



Australian
Competition &
Consumer
Commission

26 November 2008

Statement of Issues — Woolworths Limited - proposed acquisition of a supermarket lease in Wallaroo, South Australia.

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition of a supermarket lease by Woolworths Limited (**proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at www.accc.gov.au) the ACCC has established a secondary timeline for further consideration of the issues. The closing date for further market inquiries is 10 December 2008 and the ACCC anticipates making a final decision on 21 January 2009. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. 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.

Background

5. On 22 October 2008 the ACCC commenced its informal review of the proposed acquisition.

The parties

The acquirer - Woolworths Limited

6. Woolworths Limited (**Woolworths**) is an Australian and New Zealand retailer. Its operations include supermarkets, petrol, liquor, Big W general merchandise stores, and consumer electronics through Dick Smith, PowerHouse and Tandy.
7. Woolworths is Australia's largest grocery retailer. It operates approximately 780 supermarkets across Australia. Woolworths is also the owner or joint owner of approximately 1060 liquor outlets. Woolworths currently owns a 3000 square metre supermarket in Kadina, South Australia, approximately 9km from the target.

The target – supermarket lease in Owen Terrace Wallaroo

8. In May 2008 Leasecorp was selected by the Copper Coast Council as its preferred developer for the site in Owen Terrace, Wallaroo where it proposes to construct a shopping complex which will include a 3200 square metre supermarket and specialty shops. Woolworths proposes to lease the supermarket site when the development is completed.
9. The proposed supermarket at Owen Terrace, like the Woolworths supermarket in Kadina, will be a full-line supermarket¹ carrying a wide range of products.

The proposed acquisition

10. Woolworths proposes to acquire a lease from Leasecorp to operate the supermarket at Owen Terrace Wallaroo.

Other industry participants

11. Drake Food Markets (**Drake**) is an operator of 40 independent supermarkets under the Foodland and Supa IGA banners². In the Copper Coast region Drake operates two stores under the Foodland banner at Wallaroo and Moonta. Moonta is approximately 16km south of Wallaroo (please see map of the Copper Coast region at Attachment A). The ACCC notes that the existing Drake supermarkets at Wallaroo and Moonta have floor areas of approximately 1400 and 1500 square

¹ The ACCC's inquiries indicate that while some parties disagree on the precise definition of a full-line supermarket, it is generally considered to be a supermarket with a full range of goods including packaged groceries, fresh meat, bakery and deli departments, fresh fruit and vegetables and frozen foods. A full-line supermarket is generally considered to be at least 2500sqm. Some market participants draw a distinction between basic full-line supermarkets at 2500sqm, and larger, major full-line supermarkets of at least 3000sqm and up to 4500sqm.

² Drake's 30 South Australian supermarkets operate under the Foodland banner while its 10 Queensland supermarkets operate under the Supa IGA banner. It also operates three newsagencies in Adelaide.

metres respectively and may not be considered full line supermarkets. The ACCC seeks further information on the nature of the existing Drake supermarkets in Wallaroo including details of their range and the categories supplied at these supermarkets, and their competitive impact.

12. Drake has expressed an interest in operating a new 2500 square metre full line supermarket in Owen Terrace Wallaroo (see **With/Without test** below at paragraphs 18 – 25). The ACCC's inquiries indicate that a full-line Drake supermarket is generally regarded as offering a range of goods which is comparable in size but different in composition to those of Woolworths.
13. IGA Kadina – a small convenience supermarket of approximately 400 square metres operates under the IGA banner in Kadina.
14. Coles Chain (**Coles**) – There are no Coles supermarkets in the Copper Coast region.
15. Aldi Stores (**Aldi**) – Aldi does not operate any stores in South Australia.

Market inquiries

16. On 22 October 2008 the ACCC commenced a review under the Merger Review Process Guidelines. Submissions from interested parties closed on 12 November 2008. The ACCC has received information from a range of interested parties.
17. The ACCC is now calling for further information from interested parties to assist with its investigation as set out below.

