



Public Competition Assessment

14 July 2009

Woolworths Limited - proposed acquisition of Macro Life Pty Limited

Introduction

1. On 17 June 2009, the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed acquisition of Macro Life Pty Limited (trading as Macro Wholefoods Market) by Woolworths Limited (**proposed acquisition**). The ACCC was of the view that the proposed acquisition would be unlikely to have the effect of substantially lessening competition in a market in contravention of section 50 of the *Trade Practices Act 1974 (Act)*.
2. The ACCC formed its view 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 acquisition, subject to confidentiality considerations.

Public Competition Assessment

3. 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.
4. This Public Competition Assessment has been issued because the proposed acquisition is considered to raise issues of interest to the public.
5. By issuing Public Competition Assessments, the ACCC aims to provide the public with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the public to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change.

6. 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.
7. 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

8. Woolworths Limited (**Woolworths**) is Australia's largest grocery retailer. It operates approximately 780 supermarkets across Australia. Woolworths' operations also include the retailing of petrol, liquor, general merchandise and consumer electronics.
9. Woolworths supermarkets sell, among other products, a range of organic products including fruit and vegetables, dairy, meat, packaged food and non-food products. Most products sold by Woolworths supermarkets are not organic.

Thomas Dux

10. Woolworths has recently established the 'Thomas Dux' retail chain. Thomas Dux markets itself as selling high quality, premium (though predominantly non-organic) fresh fruit and vegetables, meat, bakery products, packaged food, delicatessen products, and a small range of non-food everyday items (e.g. toilet paper). There are currently two Thomas Dux stores – one in Lane Cove, NSW, and one in Paddington, NSW.

The Target: Macro Wholefoods Market

11. Macro Wholefoods Market (**Macro**) is a specialist retailer of organic products and services. It operates four stores in NSW, four stores in Victoria and a distribution centre in Alexandria, NSW. In addition, Macro had leased a site in Port Melbourne, Victoria, where it proposed to open a new store. Until recently Macro operated a stand-alone café in Newtown, NSW.
12. A typical Macro store includes:

- a. an organic delicatessen; organic fresh produce; organic meats; organic grocery products such as unrefined wholefoods (including nuts, grains, beans); vegan and kosher foods; organic non-food items such as environmentally friendly toiletries and cleaning products;
- b. an organic and wholefoods café; and
- c. a naturopathy clinic and dispensary (including a range of services including aromatherapy, massage and homeopathic services, and products such as essential oils and vitamin supplements).

Other Industry Participants

13. Independent retailers account for a significant proportion of organic food and grocery sales in Australia. While supermarkets supply organic products as part of their broader product offering, their share of sales of organic products is substantially lower than their share of grocery sales generally.

The Proposed Transaction

14. Woolworths proposes to acquire the business and assets of Macro as part of its establishment of its new Thomas Dux Grocer business. Woolworths will be assigned leases for seven of the eight existing Macro stores and one store soon to be opened. Macro's Bondi Junction store will be sold separately to an independent organic retailer, About Life. Post-acquisition, the stores acquired by Woolworths will be converted to Thomas Dux stores.
15. The Macro stores to be acquired are located at the following sites:

New South Wales

- a. 13-19 Willoughby Road, Crows Nest;
- b. Shop 2009, Westfield Hornsby, Pacific Highway, Hornsby;
- c. 12-14 Park Street, Mona Vale.

Victoria

- d. 153 Bridge Road, Richmond;
- e. 40 Bluff Road, Black Rock;
- f. Shop 2.200, Centro The Glen shopping centre, 235 Springvale Road, Glen Waverley;
- g. 1068 High Street, Armadale;
- h. 120 Bay Street, Port Melbourne (Macro store not opened).

16. The proposed acquisition also includes liquor licences for the four existing Macro stores in Victoria (Richmond, Black Rock, Glen Waverley and Armadale); Woolworths has indicated it may wish to supply liquor at its Thomas Dux stores at some point in the future.
17. Woolworths intends to adopt the Macro brand as a private label (**Macro label**) for a range of organic products to be supplied in selected Woolworths supermarkets.

Timing

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

Date	Event
13-May-2009	ACCC commenced review under the Merger Review Process Guidelines.
27-May-2009	Closing date for submissions from interested parties.
17-Jun-2009	ACCC announced it would not oppose the proposed acquisition.

Market Inquiries

19. The ACCC conducted extensive market inquiries with a range of industry participants including competitors and potential competitors in each local market, state-based and national retail supermarket chains, suppliers and growers of organic and non-organic food and grocery products, industry organisations and other interested parties. Submissions were sought in relation to the substantive competition issues.

