



## ***Public Competition Assessment***

17 October 2007

### ***Woolworths Limited - proposed acquisition of Kmart and Officeworks from Coles Group Limited***

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#### **Introduction**

1. On 17 October 2007, the Australian Competition and Consumer Commission (ACCC) announced its decision to oppose the proposed acquisition of Officeworks plus Kmart Australia Limited (Kmart) by Woolworths Limited (**proposed Kmart acquisition**). The ACCC was of the view that the proposed Kmart acquisition would be likely to have the effect of substantially lessening competition in several markets, in contravention of section 50 of the *Trade Practices Act 1974* (the **Act**).
2. The ACCC has extended its timeline to allow further consideration of the proposed acquisition of Officeworks plus Target Australia Limited (Target) by Woolworths Limited (**proposed Target acquisition**).
3. The ACCC notes that there is currently no sale agreement between Coles Group Limited (Coles) and Woolworths Limited (Woolworths) for either proposed acquisition. On 7 November 2007, Coles shareholders are due to vote on a competing proposal for Wesfarmers Limited to acquire Coles (the Wesfarmers proposal).
4. The ACCC intends to announce its decision in respect of the proposed Target acquisition prior to the Coles shareholder vote on the Wesfarmers proposal.
5. The ACCC formed its view on the proposed Kmart acquisition on the basis of the information provided by the merger parties and information arising from its market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed Kmart acquisition, subject to confidentiality considerations.

#### **Public Competition Assessment**

6. To provide an enhanced level of transparency and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:

- a merger is opposed;
  - a merger is subject to enforceable undertakings;
  - the merger parties seek such disclosure; or
  - a merger is not opposed but raises important issues that the ACCC considers should be made public.
7. This Public Competition Assessment has been issued because the proposed acquisition is considered to raise issues of interest to the public, and because the ACCC decided to oppose the proposed Kmart acquisition.
8. By issuing Public Competition Assessments, the ACCC aims to provide the market with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the market to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change, because of developments.
9. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets, it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on its own merits.
10. Many of the ACCC's decisions will involve consideration of both non-confidential and confidential information provided by the merger parties and market participants. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or its sources. While the ACCC aims to provide an appropriately detailed explanation of the basis for the ACCC decision, where this is not possible, maintaining confidentiality will be the ACCC's paramount concern, and accordingly a Public Competition Assessment may not definitively explain all issues and the ACCC's analysis of such issues.

## **The parties**

### *The acquirer: Woolworths Limited*

11. Woolworths is an ASX listed Australian company. Its businesses include the Big W chain of discount department stores (DDS), Woolworths and Safeway supermarkets, the Dick Smith Electronics and Powerhouse chains, a range of liquor stores and a chain of service stations.
12. The Woolworths business of most relevance to the proposed Kmart acquisition is Big W, a DDS chain of 141 stores operating across Australia. Big W retails general merchandise, including clothing, footwear and accessories; homewares; toys and other leisure products; gardening, hardware and tools; everyday needs products including toiletries and cosmetics; home appliances and entertainment products; and stationery and office products.

*The target: Officeworks plus Kmart (from Coles Group Limited)*

13. Coles is an ASX listed retailing company. The Coles businesses of most relevance to the ACCC's assessment are:
  - Kmart - a DDS chain of 168 stores operating throughout Australia (and a further 14 in New Zealand). Kmart retails general merchandise, including clothing, footwear and accessories; homewares; toys and other leisure products; gardening, hardware and tools; everyday needs including toiletries and cosmetics; home appliances and entertainment products; and stationery and office products. Kmart also runs Kmart Tyre and Auto Service centres.
  - Target - a DDS chain of 260 stores operating throughout Australia. Target trades under the brands Target, Target Country and Baby Target. Target retails a range of general merchandise, with a strong focus on fashionable apparel and soft homewares, e.g. sheets and towels. Other product categories include toys, leisure products, toiletries and cosmetics, technology products, and nursery products.
  - Officeworks – a retailer of office and technology products for offices, students and businesses. Officeworks has approximately 100 outlets. It also sells office and technology products online.
14. Coles also operates the Coles and Bi-Lo supermarket chains, a range of liquor stores, and Coles Express, a chain of service stations. Woolworths does not propose to acquire any of these assets.