Additional background

With/without test

18. In assessing a merger pursuant to section 50 of the Act, the ACCC must consider the effects of the transaction by comparing the likely competitive environment post-merger if the transaction proceeds (the “with” position) to the likely competitive environment if the transaction does not proceed (the “without” position) to determine whether the acquisition is likely to substantially lessen competition in any relevant market.
19. The information available to the ACCC suggests that in the absence of the proposed acquisition, it appears likely that Drake will open a large full line supermarket at the Owen Terrace site in Wallaroo either with Leasecorp or another developer. In particular, the ACCC's preliminary view is that Leasecorp intends to open a supermarket as part of its proposed development, and that if Woolworths were unable to operate that supermarket, it is likely that another supermarket operator, probably Drake, would be willing and able to operate the supermarket. Alternatively, if Leasecorp were unwilling to proceed with the development without Woolworths as a tenant, the ACCC understands that another developer is willing and able to proceed with a development on the site that would include a full-line Drake supermarket.

20. Accordingly, the ACCC's preliminary view is that this forms the basis of the "without" position for the purposes of the ACCC's competition assessment.
21. The "with" position is that the Leasecorp development and Woolworths acquisition of the lease both proceed, and that Woolworths opens a large format full-line supermarket upon construction of the shopping complex at the site.
22. The ACCC has also received submissions regarding the likely future of the existing Drake Foodland supermarket at Wallaroo if the Woolworths transaction proceeds. In particular, it has been submitted that the Drake Foodland is a smaller supermarket in a less desirable location, and would likely lose a substantial proportion of its trade to the proposed Woolworths supermarket, making it unviable and leading it to exit the market.
23. Based on this information and further confidential information available to it, the ACCC has formed the preliminary view that it is likely that the current Drake Foodland supermarket at Wallaroo is likely to exit the market if the transaction proceeds.
24. Similarly, if the acquisition does not proceed and instead Drake opens a full-line supermarket at the Owen Terrace site, the ACCC considers it likely that the existing Drake supermarket at Wallaroo will close.
25. The ACCC invites submissions from interested parties either supporting or disagreeing with the ACCC's preliminary view in relation to both the 'with' and the 'without' positions.

Market definition

Local retail supermarket market

26. Consistent with previous matters, the ACCC has considered the proposed acquisition in the context of a local retail supermarket market.
27. In defining relevant markets, the ACCC takes a purposive approach. In a number of previous supermarket matters in urban areas the ACCC has considered the geographic scope of local supermarket markets to be within a 3-5 km radius surrounding the supermarket to be acquired. In regional areas, the ACCC has generally defined broader markets, reflecting the generally greater willingness of consumers in regional areas to travel for the purpose of grocery shopping as well as the greater need to travel between towns for other purposes. In each case there are a number of geographic factors that influence the precise geographic scope of the relevant market.
28. The proposed supermarket will be located in Wallaroo, a small regional town approximately 160 kilometres from Adelaide in the Copper Coast region of the Yorke Peninsula in South Australia. Wallaroo has a population of approximately 2800. There are two other towns within the Copper Coast region. Kadina is approximately 9 kilometres from Wallaroo with a population of approximately 4200, and Moonta is approximately 16 kilometres from Wallaroo and 17 kilometres from Kadina with a population of approximately 3800.

29. The ACCC's market inquiries have indicated that Kadina is the 'regional centre' of the area, containing the local council's offices, a number of banks and insurance companies, and a broader retail offering not available in Wallaroo or Moonta. Market inquiries suggest that residents of Wallaroo and Moonta often travel to Kadina for employment, to access council services or schools, or to access the shopping options that are not available in Wallaroo or Moonta.
30. This is relevant to the question of market definition. As residents of Wallaroo and Moonta regularly travel to Kadina, they have the opportunity to shop at the supermarket in Kadina in conjunction with a trip already being made to Kadina for other purposes. For this reason there is relatively high potential for consumer substitution between the supermarkets at Wallaroo and Moonta and the Woolworths supermarket at Kadina (much more than would be the case for supermarkets separated by similar distances in an urban area).
31. The ACCC's inquiries suggest that comparatively fewer trips are made between Wallaroo and Moonta, since neither is the regional centre and they are further apart than Wallaroo and Kadina. Further, there is less need for residents of Kadina to travel to either Moonta or Wallaroo on a regular basis, since there are few services available in those towns that are not available in Kadina. Accordingly, the ACCC has formed the preliminary view that the Drake supermarket at Moonta is unlikely to impose a close competitive constraint on either the supermarket at Kadina or the proposed supermarket at Wallaroo.
32. The ACCC's preliminary view is that the geographic scope of the relevant retail supermarket includes both Wallaroo and Kadina, but not Moonta.
33. The ACCC seeks further information from interested parties in relation to this preliminary view.