Areas of Concern

20. The ACCC received mixed views on the competitive effects of the proposed acquisition. Some concerns were raised that the proposed transaction could lead to a reduction in consumer choice as a result of the removal of Macro's product offering; and an increase in Woolworths' buying power against its suppliers, resulting in increased supply shortages and higher wholesale prices for other retailers relative to Woolworths.

With/Without Test

21. 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 post-merger if the transaction does not proceed (the "without" position).

22. Based on information provided by the merger parties and information obtained during its market inquiries, the ACCC considered that in the absence of the proposed acquisition it was unlikely that Macro would continue to operate in its current form. This, and the associated level of competitive constraint which Macro would provide to Woolworths in the reasonably foreseeable future, formed the basis of the “without” position for the purposes of the ACCC’s competition assessment.

Industry Background

23. ‘Organic’ generally refers to products grown or produced without the use of artificial chemicals such as synthetic pesticides, chemical fertilisers, growth hormones or antibiotics. Organic farming emphasises the use of renewable resources, the need for conservation of energy, soil and water resources and the maintenance of environmental quality. Animal welfare is also an important consideration.
24. The National Standard for Organic and Biodynamic Produce (**the Standard**) codifies these principles by providing a certification system covering production, processing and labelling. However, this standard only applies to exports of organic products; there is currently no mandatory standard regulating organic products sold within Australia.
25. The Australian Quarantine and Inspection Service (**AQIS**) administers the Standard in collaboration with seven AQIS approved certifying bodies. Certifying bodies inspect organic operators annually to ensure compliance with the Standard.
26. Organic producers must be capable of satisfying the requirements of the Standard for at least one year before products can be labelled as ‘organic in-conversion’. Producers must then continue to meet the specified requirements for a further two years before being permitted to use the term ‘organic’.
27. While the Standard is not mandatory for products sold within Australia, it has been adopted by some certifiers as a ‘de-facto’ organic standard for the domestic market. Despite the lack of an officially recognised domestic standard, certification may be considered an important mechanism to instil consumer confidence in organic products.
28. While the consumption of organic food in Australia has been increasing in recent years, only a small proportion of consumers are exclusive buyers of organic products. According to the *Australian Organic Market Report 2008*, 40% of consumers buy organic food at least on occasion; however, it is only around 1% of consumers who are regular or almost exclusive buyers of organic food with the remaining 39% purchasing organic food to varying degrees.¹

¹ Australian Organic Market Report 2008, Commissioned by Biological Farmers of Australia Co-op Ltd, p77.

29. The ACCC considered that 'premium' products, such as those sold by Thomas Dux, are defined by their prices, which are generally higher than conventional groceries. Consumers may be willing to pay higher prices for premium products for a range of reasons, including quality and rarity.

Local Markets for the Retail Sale of Organic Food and Grocery Products (the Retail Markets)

Market Definition

30. The ACCC took the view that local markets for the retail sale of organic food and grocery products within 3-5kms of each of the Macro stores being acquired were relevant markets for the purpose of assessing the proposed transaction.
31. The ACCC found that the appropriate product dimension of the retail markets was limited to the retail sale of organic food and grocery products.
32. In relation to demand side substitutability, the ACCC's inquiries indicated that Macro's organic focus was its key attraction for customers and that these customers viewed other retailers which specialise in organic products as the closest substitutes for Macro.
33. The ACCC's inquiries suggested that retailers of organic products (irrespective of their retail format) are likely to be closer substitutes to Macro than supermarkets or specialty retailers of non-organic products. In particular, inquiries revealed that the products themselves, rather than the format of the stores in which they are sold, were generally of primary importance to consumers. Accordingly, the fact that supermarkets have the ability to offer both organic and non-organic goods did not appear to provide those suppliers with any particular advantage in the retail markets.
34. While supermarkets provide a range of organic food and grocery products and compete to some extent with specialist retailers of organic products such as Macro, the ACCC's inquiries confirmed that they do not compete as directly as other retailers with an organic focus.
35. Inquiries revealed that some features of the retail offering of specialty retailers of non-organic premium products such as Thomas Dux overlap with Macro to a degree. For example, there are some similarities in the format of the stores and the level of personalised customer service. However, it was found that there was only limited overlap with respect to the sale of organic products. Accordingly, the ACCC considered that stores such as Thomas Dux were not close substitutes for specialist retailers of organic food and grocery products.
36. While the ACCC's inquiries revealed that for Macro's customers the closest substitutes were other retailers of organic food and grocery products, it was noted that some customers may substitute non-organic products for organic products in some circumstances.