**The proposed transaction**

15. The proposed transaction involves the acquisition by Woolworths of Officeworks and Kmart.
16. Woolworths has also asked the ACCC to review an alternative proposal: the acquisition by Woolworths of Officeworks and Target (the proposed Target acquisition) instead of Officeworks and Kmart. The ACCC will announce its decision on the proposed Target acquisition separately.
17. This Public Competition Assessment addresses only the proposed Kmart acquisition.

**Areas of overlap**

18. Most of the product categories Big W retails are also retailed by Kmart.
19. Officeworks, Big W and Kmart all retail office products.

**Timing**

20. The following table outlines the timeline of key events in this matter.

Date	Event
15-Jun-2007	ACCC commenced its review under the Merger Review Process Guidelines. Market inquiries commenced.
13-Jul-2007	Closing date for submissions from interested parties.
5-Sep-2007	ACCC published a Statement of Issues outlining preliminary competition concerns. Proposed date for announcement of ACCC's findings amended accordingly.
19-Sep-2007	Closing date for submissions from interested parties.
28-Sep-2007	Decision date amended from 3 October to 17 October 2007 due to Woolworths' delay in providing a submission in response to the Statement of Issues.
17-Oct-2007	Date for announcement of ACCC's findings.

### **Market inquiries**

21. The ACCC conducted market inquiries with hundreds of industry participants, including competitors, potential competitors, customers, suppliers, industry bodies and other interested parties. Submissions were sought in relation to the substantive competition issues.

### **Statement of Issues**

22. The ACCC published a Statement of Issues on 5 September 2007, identifying its preliminary concerns with respect to the proposed acquisition. The Statement of Issues is available on the ACCC's website at [www.accc.gov.au](http://www.accc.gov.au).
23. The Statement of Issues sought further information on the closeness of competition between Big W, Kmart, Target and other retailers and the ability of other retailers to reposition themselves to constrain the merged firm post-acquisition. The Statement of Issues also sought information on the likelihood that the proposed acquisition would substantially lessen competition, resulting in higher prices, reduced range or distortion of supplier markets.
24. The Statement of Issues identified competition issues in relation to the proposed Kmart acquisition in a number of product categories in which market participants consistently stated that Kmart and Big W are each other's closest competitors. The Statement of Issues raised the possibility that, post-acquisition, the combined Big W/Kmart business would not face sufficiently close competition from other retailers to prevent it from profitably instituting a small but significant increase in its prices on a sustained basis.

### **Areas of concern**

25. The ACCC's inquiries have led it to the view that Big W and Kmart are each other's closest competitor in most respects. In particular, the ACCC identified a number of product markets in which no other retailer (including Target) is a sufficiently close competitor to prevent a merged Big W/Kmart from increasing prices. These include the retail sale of:
  - Basic footwear
  - Men's basic apparel
  - Women's basic apparel

- Children's basic apparel
- Toys
- Books
- DVDs.

## **Industry background**

### *Different store formats*

26. General merchandise is sold by a large number of retailers operating in different formats. Key formats tend to be comprised of national chains. They include:
- **Discount Department Stores (DDS)** – sell a broad range of general merchandise. They generally focus on attracting price conscious customers, with an emphasis on low prices and good value. Customers are usually expected to self-serve in store, and transactions take place via a large bank of checkouts at the front of the store. e.g. Big W, Kmart, Target.
  - **Traditional Department Stores** – sell merchandise across a relatively broad range of product categories. They generally focus on attracting medium to higher income customers, with an emphasis on fashion and on well-known national and international brands. These stores market themselves as offering a higher degree of customer service, and cashiers are located throughout the store. e.g. David Jones, Myer.
  - **Large specialty retailers** – sometimes referred to as 'mini-majors' or 'category killers', specialise in a particular category (or a small number of categories) of general merchandise, sold in a relatively large format and with an extensive product and brand range. e.g. Harvey Norman (furniture and electrical goods), Rebel Sport (sporting goods).
27. General merchandise is also sold in **discount variety stores**, which sell lower priced and generally non-branded merchandise across a range of categories (e.g. The Reject Shop, Crazy Clarks) and **smaller specialty retailers**, which specialise in a particular category or type of merchandise (e.g. Orotan in accessories or Seed in children's apparel). Discount variety stores and smaller specialty retailers often operate as chain stores.
28. **Supermarkets** also complement their primary food and grocery product range with a small to medium range of general merchandise goods, most of which fall into the category of everyday needs.