Market concentration

34. Following the proposed acquisition (and once the supermarket has been constructed in Wallaroo), Woolworths would operate large full line supermarkets at Wallaroo and Kadina. As outlined in the **with/without test** section above, the ACCC considers it likely that if Woolworths opens a full-line supermarket at Wallaroo, the existing Drake supermarket at Wallaroo would close.
35. Accordingly, if the transaction proceeds, Woolworths' two supermarkets would be the only two supermarkets in the relevant market. There would also continue to be a small (400 square metres) IGA store in Kadina and a Drake supermarket outside the relevant market in Moonta.

Procurement market

36. Consistent with its consideration of previous supermarket acquisitions, the ACCC has also considered the acquisition in the context of a state wide market for the procurement of products sold in supermarkets by supermarket wholesalers (including vertically integrated supermarket chains who provide their own "wholesaling" services) from growers and suppliers of products sold in supermarkets.

Wholesale market

37. Consistent with its consideration of previous supermarket acquisitions, the ACCC has also considered the acquisition in the context of a state wide market for the wholesaling of products sold in supermarkets.

Statement of issues

38. For the purposes of this Statement of Issues, the issues in this matter are divided into two categories, “issues which may raise concerns” and “issues unlikely to pose concerns”.

Issues which may raise concerns

A substantial lessening of competition in the local retail supermarket market

Overview

39. The ACCC’s preliminary view is that the proposed acquisition may constitute a substantial lessening of competition in the relevant local supermarket market when compared with the likely situation without the acquisition. The factors considered in reaching this preliminary view are discussed below. The ACCC is seeking further information from interested parties regarding these issues before it forms a final view of the proposed acquisition.
40. As outlined at paragraphs 19 – 20 above, the ACCC considers that if the proposed acquisition does not proceed, it is likely that Drake or another non-Woolworths entity will acquire the lease to operate a full line supermarket at the Owen Terrace site in Wallaroo, in competition with the full line Woolworths supermarket in Kadina.
41. The ACCC must therefore consider whether the acquisition of the lease by Woolworths will result in a substantial lessening of competition relative to the “without” position. The ACCC has considered the likely level of competitive tension in the context of a larger full line supermarket as outlined in the “without” position. This has been compared with the competitive environment ‘with’ the proposed acquisition.
42. A higher level of competitive tension may be manifested in a number of ways including more price competition, specials and promotions, an increase in quality, increased range and/or consumer choice, better service levels and other relevant factors.
43. While the ACCC is primarily seeking information regarding the likely level of competitive tension in the ‘without’ position, it has also received some submissions from parties who consider it more likely that if the Woolworths transaction does not proceed, there will be no development on the Owen Terrace site, and the status quo will instead continue. Accordingly, the ACCC also seeks information regarding the current level of competitive tension between the existing Drake supermarket at Wallaroo and the Woolworths supermarket at

Kadina, and how this would compare with the competitive environment if Woolworths operated supermarkets in both Kadina and Wallaroo.

Competitive response to new entry or expansion

44. The ACCC considers that some supermarkets and supermarket chains respond to the opening of a new full line supermarket (such as a Drake supermarket) in a number of ways, including by offering discounts and additional promotions in nearby supermarkets. Consumers benefit from this competitive response. The ACCC seeks further information regarding the forms and duration of the competitive response by supermarkets to the entry of new full-line competitors (especially Drake).