37. Nevertheless, the ACCC considered that the weight of evidence at this time indicated that the relevant retail markets for the purpose of assessing this transaction were markets for the retail sale of organic food and grocery products. However, a definitive view on the product dimension of the market was not formed in this matter as it was not considered to be determinative of the ACCC's conclusions.
38. The ACCC took the view that the geographic scope of the relevant retail markets was a distance within 3-5kms of each of the Macro stores being acquired as the ACCC's inquiries revealed that consumers were unlikely to travel further than this to purchase organic food and grocery products from alternative retailers.

Competition Analysis

Closeness of Competition between Macro and Woolworths

39. In assessing whether the proposed acquisition would result in a substantial lessening of competition, the ACCC examined the extent to which Macro and Woolworths (both in terms of its supermarkets and Thomas Dux stores) imposed a competitive constraint on each other and the likely strength of this constraint in the reasonably foreseeable future.
40. While it was found that Woolworths supermarkets and Thomas Dux stores offer some organic products, neither have an organic focus and their range of organic products is considerably narrower than that supplied by Macro. The product mix, target market, pricing and business model for Macro stores were found to be substantially different from the large-scale, broad-range food and grocery offering at Woolworths supermarkets. Similarly, Thomas Dux's non-organic, specialty retail offering with an emphasis on premium products and the shopping experience, is not closely aligned with Macro's business model.
41. The ACCC's inquiries revealed that Macro's closest competitors are other local, independent retailers of organic products. These retailers offer consumers an organically-focussed product range, coupled with personalised customer service including specific advice about the products supplied. The ACCC considered that to the extent Woolworths supermarkets and/or Thomas Dux compete in the market for the retail sale of organic food and grocery products it is only at the margin.

Vigorous and Effective Competitor

42. The ACCC's inquiries suggested that Macro relies on its broad range of organic products, including product lines which are new to the market, to compete.

43. However, on the basis of information provided by the merger parties and information arising from its market inquiries, the ACCC formed the view that to the extent that Macro may currently be considered an *effective* competitor in the relevant markets, this was unlikely to continue to be the case. Indeed, it was submitted by some market participants that Macro's organic focus had declined in recent months, suggesting its current business model was not sustainable. The ACCC concluded that it was unlikely that Macro would operate as a strong competitive force in the future due to its declining financial position.

Local Market Analysis

44. The ACCC examined each local market and the competitive constraints which would remain post-acquisition in each of these markets. In most markets several specialist retailers of organic products would continue to compete, in addition to a range of other retailers of food and grocery products who do not have an organic focus, but some of whom sell organic products alongside conventional lines. The ACCC concluded that, post-acquisition, these retailers would continue to provide consumers with a range of organic products and a level of service comparable to that currently offered by Macro.
45. In respect of those local markets where fewer alternate specialist retailers of organic products exist, the ACCC's inquiries showed that barriers to entry for new specialty grocery outlets are low and that existing retailers of conventional food and grocery products could enter the market by supplying organic food and grocery products.

Conclusion

46. To the extent that Macro is currently competing effectively through its broad range of organic products or its support for new product lines, the ACCC concluded that it was unlikely that Macro would operate as a strong competitive force in the future due to its declining financial position.
47. The ACCC found that Macro and Woolworths do not closely compete in the retail sale of organic food and grocery products, with independent specialist organic retailers representing Macro's closest competition in the supply of these products. Post-acquisition, these competitors would continue to offer a comparable range of products, level of service and shopping experience for consumers. Further, the ACCC found there was a credible threat of entry by new competitors including existing retailers of non-organic food and grocery products. Accordingly, it was found that the acquisition was not likely to result in a substantial lessening of competition in any of the retail markets.

State-wide or Regional Markets for the Wholesale Supply of Organic Food and Grocery Products

Market Definition

48. The competitive effects of the proposed acquisition were also considered in the context of state-wide or regional markets for the wholesale supply of organic food and grocery products.
49. Wholesalers, in this context, were found to include distributors, manufacturers, producers and growers, each of which supply organic good and grocery products to retailers.
50. The ACCC's inquiries revealed that most organic food and grocery products were supplied to retailers by wholesalers operating on a state-wide basis. However, in some cases wholesalers supplied their products on a regional basis, particularly in relation to fresh products. Inquiries revealed that the perishable nature of these products and the transportation costs involved constrained the ability of wholesalers to supply beyond these distances.
51. A definitive view on the geographic scope of wholesale markets in relation to particular products was not formed in this matter as it was not considered to be determinative of the ACCC's conclusions.
52. It was submitted by some market participants that the wholesale supply of organic and premium food and grocery products is distinguishable from that of other food and grocery products, citing:
 - different wholesalers, manufacturers and suppliers;
 - differences in the volumes supplied and the frequency of supply; and
 - differences in the degree of emphasis placed on quality, origin or environmental credentials compared with price and volume.