### *Industry structure and competition*

29. While there are a range of different store formats selling various categories of general merchandise, the customer experience differs depending on the format. Retailers compete not only by broad product category, but also on other factors including price, quality, range, convenience and service.

30. Therefore, the extent to which one firm competitively constrains another depends on all of these factors, not simply on its share of sales in a particular product category. A firm which has a similar offering in terms of these factors is a much stronger competitive constraint than a firm which, despite selling items in the same product category, operates at a very different price point and with different levels of service and quality.
31. Market inquiries suggested that a significant number of consumers value highly the multi-product offering of the DDS chains ('one-stop shop'), and that the DDS chains are generally stronger competitive constraints on each other than are other retail formats.

*Differences between the three DDS chains*

32. There are some key differences between the three major chains of DDS: Big W, Kmart and Target.
33. Big W and Kmart each retail merchandise across a wide range of product categories, comprising approximately 60% hard goods (e.g. electrical appliances, books, DVDs, toys) and 40% soft goods (e.g. apparel, sheets, towels). Although Target retails merchandise across a similar range of product categories, its offering in many categories is more limited. Target focuses more strongly on apparel and homewares (which together constitute nearly 70% of Target's sales).
34. Big W and Kmart both promote themselves as offering low prices. Big W operates on an 'everyday low prices' (EDLP) model. Big W aims to have low undiscounted prices all the time, with limited promotional specials on some product lines. Kmart operates on what market participants called a 'hi-lo' model. Kmart generally sets its regular prices slightly above those of Big W on most items, but it runs frequent and significant sales on a broad range of products (e.g. 20% off all toys) at which time its prices are lower than Big W's for many such items. In addition to frequently price checking against Kmart, Big W has very close regard to how frequently and how deeply Kmart discounts its products in setting its own prices. Likewise Kmart frequently checks Big W's everyday low pricing and takes Big W's pricing into account in determining its own pricing and special discount promotions. As a result, Big W's and Kmart's different pricing policies interact closely.
35. Overall, the ACCC's market inquiries indicated that Big W and Kmart were very similar to each other in terms of range, price and service in most product categories. Target, on the other hand, actively seeks to differentiate its consumer offer through higher quality and more fashionable merchandise and brands in many product categories.

**Future with/without test**

36. In assessing whether a merger is likely to breach section 50 of the Act, the ACCC applies a future with and without test. That is, it considers and compares the likely future state of competition with and without the acquisition.

37. Without the proposed acquisition by Woolworths, it appears likely that Kmart and Target will be owned by a single company, which, at present, appears likely to be Wesfarmers.
38. Woolworths has informed the ACCC that its general intention is to convert Kmart stores to Big W, subject to landlord and other consents where applicable. In that case, if the proposed Kmart acquisition proceeds, the ownership of DDS chains would change from Coles owning 2 DDS chains and Woolworths owning 1 DDS chain, to Coles and Woolworths each owning 1 DDS chain (see Table 1 below). That is, Kmart would essentially be eliminated from the market.

Table 1: Ownership of DDS chains with and without the proposed Kmart acquisition

	Coles (or Wesfarmers)	Woolworths
Without the proposed Kmart acquisition	2 DDS (Kmart and Target) + Officeworks	1 DDS (Big W)
With the proposed Kmart acquisition	1 DDS (Target)	1 DDS (Big W including converted Kmart outlets) + Officeworks

39. Market inquiries indicated that, in many product categories, Target is significantly differentiated from Big W and Kmart and Big W and Kmart are each other's closest competitors. The ACCC therefore considered that the scenario of a combined Big W/Kmart, where Target is the separately owned DDS chain, to be significantly different from a market structure in which Kmart and Target exist under a single owner and Big W is the separately owned DDS chain.
40. The ACCC also received a large amount of confidential material in relation to the operations and pricing policies and practices of the relevant businesses and their post-acquisition plans, which was significant in forming a view on the likely competition effects of the proposed acquisition.

### Market definition

41. The ACCC considered that the relevant markets for the purpose of assessing the competition effects in this matter were the:
- national markets for the retail supply of various categories of products;
  - national markets for the wholesale supply of various categories of products;
  - national market for the leasing of floor space in retail shopping complexes.
42. When identifying the field of rivalry, the ACCC looks at the product, geographic and functional overlaps. In this context, 'functional' refers to the relevant level of the supply chain, whether it be retail, wholesale or production.

