move into garment laundering. This may reflect the potential commercial risks involved in shifting to garment laundering in terms of:

- the time and cost involved in developing a specialisation (including the necessary expertise and salesforce as well as the equipment). Linen

[16] Radio Frequency Identification.

laundry suppliers would require a certain level of garment volumes to cover operating costs and recover their initial capital outlay;

- the already concentrated market and significant economies of scale enjoyed by the Parties; and
- generally short-term contracts and building a garments customer portfolio.

65. At the same time, the ACCC's investigation has indicated that some linen laundry suppliers process garments, and most (especially larger) garment laundry suppliers also launder linen. For example, Spotless Laundries, Alsco, and Sunshine process both linen and garments. Further:

    - some of Spotless' plants process both linen and garments at the same site, and only two of its plants process only garments; and
    - except for its clean room,[17] all of Alsco's garment processing plants also launder linen and mats, although often in a different part of the facility.

66. The ACCC is continuing to explore the applicable costs, ease and risks with which existing suppliers specialising in linen can reallocate capacity to garments, and how important it is for suppliers to invest in more costly garment-specific equipment or operational processes as their garment volumes rise. The ACCC is also continuing to examine whether the limited demand for outsourced garment services would deter linen suppliers from moving into garments in the event of a significant price increase or service degradation by the merged entity. If these barriers appear unlikely to limit the willingness of linen suppliers to compete with the merged entity, the ACCC may ultimately consider that the relevant product market is better characterised as being for commercial laundry services.

Limited constraint from alternative suppliers

67. The ACCC is concerned that the proposed acquisition would remove Alsco's closest competitor in the already-concentrated garment laundry industry, particularly in relation to larger customers. It would also remove Alsco's only large-scale multi-state competitor for garments customers.

68. Market feedback suggests that there are a limited number of commercial laundry suppliers with a presence in more than one state. In addition to the Parties, these include SPL (national), Princes (Adelaide, Melbourne and Brisbane), and Sunfresh (Brisbane and Melbourne).

69. However, SPL, Princes and Sunfresh do not currently provide any significant volumes of garment laundry services.

70. Market feedback suggests that certain customers that require or strongly prefer a multi-state supplier would only consider the Parties as viable options. This is attributed to a variety of reasons, including no alternative suppliers that possess suitable capacity and delivery capabilities at a multi-state level, the reduction of administration costs, operational consistency, and the potential to leverage

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[17] A 'clean room' is an enclosed space where levels of pollutants such as dust and airborne particles are highly controlled.

volumes for pricing benefits. These customers' large operational footprints suggests that only Alsco and Spotless Garments possess the capacity, logistical reach and systems to meet the high demand requirements.

71. The ACCC accepts that certain customers that currently contract on a multi-state basis would consider moving to single-state contracts if the Parties increased prices. Certain customers already use multiple suppliers across different states. In some instances, these customers have found Alsco and Spotless Garments are the only suppliers of sufficient scale.

72. Alsco submits that there are a number of alternative suppliers to the Parties with a presence in specific states. However, market feedback suggests that there are limited alternative suppliers of similar scale to the Parties in the majority of state-based markets. Therefore, larger customers – including those considered large when their volumes across multiple states are combined – may have little alternative but to contract with one of the Parties.

73. In certain instances, customers may award the majority of volumes to either Alsco or Spotless Garments, with remote sites typically awarded to smaller local suppliers. This appears more common at certain industrial operations with sites outside major capitals than it is for hospitality customers. Some of these local suppliers may even provide garment services on a sub-contracting arrangement with the Parties.

74. The ACCC's investigation indicates that there are a number of state specific and local community suppliers of varying scale and constraint. Many local suppliers generally appear to have the capability to provide garment laundry services but on a substantially smaller scale to the Parties, and thereby lacking the ability to compete with the Parties on pricing and on service coverage beyond their local community (see 'Constraint from smaller suppliers' below). Further details include:

- **New South Wales.** Lawrence and Sunshine are well-known linen suppliers with a degree of garment capability. Market feedback suggests that for hospitality customers, Lazy Lakes focuses on regional NSW. The ACCC understands that the Government-owned laundry Capital Linen Services provides limited garment laundry services within Canberra and may be considered an alternative option by some customers. The ACCC is continuing to investigate the alternative options apart from Alsco and Spotless for larger industrial customers across New South Wales.

- **South Australia.** Market feedback indicates there are little to no alternatives to the Parties in South Australia, particularly for large customers. Smaller suppliers may lack the capacity and logistics capability to deliver garment services on a large scale. The ACCC's preliminary view is that there may be potential concerns regarding the level of competitive tension within South Australia.

- **Queensland.** Market feedback suggests that Holy Cross may have suitable capacity and capability to meet certain hospitality and industrial customers' needs, although not at a similar scale to the Parties. Other suppliers such as CLS focus more on customers outside Brisbane. In some instances, smaller laundry suppliers have entered into sub-contractor arrangements with either of the Parties.