The ACCC's inquiries indicated that these differences are particularly evident with respect to fresh produce.

53. Further, the ACCC found that there are key differences in the wholesale supply of organic, as opposed to non-organic premium food and grocery products. Due to unique production and certification requirements for organic products, and differences in transportation and handling between organic and non-organic products, many wholesale suppliers exclusively supply organic products. On the demand side, the ACCC's inquiries suggested that wholesale suppliers of organic products had a distinct customer base from that of wholesale suppliers of premium products.

54. The ACCC therefore considered that a narrower wholesale market for the supply of organic food and grocery products to retailers was the appropriate product dimension of the market in this matter. However, adopting a broader market definition which includes the wholesale supply of organic and premium products would not have changed the ACCC's conclusion.

Competition Analysis

55. As part of its analysis the ACCC considered whether the proposed acquisition would increase Woolworths' buying power against wholesale suppliers of organic food and grocery products enabling Woolworths to influence wholesale prices or creating shortages in some product categories to the detriment of other wholesale customers.
56. The ACCC considered whether:
- the exit of Macro as a customer would reduce the options for suppliers;
 - Woolworths' acquisition of the Macro label would increase its ability to delete, or threaten to delete, competing branded products; and
 - the increase in volumes of organic products acquired by Woolworths due to its acquisition of the Macro label may increase suppliers' dependency on Woolworths as a customer.
57. This issue largely applies to packaged products rather than fresh produce, since these are the products sold under the Macro label.
58. The ACCC concluded that Woolworths' buying power in relation to organic products would not increase significantly as a result of the proposed acquisition. In this regard the ACCC noted that any buyer power which Woolworths possesses in relation to organic products is less than the buyer power it enjoys with respect to non-organic groceries, because the prevalence of small and independent retailers within the organic industry means that Woolworths accounts for a smaller proportion of sales of these products than many other categories.
59. The ACCC formed the view that the increased volumes purchased by Woolworths as a result of the introduction of the Macro label and expansion of the Thomas Dux chain are unlikely to lead to supply shortages in particular product categories, particularly as the increased volumes are likely to be of packaged products and the supply of these products is more stable and less subject to seasonal variation than fresh organic products. Further, there is likely to be a contraction in demand at the wholesale level arising from the exit of Macro as a purchaser of fresh and packaged organic products.

60. Concerns were also expressed that the proposed acquisition would increase Woolworths' ability to bypass distributors of organic products. After investigating this concern, the ACCC concluded that the proposed acquisition will not substantially alter Woolworths' ability to bypass distributors of these products. Information obtained from the ACCC's inquiries also demonstrated that scale is not a prerequisite for retailers to form direct supply relationships with growers and producers in the organic industry.
61. Market participants also expressed a concern that the proposed acquisition may result in some wholesale suppliers of organic products having excess capacity as a result of the exit of Macro as a customer. Following inquiries with a range of relevant parties, the ACCC concluded that wholesale suppliers would have sufficient alternative supply options post-acquisition. In particular, the ACCC had regard to the fragmented nature of organic wholesaling in reaching this conclusion.

Conclusion

62. The ACCC concluded that the proposed acquisition is unlikely to result in an increase in Woolworths' ability to influence wholesale prices and is unlikely to substantially lessen competition in relevant markets for the wholesale supply of organic food and grocery products.

Other Markets

63. The ACCC also investigated concerns raised that because Woolworths has a strong position in supermarket retailing, post-acquisition its Thomas Dux business may have advantages not available to other competitors. However, the ACCC considered that this concern did not appear to be merger-specific. That is, it found that the acquisition of Macro was unlikely to substantially increase any advantages the Thomas Dux business may have had through its association with the larger Woolworths group.

Naturopathy Products and Services

64. The ACCC formed the view that the proposed acquisition was unlikely to result in a substantial lessening of competition in relation to the supply of naturopathy products and services. While Woolworths supermarkets offer some naturopathy products, it was found that their range is narrower than that of Macro and there are a variety of other competitors including naturopaths, health food stores and health clinics which will continue to provide a significant competitive constraint to Woolworths in this area of activity post-acquisition.

Conclusion

65. On the basis of the above the ACCC formed the view that the proposed acquisition of Macro by Woolworths would not be likely to result in a substantial lessening of competition in any of the relevant markets in contravention of section 50 of the Act.