Product dimension of the retail markets

43. For the purpose of its competition analysis, the ACCC defined separate markets for the retailing of products within product categories. The ACCC's inquiries indicated that this reflected the way in which most consumers tend to shop. The ACCC was of the view that defining markets in this manner was the most effective way of identifying issues relevant to the competition analysis of the proposed acquisition.
44. Woolworths submitted that the relevant product markets comprised broad product categories or groups of product categories based on its in-store divisions (e.g. menswear or toys/sports/travel). However, following an extensive examination of the relevant categories and consultations with market participants, it was clear to the ACCC that the relevant markets should be defined on a more segmented basis (e.g. men's basic apparel, or toys). Defining markets on a more segmented basis enabled the ACCC to focus on the nature of competition between Big W, Kmart and Target.
45. The ACCC also considered that the extensive differentiation by retailers in their retail formats, including in relation to price point, service, convenience, network, 'one-stop shop', quality and range, is part of the total offer supplied by each retailer and is relevant to the closeness of competition among retailers. However, despite the close competition between DDS chains, the ACCC did not exclude other retailers from the market. That is, the retail markets were defined with respect to the types of product sold (e.g. basic footwear) rather than by the store format (e.g. DDS).
46. The ACCC notes that its competition analysis would not have been materially different if it used broader product categories as markets (such as footwear) and defined basic footwear as a substantial segment of that market. A key consideration under such a market definition would have been the closeness of competition between the merger parties within the market segments.
47. In technical terms, the ACCC recognised that, due to the differentiated nature of the offerings of retailers, competition may be non-uniform. As a result, individual retailers compete more directly with those rivals selling closer substitutes. This led the ACCC to adopt a unilateral effects analysis. That is, it looked at the ability of the merged firm to profit by unilaterally raising prices above the competitive level.
48. Substantial unilateral price elevation in a market for differentiated products requires that there be a significant share of sales in the market accounted for by consumers who regard the products of the merging firms as each other's closest competitor, and that repositioning of the non-parties' product lines to replace the close competition lost through the merger is unlikely. The price rise will be greater the more closely substitutable are the retail offerings of the merging firms, i.e. the more the buyers of one retail offer consider the other retail offer to be their next choice.<sup>1</sup>

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<sup>1</sup> Adapted from the US Merger Guidelines.



Functional dimension

49. The ACCC considered there to be separate retail and wholesale markets.

Geographic dimension

50. Retail competition often occurs at a local level driven by shopper behaviour, local pricing and local conditions.

51. However, in this matter, the relevant businesses all operate at the national level. The ACCC's review indicated the three DDS chains price nationally with very limited exceptions. As such, the impacts of the proposed acquisition are likely to occur initially at a national rather than at local levels.

52. Given this, and noting the purposive approach to markets for competition analysis, the ACCC considers that the relevant geographic retail markets for analysis of the proposed acquisition are national.

53. On a national basis, Big W and Kmart are each other's closest competitors and impose the strongest constraint on each other. This is also true at a local level, where 132 of the 168 Kmart stores are located less than 10km from a Big W store, with most significantly closer.

54. The ACCC's conclusions on the competition effects of the proposed acquisition would not be affected if local retail markets were adopted rather than national markets.

55. The ACCC considered that the markets for the wholesale supply of products exist at a national level (the 'supplier markets').

Relevant markets

56. The ACCC analysed the competition effects of the proposed acquisition in a number of national markets, including markets for the retail and wholesale supply of:

- Basic footwear
- Men's basic apparel
- Women's basic apparel
- Children's basic apparel
- Toys
- Books
- DVDs.

57. The ACCC also analysed the competition effects of the proposed acquisition in the national market for the leasing of floor space in retail shopping complexes.