- **Victoria.** Park Avenue Laundry, Just Tea Towels and Gouge appear to have suitable capability in garment laundry services for both hospitality and industrial customers. Other suppliers, such as GEM Laundry, appear to provide localised services at a smaller scale to the Parties. The ACCC is continuing to explore the extent to which these suppliers possess a suitable capacity to constrain the Parties.

- **Western Australia.** CleanTex and Atlas appear to possess suitable garment servicing capability for industrial customers but may lack the necessary scale for larger volumes. Market feedback also suggests that Atlas may only provide laundering and not garments hire services. Other suppliers appear focused on smaller volumes and may not be as price competitive to the Parties. The ACCC's preliminary view is that there may be potential concerns regarding the level of competitive tension within Western Australia.

Constraint from smaller suppliers

75. Market feedback suggests that smaller suppliers can be viable alternatives within a certain local region, more commonly a remote or rural location, for reasons that may include:

    - garment volumes being smaller, reducing the need to achieve significant scale benefits to be economical;

    - customer sites located in remote or regional areas where the Parties do not have a logistical presence. In some instances, the Parties may enter into sub-contracting arrangements with local suppliers to meet their customer's contract; and

    - the ability for smaller local suppliers to provide specialised customer service tailored within that community.

76. The ACCC considers that these suppliers may struggle to compete against the Parties in locations other than local remote or rural regions, such as in the capital cities. There are certain characteristics that the larger and more established Alsco and Spotless Garments possess in each state that may provide a competitive advantage over smaller suppliers, particularly in relation to their ability to compete for larger customers with multiple sites or larger volume contracts. Established scale competitors typically possess:

    - **High laundering capacity:** large laundering capacity reduces customer concentration risk as the supplier can diversify its customer base across multiple large contracts.

    - **Specialised equipment:** processing large volumes justifies the capital investment into specialised equipment, such as garment steamers, sorting systems, storage, and rail conveyors, as well as the necessary workforce. This equipment reduces labour costs through more automated or efficient processing that helps reduce per-item operating costs, leading to the ability to quote lower prices to customers. Laundries processing smaller volumes are likely to have more basic or manual processes with limited scalability (e.g. using tumble driers rather than steam tunnels), likely resulting in a higher unit cost base and less ability to price competitively against larger suppliers.

Suppliers of scale may also be better placed to offer a full service, including laundering items to a sterile level, RFID tagging technology for more efficient tracking, and a logistics system facilitating garment delivery to individual customer lockers.

- **Greater funding capacity, including to purchase garments upfront:** it is industry standard for suppliers to purchase large volumes of garments prior to delivering service. The larger the customer's volume requirement, the higher the upfront spend needed for garment inventory which may create cash flow issues that smaller suppliers are less willing or capable to accept. Larger suppliers also receive more attractive wholesale rates by utilising their purchasing scale.

77. While smaller suppliers may theoretically be able to provide the same commercial laundry service for garments, they may lack the Parties' scale, capacity and funding, and may also be less willing to accept large customers due to customer concentration risk. As a consequence, the ACCC considers that smaller suppliers will not significantly constrain the merged entity from raising prices (or reducing service quality).

Barriers to entry and expansion

78. The ACCC is continuing to consider the scale of barriers to entry and expansion, and the effect of the proposed acquisition on these.

79. There appear to be significant sunk capital costs (including the need for considerable plant space) required in setting up a brand new commercial laundry business. While small-scale entry within garment laundering may incur capital costs of a few million dollars (potentially less if second-hand equipment can be sourced), the cost of developing a plant that captures equivalent economies of scale to those generated by the target, Spotless Garments, is considerably higher.

80. To ensure sufficient scale to both harness the majority of available plant cost efficiencies and be capable of competing for the highest-volume customers against Alsco and Spotless Garments, it seems necessary to enter with a size of plant well above the technical minimum. The efficient scale of entry appears to vary according to regional demand.

81. The ACCC understands that the initial capital costs of a greenfield facility of a scale that would maximise plant cost efficiencies for a given regional market could be in excess of five million dollars, with a sizeable proportion of these costs unrecoverable or 'sunk' once incurred. This is in addition to the cashflow demands imposed by the need to purchase garment inventory upfront to meet large contracts, which can exceed a million dollars each for a range of high volume customers.

82. To date, the ACCC has not received market feedback identifying any garment suppliers that have recently established from greenfield entry, or expanded interstate. This suggests that it may be risky to enter interstate without a prior commitment for customer volumes or by acquiring an existing provider. This

contrasts with indications of interstate expansion by suppliers specialising in linen items.