Range

45. If Drake were to open a supermarket at the Owen Terrace site, it is likely that it would be a full-line supermarket of approximately 2500 square metres. The supermarkets that Drake currently operates at Wallaroo and Moonta are medium sized supermarkets with floor areas of around 1400 and 1500 square metres respectively. The ACCC seeks further information regarding the range of products that are offered at full line Drake supermarkets as compared to Woolworths in Kadina. In particular, the ACCC is interested in obtaining further information regarding the extent to which Drake offers a different range, including the number of lines that are available in its supermarkets, the extent to which different branded or private label products are on offer, and differences in the number and range of specialty items and locally produced products.
46. The ACCC also seeks further information regarding the range of products that are offered at the existing Drake supermarket at Wallaroo.

Price competition and promotions

47. The ACCC considers that the price of grocery items is one of the features customers take into consideration when choosing between supermarkets. The ACCC seeks further information on the extent to which Drake's full line supermarkets compete on prices with Woolworths and other supermarket operators. The information may relate to every day pricing, promotional pricing or other issues relating to price, such as suppliers seeking to promote their product to customers by offering 'case deals' or discounts via Drakes or Woolworths. These may occur at different times due to the timing of the deals between the supplier and the wholesaler/ retailer.
48. The ACCC also seeks further information as to the extent that the existing Drake supermarket in Wallaroo currently competes, or attempts to compete with the Woolworths supermarket in Kadina on price.

Fresh produce

49. Fresh produce is an important part of a supermarket's offering to customers. The ACCC seeks further information on the quality of Drake's and Woolworths' fresh

produce, and in particular any difference in their supply arrangements which may affect this.

50. In addition, the ACCC seeks information as to the difference in the quality and range of fresh produce that is offered at Drake's full-line supermarkets and that currently available to shoppers at the existing Drake supermarket in Wallaroo.

Service levels

51. The ACCC considers that service levels including the number of staff at check out points or available to customers in store, the maintenance of the store, store opening hours and other aspects of service are important features of a supermarkets offering. The ACCC seeks information regarding the ways in which full line Drake supermarkets seek to compete with Woolworths and other supermarkets on service, and evidence that competition between supermarkets in a local market results in better service.
52. The ACCC also seeks information regarding the ways in which the existing Drake supermarket in Wallaroo seeks to compete with Woolworths in Kadina on service, and any evidence that competitive tension between Drake in Wallaroo and Woolworths in Kadina results in better service.

Choice

53. The ACCC notes that in the 'with' position, Woolworths will operate the only two full line supermarkets in the relevant local market. The ACCC is seeking further information regarding the value to consumers of having a choice between different supermarket operators in the relevant market.

Other

54. The ACCC seeks further information and submissions on other ways in which full line Drake supermarkets compete with Woolworths and other supermarket operators. Other factors that may be important may include such things as customers being able to choose between supermarkets on the basis of corporate citizenship or their sponsorship of local sporting clubs.
55. The ACCC also seeks further information regarding any other ways in which the existing Drake supermarket in Wallaroo currently competes with Woolworths in Kadina.

Barriers to entry

Access to new sites

56. The ACCC has considered whether it is likely that a potential new entrant could gain access to other sites for a new supermarket in the relevant local market. Generally, if there are few barriers to new entry, a substantial lessening of competition may be unlikely.