## **Competition analysis – proposed acquisition of Kmart + Officeworks**

### *Competitive harm*

58. Market inquiries indicated that the proposed acquisition would be likely to lessen competition in one or more of the following ways:
- Removal of the competitive constraint between Big W and Kmart, resulting in an increase in Big W's retail market power. This is likely to allow the merged Big W/Kmart to profitably increase prices post-acquisition compared with the situation if they continued as separate competitors.
  - Removal of the interaction between Big W's everyday low price (EDLP) policy and Kmart's hi-lo pricing policy, leading to higher average prices paid by consumers. Big W and Kmart check each other's prices constantly and comprehensively. They are closely cognisant of each other's pricing practices and have regard to this in determining their own prices. This competitive interaction and constraining influence would be lost.
  - Increase in Woolworths' power in negotiating leases as an anchor tenant in retail shopping complexes. Market inquiries indicated that by reducing the anchor tenants available to landlords, the acquisition may have the effect of reducing investment in retail shopping complexes, which may in turn lead to higher rents for specialty retailers.

Each of these effects is explained further below.

59. A number of market participants expressed concerns about the likely effect of the proposed acquisition on supplier markets. In some product categories, Woolworths obtains the majority of its supplies from large overseas suppliers, and the proposed acquisition is unlikely to affect these suppliers. On the evidence provided in relation to Australian-based suppliers, the ACCC considered that the likelihood that the supplier market concerns submitted by market participants would arise in the future was not significantly increased by the proposed acquisition.
60. Market inquiries indicated a view among a number of retailers that a combined Big W/Kmart may be able to negotiate lower prices from suppliers, in addition to the cost savings it would achieve through greater scale. Many market participants expressed concern that this would increase Big W's ability to aggressively resist new entrants by offering low prices in the short term, forcing some other retailers to exit or scale back their operations. No evidence was provided to support these arguments such that the proposed acquisition would increase the costs of existing retailers or increase the costs of new retailers entering the market (except in relation to retail leases as noted above). If the proposed acquisition made the merged firm a better competitor by reducing its costs, this is likely to be of competitive benefit rather than harm.

Increase in Big W's retail market power

61. The ACCC considered that the proposed acquisition would combine Big W with its closest competitor in most product categories, Kmart. The ACCC's inquiries led it to the view that Big W is the primary point of reference for Kmart in setting prices, and Kmart is the primary point of reference for Big W in setting its prices.
62. The ACCC considered it likely that, with the removal of competition between Big W and Kmart, the combined Big W/Kmart would be faced with retailers who are positioned differently from it on the basis of price, store format, range, service levels and national footprint. These retailers, in general, are less able to provide as strong a competitive constraint on Big W, due in large part to their different competitive positioning and in some cases their more limited scale.
63. In markets where Kmart and Big W are each other's closest competitor, and other retailers (including Target) are sufficiently different from Kmart and Big W, the ACCC concluded that a combined Kmart/Big W would be able to increase prices while losing little or no market share to competitors.

Removal of interaction between Big W's everyday low pricing policy and Kmart's hi-lo pricing policy

64. The ACCC considered an important element of competition between Big W and Kmart is their different pricing strategies. Consumers benefit from having the option of both a large, national everyday low price (EDLP) retailer and a large, national hi-lo retailer available (in each of the product categories). Big W's EDLP offers value to consumers wishing to make an immediate purchase. Kmart's periodic deep discounts provide value to consumers who are willing to delay their purchases. The ACCC considers that the removal of Big W's main hi-lo competitor will lead to consumers losing the opportunity to purchase products at lower discounted prices.
65. The ACCC also considered that EDLP retailers such as Big W are likely to take into account the discounting practices of hi-lo retailers such as Kmart in setting their own everyday prices. The removal of Kmart, a large hi-lo retailer with a national network, range and format which more closely matches Big W's than does any other retailer, removes the need for Big W to take account of Kmart's frequently discounted prices when setting its own prices, and is therefore also likely to lead to increased prices at Big W.
66. The ACCC concluded that the removal of the interaction between Big W's EDLP policy and Kmart's hi-lo pricing policy is likely to substantially lessen competition.

Increase in Big W's buyer power in relation to landlords and rationalisation of retail space

67. Market participants referred to the special role of 'anchor tenants' in plans for new shopping centres and significant redevelopment of existing centres. Market inquiries indicated a strong concern that the proposed acquisition would increase Woolworths' power in negotiating leases as an anchor tenant in retail shopping complexes.
68. The ACCC received information including a submission from Woolworths in relation to retail space on 10 October 2007. As a result, the ACCC intends to make further inquiries in order to determine whether either proposed acquisition would substantially lessen competition in relation to retail space.
69. Given the ACCC's view that the proposed Kmart acquisition would substantially lessen competition in a number of other relevant markets, the outcome of these inquiries would not alter the ACCC's decision to oppose the proposed Kmart acquisition and will primarily be relevant to its decision on the proposed Target acquisition.