83. At the same time, winning contracts with new customers without having an existing facility in a particular area appears to be rare. Therefore, entering interstate on a greenfield basis often appears unattractive due to the combination of the sunk costs and commercial risks involved.

Barriers to expansion

84. Existing garment laundry suppliers within a particular area may feasibly expand throughput by increasing the number of hours its machines operate. However, there are limits to this due to higher labour costs. Alternatively, the supplier can install additional machines if there is available floor space, or upgrade to equipment with a higher throughput and/or more automation. Small suppliers are likely to expand only incrementally (as they gain new customers) such that it will take multiple years to grow their capacity.

In-house laundering is not a viable alternative

85. The ACCC accepts that there are customers who in-house their laundry service requirements rather than outsourcing. However, these appear to be for small sites or remote sites with limited volume requirements. Certain customers have also considered outsourcing in-house laundry operations.

86. Overall, the ACCC understands that doing in-house garment laundry is generally not a feasible alternative to using an external laundry supplier. Customers appear to consider laundry services as a non-core operation with high operating costs, resulting in a general trend towards using external laundry suppliers.

87. In-house laundry processes are primarily on a much smaller scale, with some sites operating in-house laundry services due to the limited number of employees at particular sites or remote location. Sites with small volumes are not the focus of the ACCC's review as these sites are likely to have more alternative suppliers available to them, including small local suppliers. It appears that market participants generally consider outsourcing their garment laundry requirements when operations exceeded a certain size.

88. The ACCC understands that certain customers may be more sensitive to price increases, and may offer employees an allowance to undertake their own laundry requirements. The ACCC is continuing to investigate the prevalence of customers providing an allowance to their employees.

89. In contrast, certain industries appear more reliant on outsourced garment laundry services, such as food manufacturing, medical, or manufacturing involving hazardous materials, where regular audits are taken to ensure a level of sterility.

90. For this customer segment, garments are typically required to be laundered to a certain hygiene standard which is difficult to achieve or guarantee under an in-house arrangement, or if employees undertake their own garment laundering.

Limited customer bargaining power

91. The ACCC does not consider that even the Parties' largest customers have sufficient bargaining power in purchasing garment laundering services to prevent the merged entity from raising its prices or lowering service quality. Even large garment laundry customers do not individually account for a particularly large share of the Parties' total revenue, which is an important consideration for customers in negotiating more favourable terms.[18] Such customers do not appear to have an existing alternative to the Parties on a multi-state basis. Further these companies mostly do not appear to see in-house laundries or sponsoring a new entrant to garment laundering as viable options.

The ACCC invites comments from market participants on its concerns in relation to the reduction in competition for the supply of commercial laundry services for garments particularly, in the overlapping state-based markets or on a multi-state basis. In particular market participants may wish to comment on the following:

<u>For customers of commercial laundry services</u>

- The extent to which Alsco and Spotless Garments compete with and constrain each other in each state and on a multi-state basis.
- Whether there are viable alternatives to Alsco and Spotless Garments for all or some areas and sizes of customer, including whether:
    - regional or smaller suppliers are viable alternatives to large or established suppliers like Alsco and Spotless Garments, and why; and
    - large or established suppliers have a competitive advantage over smaller suppliers, and why.
- The ease of switching between different laundry suppliers.
- Whether switching to on-premises laundries would be a viable alternative to using outsourced garment laundry services and if so, in what circumstances.
- Whether providing a laundry allowance to employees would be a sufficient alternative to outsourcing laundry services.
- Whether there are certain industries where hygiene standards or regulations realistically requires garment laundry needs to be outsourced.

<u>For commercial laundry suppliers</u>

- The key reasons why suppliers may focus on linen or garments, and may even specialise on particular industry segments.
- The key reasons why linen focused suppliers may be hesitant to enter or further expand into garment services.

[18] ACCC, *Merger Guidelines 2008* (updated 2017), paragraph 7.50.

- The relevance of scale to a supplier's competitiveness.
- Any differences in the type of equipment (and the costs of that equipment) or operational processes that differentiate between a small and large scale garment laundry supplier.
- Any barriers to entry or expansion, both generally as well as into new regions or type of item laundered (for example, from garments laundering to linen laundering and vice versa).
- The impact of COVID-19 on your laundry operations, and whether it is feasible to reallocate capacity to meet demand from garments customers.
- Market share estimates, in each state and nationally, for the supply of commercial garment laundering services.

ACCC's future steps

92. As noted above, the ACCC invites submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter. Submissions should be emailed to mergers@accc.gov.au by no later than 30 October 2020.

93. The ACCC will finalise its view on this matter after it considers submissions invited by this Statement of Issues.

94. The ACCC intends to publicly announce its final view by 17 December 2020. However the anticipated timeline may change in line with the Informal Merger Review Process Guidelines. A Public Competition Assessment explaining the ACCC's final view may be published following the ACCC's public announcement.