

ACT LEGISLATIVE ASSEMBLY

Select Committee on ACT Supermarket Competition Policy

**Submission
by**

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Strategies for promoting real competition within the ACT supermarket sector

This Submission is prepared by Associate Professor Frank Zumbo who is a longstanding researcher and commentator on competition, consumer and small business issues. More recently, the author has been appointed as the South Australian Deputy Small Business Commissioner which is a part-time statutory role under the South Australian *Small Business Commissioner Act 2011*.

For the avoidance of any doubt the Submission has been prepared by the author in a private capacity.

The Submission is based on the fundamental premise that the level and intensity of competition in a marketplace depends squarely on the intensity and strength of independent competitors in that marketplace. Remove those independent competitors; or hamper their ability to enter the market or to compete vigorously and you prevent, remove or hamper competition in that market to the considerable detriment of consumers.

Put simply, the absence of independent competitors enables the existing dominant players in the market to entrench their market dominance and allows those dominant players to act as cosy club where they are able to push up price; prevent the entry of new players; and/or reduce choices available to consumers.

It is within this context that the ACT supermarket policy is a valuable and measured policy for promoting diversity and competition. The ACT supermarket policy is appropriately designed to encourage the entry of new independent competitors into the ACT supermarket sector.

In the absence of the ACT supermarket policy ACT consumers would not only be at risk of higher prices across the supermarket range, but also reduced access to products as the major supermarket chains are increasingly tempted to delete branded product lines from their shelves as a way of trying to shift consumer demand to the increasing number of homebrand products offered by the chains.

Independent competition and the conditions that allow independent competition to flourish are critical to putting downward pressure on retail prices and providing consumers with the widest possible set of choices that a market economy is designed to provide. Indeed, the essence of a market economy is the availability of a wide variety of efficient competitors and product choices from which consumers can choose.

More dangerously for consumers, the market economy is simply unable to realise its full potential in delivering the best and most efficient outcomes for consumers where the particular market is as highly concentrated as is the ACT full line supermarkets sector which is dominated by just two players.

Whatever “competition” there may be between two dominant players like Coles and Woolworths, the level or intensity would no doubt be much greater and more beneficial to consumers if there were many more full line supermarkets operated by independents.

The ACT supermarket policy is expertly designed to try and get more of those much needed independent full line supermarkets into local markets. In doing so, the policy rightly seeks to restore competitive diversity in the ACT supermarket sector and to give consumers access to a wider range of full line supermarkets and to a wider range of product choices and service levels than is the case from just having a Coles and Woolworths supermarket in a particular location.

The restoration of independent competition and the conditions conducive to such independent competition in the ACT supermarket sector requires a carefully coordinated and targeted approach. The recommendations made in this submission would, if implemented, provide such a coordinated and targeted approach.

List of recommendations

- (1) Maintain the ACT supermarket policy;**
- (2) Require all ACT supermarkets over 2,000 square metres to publish all their shelf prices online in near real time;**
- (3) Consider extending the ACT supermarket policy to the ACT petrol market;**
- (4) Require all ACT petrol stations to publish all their petrol prices online in near real time; and**
- (5) Consider re-establishing an ACT Small Business Commissioner to assist independent competitors in their dealings with larger businesses in highly concentrated markets such as supermarkets and petrol.**

Placing the ACT supermarket sector under the competition spotlight – The need to maintain the ACT supermarket policy

There can be no doubt that the ACT supermarket sector is not as competitive as it could be. At best, the ACT supermarket is, to use the ACCC's words, 'workably competitive.' This is the minimum level of competition that one would expect in a market within a market economy. Anything less than so-called workable competition would effectively mean that the particular market has 'stalled' or is 'failing in the worst possible way.'

By way of comparison, the notion of 'workable competition' as applied to the ACT supermarket sector is very much like a car's idle speed where that idle speed is effectively the minimum required to keep the car engine running. Fall below that idle speed and the engine is likely to stop.

Clearly, the notion of 'competition' as applied to a market economy can be seen as a spectrum of competitive activity ranging from 'workably competitive' to 'vigorously competitive' and even 'perfectly competitive.' Importantly, there is a direct relationship between the level and intensity of competition and the benefits to consumers. Indeed, the more intensive the competition, the more benefits that consumers receive.

In short, whatever the benefits to consumers from so-called workable competition, the benefits to consumers would be greater and more sustainable where there is vigorous competition in all local markets. In other words, ACT consumers are currently not getting the considerable benefits that would flow from having an ACT supermarket sector that was vigorously competitive rather than simply workably competitive as is currently the case.