Reduced consumer choice in local areas where Big W and Kmart co-exist

70. The ACCC's inquiries indicated that Big W and Kmart co-exist within the same local areas across Australia. 132 of the 168 Kmart stores are located less than 10km from a Big W store, with most significantly closer.
71. In each local area which is currently serviced by both a Big W and a Kmart, the conversion of Kmart stores to Big W stores would reduce the range of products available to consumers and remove the (local) direct benefit of Kmart's discounting practices. With the removal of its main national competitor, Big W may also have the incentive to commence local pricing in response to local market conditions, potentially leading to higher prices in some local areas.

*Relevant merger factors*

72. In determining whether the proposed acquisition would be likely to have the effect of substantially lessening competition in each relevant market, the ACCC took into account each of the factors outlined in section 50(3) of the Act.
73. The likelihood that the proposed acquisition would result in Woolworths being able to significantly and sustainably increase prices or profit margins is discussed above. The following factors were also particularly relevant to the ACCC's assessment of the competition effects in each market.

Entry and expansion

74. Market inquiries indicated that barriers to entry are low for single stores or small chain retailers. However, inquiries also indicated that in most cases only a large chain could competitively constrain Big W, and barriers to entry on a larger scale are very significant.

75. The ACCC found that there are high barriers to entering on a state or national basis. In particular, it is extremely difficult to obtain access to a large network of suitable store sites. Market inquiries indicated that Big W, Kmart and Target's networks of DDS sized centres are irreplaceable. The ACCC also found there to be substantial economies of scale and high capital costs of entry, including sunk costs.
76. Market participants considered there to be a real likelihood that Big W would respond aggressively to entry, particularly if the new entrant offered prices, product range and format which closely matched that of Big W. Market participants submitted that this would act as a further deterrent to entry or expansion by other retailers.
77. Market inquiries indicated that existing retailers would either lack the ability or the incentive, and in many cases both, to reposition themselves closer to Big W post-acquisition.

#### Market concentration and market shares

78. Big W and Kmart's product ranges focus primarily on basic products of sound quality at low prices. As a result, their market shares for the retail sale of products which compete closely with these basic items are significantly higher than their shares of the industry as a whole.
79. Woolworths argued strongly in support of the proposed acquisition on the basis that there are a wide range of stores selling like products. However, market inquiries suggested that many of the items included in industry-wide figures submitted by Woolworths are for the sale of higher priced or even luxury items, which do not impose a competitive constraint on Big W or Kmart and should therefore be excluded from the relevant market for the purposes of a competition analysis, or at least recognised as a significantly lesser constraint. In the ACCC's view, Big W's, Kmart's and Target's shares of retail sales within broad product categories (such as footwear) provide little insight into the competitive dynamics and constraints faced by these retailers.
80. In industries consisting of differentiated products, such as the retail of general merchandise, market shares may not be a useful indicator of the strength of the threat to competition posed by the merger and in some cases may be misleading. This is because an analysis based on market shares assumes that the competitive influence of products within the market is in direct proportion to their market shares. However, the relevant consideration is the extent to which a significant proportion of customers view Kmart and Big W as close competitors.
81. Market concentration figures are a function of market shares. Although important, concentration ratios may not reflect the closeness of competition between any two competitors. This is a highly significant point in a competition analysis such as this, where Big W and Kmart operate in a highly differentiated industry and are each other's closest competitors.

#### Availability of substitutes

82. In each of the relevant markets, the ACCC concluded that other retailers supply items within the same product categories. However, due to significant differentiation between retail offerings, other retailers exercise a more limited constraint on Kmart and Big W in the relevant markets and would be unlikely to prevent a significant and sustained increase in Big W's prices or profit margins.

#### Dynamic characteristics, including growth, innovation and product differentiation

83. The ACCC considered the dynamic characteristics of the market. One particular characteristic, the degree of product differentiation, was significant to the ACCC's analysis.
84. The ACCC also considered the extent to which the growth in internet sales and downloads would constrain the parties post-acquisition, particularly in relation to books, DVDs and recorded music.