57. Market inquiries have identified some potential development sites in the relevant local market.
58. The Kadina Agriculture, Horticulture and Floriculture Society is currently seeking expressions of interest from developers with possible proposals for the development of the 'Showgrounds site' which comprises more than 10 acres of land and is approximately 500 metres from the town centre of Kadina. If the Showgrounds site is ultimately sold to developers, it is possible that developers may suggest a retail development of this site. However, if the Showgrounds site were to be developed, there are a number of planning and approval stages that must be completed before it could be developed and it is likely to be a number of years before any possible supermarket could be developed. Further, a supermarket operator would have to compete for the Showgrounds site with alternative development proposals.
59. There is a portion of former industrial land of sufficient size for the development of a supermarket in Wallaroo which is referred to as the 'Pivot site'. The Pivot site is located approximately 300 metres from the proposed development site in Wallaroo. However, this site is currently under rehabilitation which will require completion before any steps to develop it can occur. Similarly to the Showgrounds site in Kadina, there are a number of planning and approval stages that must be completed before it could be developed and it is likely to be a number of years before any possible supermarket could be developed. Further, a supermarket operator would have to compete for the Pivot site with alternative development proposals.
60. Market inquiries have identified a number of other smaller potential development sites. However, market inquiries indicate that no other sites are sufficiently large or appropriately located for the development of a new full-line supermarket.
61. While there is some potential for the development of a new supermarket in the relevant local market, the ACCC considers this prospect to be highly uncertain. In its preliminary view, the ACCC considers access to suitable new sites to constitute a high barrier to entry. However, further submissions on this point will be taken into account before the ACCC forms a concluded view on the proposed acquisition.

Commercial viability of entry

62. The ACCC has considered whether, even if a potential new entrant could gain access to an appropriate site in the relevant local market, it is unlikely that entry would be commercially viable.
63. Full line supermarkets rely on having access to a relatively large group of customers; there are significant sunk costs in establishing a new supermarket and significant fixed costs which the supermarket's owner seeks to spread over a large volume of sales.
64. It is proposed that the new Woolworths supermarket at Wallaroo would be a full-line supermarket, as is the existing supermarket at Kadina. Market inquiries suggest that the relevant local market has a relatively small population to support

two such large full line supermarkets. The average “spend per head” by residents on supermarket products is also somewhat below the state average as a result of the higher average age of residents, lower proportion of families with children and lower proportion of the population in full-time employment.

65. In these circumstances, the ACCC’s preliminary view is that it is unlikely that another supermarket operator will consider it viable to open a new full line supermarket within the next 2-3 years.
66. The ACCC seeks further submissions as to whether the relevant local market is large enough to induce new entry by a full line competing supermarket if Woolworths were to seek to increase prices or lower service levels following the opening on its new store in Wallaroo.

Issues unlikely to raise concerns

Procurement market

67. The ACCC has conducted a preliminary assessment to determine whether the proposed acquisition will lessen competition in the market for the procurement of products for sale in supermarkets.
68. Supermarket chains compete with each other and with independent supermarket wholesalers to acquire products from growers and other producers for subsequent retail sale. The proposed acquisition will lead to a small increase the volume of supermarket products acquired by Woolworths and a similar decrease in the amount acquired by its competitor Metcash, which supplies products to Drakes.
69. However, given the size of the transaction relative to the volumes of each of the players in the procurement market, the ACCC’s preliminary view is that the proposed acquisition is unlikely to result in a substantial lessening of competition for the procurement of products sold in supermarkets.

Wholesale market

70. The ACCC has conducted a preliminary assessment to determine whether the proposed acquisition will lessen competition in the wholesale market for goods sold in supermarkets.
71. The ACCC considers that the proposed acquisition is likely to reduce the wholesale volume of its wholesaler, Metcash, by the amount that the Drakes supermarkets at Wallaroo and Moonta will lose to the new Woolworths supermarket in Wallaroo.
72. While this reduced volume may have an incremental impact on Metcash, reducing the volume of sales over which it is able to spread its cost, it is likely that the impact will not be large enough to materially raise its average cost nor to force Metcash to increase the prices it charges to its remaining customers (i.e. other independent supermarkets, particularly in South Australia).

73. Therefore, given the relatively small volume that Metcash may lose compared with its South Australian turnover, the ACCC considers any impact is unlikely to result in a substantial lessening of competition in this market.

ACCC's future steps

74. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
75. The ACCC now seeks 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.
76. Submissions are to be received by the ACCC no later than **10 December 2008**. The ACCC will consider the submissions received from the market, Leasecorp and Woolworths in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
77. The ACCC intends to publicly announce its final view by 21 January 2009. However the anticipated timeline may change in line with the *Merger Review Process Guidelines*. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.