#### Import competition

85. Market inquiries indicated that in some product categories the majority of items sold in Australia are imported, but that these are imported by the retailers themselves (i.e. they are not independent imports). The ACCC noted that these imports were already taken into account in the competition analysis, through the assessment of market concentration and the availability of substitutes.
86. The ACCC concluded that direct and independent imports (as opposed to retailer imports) did not provide a significant competitive constraint at the retail level.
87. The ACCC also considered the effect of consumer imports of products directly from online retailers overseas and concluded that they are not significant enough to provide a competitive constraint to Australian retailers.

#### *Competition assessment in relevant markets*

##### Basic footwear

88. The ACCC considered that basic footwear (including footwear for men, women and children) can be distinguished from footwear more broadly. Distinguishing features of basic footwear include: very low price points, the general lack of significant brands (with limited exceptions), and a retail model which is generally volume driven and involves self service or very limited customer service.
89. Taking into account the relevant merger factors discussed above, the ACCC concluded that the proposed acquisition was likely to substantially lessen competition in the retail market for basic footwear. The merged entity would have a very high share of sales of basic footwear nationally. The acquisition would remove the only comparable (in terms of size and competitive influence) competitor to Big W in this market, and other retailers would be unlikely to constrain the merged entity from increasing prices above competitive levels.

90. The ACCC considered that, post-acquisition, the main areas of competitive harm would be the potential for increased prices and a possible reduction in consumer choice if Woolworths decided to convert a significant number of Kmart stores into Big W stores.

Men's basic apparel, Women's basic apparel, and Children's basic apparel

91. Basic apparel can be distinguished from apparel more broadly. Some distinguishing features include: relatively low prices, limited importance of national brands and a relatively simple product with comparatively high degree of similarity of product (in comparison with more fashion driven clothing which is frequently very strongly differentiated). Basic apparel is often sold via a retail model which is volume driven and involves self service or very limited customer service.
92. The products are also 'basic' in the sense that they are all of the items necessary to form the foundation of a person's wardrobe. For example, children's basic apparel may include baby suits, socks and underwear, sleepwear and casual clothes. These are referred to as essentials. At back-to-school time, the DDS chains also increase the range of items that can function as basic school-wear such as plain netball skirts and coloured shorts. Lower volume, higher margin products for more formal occasions such as suits, pressed trousers, and distinctive school uniforms are not considered to be children's basic apparel.
93. Similar distinctions exist in relation to men's and women's basic apparel as distinct from men's and women's apparel more broadly.
94. Taking into account the relevant merger factors discussed above, the ACCC considered that existing competitors would be unlikely to constrain the merged entity from increasing prices above competitive levels in each of these three categories. While some specialty retailers offer some similar products to those offered by the merger parties, the ACCC's inquiries suggested that the competition between these retailers and the merger parties appears to be asymmetric in many instances (in that Big W may constrain them, especially during their sale periods, but they do not provide an effective constraint against Big W), and the ACCC considered that they do not offer sufficiently close competition to prevent a small but significant price increase by a merged Big W/Kmart.
95. Target is only likely to provide a limited constraint, due largely to its different product range and pricing in the markets for men's basic apparel, women's basic apparel and children's basic apparel.
96. The proposed acquisition would also remove a vigorous and effective competitor, with the ACCC's inquiries suggesting aggressive competition between Kmart and Big W plays a significant role in keeping prices low.

97. The ACCC considered that, post-acquisition, the main areas of competitive harm would be the potential for increased prices and a reduction in consumer choice if Woolworths decided to convert a significant number of Kmart stores into Big W stores.

Toys (other than electronic games)

98. Taking into account the relevant merger factors discussed above, the ACCC concluded that the proposed acquisition is likely to substantially lessen competition in the market for the retail sale of toys (other than electronic games).
99. Kmart is the closest competitor to Big W on the basis of price and range, and appears to compete aggressively with Big W. Post-acquisition, the merged entity is likely to face a more limited constraint from Target and Toys R Us; the ACCC's inquiries suggested that these retailers have a different range, focus and pricing strategy from Big W and Kmart.
100. The ACCC considered that, post-acquisition, the main areas of competitive harm would be the potential for a small but significant price increase and a reduction in consumer choice if Woolworths decided to convert a significant number of Kmart stores into Big W stores.

Books

101. Market inquiries indicated that Big W is the most effective DDS in the sale of books, with Kmart operating as Big W's closest competitor.
102. Target was not considered by market participants to have a particularly strong focus on books, and market participants considered that it would not operate as a strong constraint on a combined Big W/Kmart, primarily due to what market participants considered to be a narrower range.
103. Although specialty retailers offer a wider range of books than DDS chains, their prices on those titles which are sold in DDS chains are generally significantly higher.
104. Taking into account the relevant merger factors discussed above, the ACCC therefore concluded that the proposed Kmart acquisition may be likely to result in a substantial lessening of competition in the sale of popular, low priced and discounted books, including popular new release titles. This would most likely lead to increased prices.

DVDs

105. Market inquiries indicated that Big W and Kmart compete strongly in the retail sale of DVDs. Competition between Kmart and Big W in this market is driven by offering an everyday/mainstream range of titles at low prices.



106. While there are other stores which retail DVDs in competition with Big W, Big W competes in the DVD retail market primarily by offering popular DVDs at low prices. The other stores which compete in a similar way are Kmart, and to a lesser extent JB Hi-Fi and Target. JB Hi-Fi appears to have a strong focus on providing a broad range of DVDs, rather than focussing on having the lowest prices for a more limited range of products. JB Hi-Fi also has a limited national presence when compared with the DDS chains. Market participants suggested that Target is generally not as driven by low prices as Kmart and Big W and that Target focuses on family-friendly titles more than other retailers.
107. Specialty retailers such as Sanity and Ezy DVD also participate in this market. However, these stores compete more on the basis of range and service, and consequently do not provide such close competition or as effective a constraint on Big W as does Kmart in the sale of low price, popular DVDs.
108. Market inquiries indicated that online DVD models are not of sufficient market size to have a significant constraining impact on the merged entity.
109. Taking into account the relevant merger factors discussed above, the ACCC concluded that the transaction may substantially lessen competition in the DVD retail market, particularly in relation to competition for the retail of popular/mainstream DVDs.

#### Other product categories

110. While market participants indicated that Big W and Kmart are each other's closest competitor in most product categories, the ACCC concluded that other retailers, including Target, would constrain Woolworths from raising prices significantly post-acquisition in other relevant markets.

#### **Competition analysis – proposed acquisition of Officeworks**

111. On balance, the ACCC concluded that the acquisition of Officeworks in its own right is not likely to lead to a substantial lessening of competition in any market due to competitive constraint from other retailers, including Harvey Norman and the Office1 Superstore chain, and the likelihood of new entry and expansion by these retailers.
112. However, Woolworths' proposal is not for an acquisition of Officeworks in its own right, but for an acquisition of both Kmart and Officeworks. Given the ACCC's decision to oppose the proposed acquisition of Kmart, it also opposes the combined acquisition of Kmart and Officeworks.

#### **Competition analysis – proposed Target acquisition**

113. The ACCC identified some preliminary concerns in respect of the proposed Target acquisition in its Statement of Issues.
114. The ACCC has extended its timeline to allow further consideration of the proposed Target acquisition. The ACCC received information including a further

submission from Woolworths on 10 October 2007 and intends to make further inquiries to determine whether the proposed Target acquisition would result in a substantial lessening of competition. Specifically, the ACCC intends to make further inquiries in relation to:

- any conglomerate effects of the proposed acquisition, and the question of whether the post-acquisition structure of a Coles Group consisting of supermarkets, liquor stores, service stations and Kmart, facing a Woolworths consisting of supermarkets, liquor stores, service stations, Target, Big W, Dick Smith, Tandy and Officeworks may constitute a lessening of competition relative to the counterfactual of a Wesfarmers consisting of the above Coles Group companies plus Bunnings, Officeworks and Target facing Woolworths in its current form; and
- the effect of the proposed acquisition in markets for retail space, in light of information from landlords and the further submission from Woolworths on 10 October 2007.

115. The ACCC still intends to announce its decision in respect of the proposed Target acquisition prior to the Coles shareholder vote on the Wesfarmers proposal. (The shareholder vote will take place on 7 November 2007.)

### **Conclusion**

116. On the basis of the above, the ACCC formed the view that the proposed acquisition of Kmart by Woolworths would be likely to result in a substantial lessening of competition in the national markets for the retail supply of:

- Basic footwear
- Men's basic apparel
- Women's basic apparel
- Children's basic apparel
- Toys
- Books and
- DVDs

in contravention of section 50 of the Act.