Importantly, the level of competition in any market needs to be considered objectively. So while Coles and Woolworths may *subjectively* believe that they are competing strongly with each other, they may not *objectively* be competing as vigorously as they *could*.

Coles and Woolworths, as competitors, will generally copy one another and generally do not truly behave independently of one another. While Coles and Woolworths may make independent decisions in the sense that they may not be colluding, their individual decisions will ultimately reflect the decisions of the other. If Coles announces a pricing gimmick on a particular product, Woolworths will announce the same or very similar pricing gimmick. If Woolworths revamps its loyalty card, then Coles will also revamp its loyalty card. At its simplest, Coles and Woolworths 'behave' in the same general way and do so within the same general parameters.

In contrast, independent competitors by their very nature behave in an independent way. They may seek to differentiate themselves by way of price; service; or product quality or choices. It is these independent competitors that bring diversity of competition and increase the intensity of competition in the particular market. Remove these independents from the market or prevent

their entry and you end up with so-called 'workable competition' which is simply the minimum level of competition in a market economy. Conversely, actively seek the entry of independent competitors as the ACT supermarket policy seeks to do and you raise the level and intensity of competition in the ACT supermarket sector over time to the considerable benefit of ACT consumers.

Why the ACT supermarket policy needs to be maintained

The ACT supermarket policy needs to be maintained to address the following market failures or potentially anti-competitive conduct in the ACT supermarket sector:

- The dominance or stranglehold of Coles and Woolworths in the ACT supermarket sector;
- Creeping acquisitions of potential supermarket development sites by Coles and Woolworths so as to protect and increase their dominance of the ACT supermarket sector; and
- The offering of artificially inflated financial premiums by Coles and Woolworths to acquire potential supermarket development sites so as to prevent each other or independent competitors from acquiring the sites.

Dealing with the dominance or stranglehold of Coles and Woolworths in the ACT supermarket sector

In its 2008 Grocery Report, the ACCC found that across Australia Coles and Woolworths operated 87% of full-line supermarkets over 2,000 square metres. In the Martin Review of the ACT supermarket sector Coles and Woolworths were found to have around 90% of the full-line supermarkets in the ACT. Both these extraordinarily high percentages have most likely increased since both reviews given that Coles and Woolworths have continued to engage in a pattern of creeping acquisitions where they continue to acquire independent supermarkets and potential development sites across the country.

This overwhelming stranglehold of the Australian supermarket sector by just two players makes the Australian supermarket sector one of the most highly concentrated supermarket sectors in the world leaving aside old soviet style economies where one or two state owned enterprises controlled particular sectors of the economy. It is hardly surprising, therefore, to find that Australia has historically and consistently faced some of the highest levels of food inflation in the OECD. Even in more recent times where there have been examples of food deflation Australia still has one of the highest levels of food inflation in the OECD.

Not surprisingly, where there is just a Coles and Woolworths supermarket in a local area there is every temptation for Coles and Woolworths to simply keep their prices higher across the full range of supermarket products. Yes, there

may be pricing gimmicks on particular products at those Coles and Woolworths supermarkets, but neither Coles and Woolworths are likely to engage in a full scale price war across the full range of supermarket products as that would simply lead to lower profit margins for both of them without any obvious or sustainable overall increase in market share for them individually as each are equally matched.

Given the typically restrained or 'workably' competitive interaction between Coles and Woolworths across their full range of supermarket products it is also not surprising to find that the ACCC's 2008 Grocery Report showed that grocery prices at a Coles and Woolworths are cheaper in those local markets where there is an ALDI. That's not surprising given that ALDI is a tough independent competitor that competes vigorously on price. To counter any temptation by consumers to shift their business to an ALDI, Coles and Woolworths need to respond in a vigorously competitive way to ALDI. Hence, consumers get lower prices and competitive diversity as an ALDI keeps Coles and Woolworths honest. In short, having more ALDI stores in the ACT would, in line with the ACCC's evidence, put downward pressure on grocery prices in the ACT supermarket sector.

In relation to full line independents, the ACCC found that these also offer competitive constraint in some instances to a Coles and Woolworths supermarket. While the degrees of competitive constraint offered by full line independent supermarkets may vary, the key point is that the presence of full line independent supermarkets in a local market does constrain the natural tendency of Coles and Woolworths to increase prices whenever they can. It is the competitive constraint offered by independents that is critical to keeping Coles and Woolworths honest and we should not be fooled by any limited pricing gimmicks that Coles and Woolworths may engage in from time to time.

Of course, where new independent full-line supermarkets enter the ACT supermarket sector, the existing Coles and Woolworths supermarkets in the ACT will continue to offer or would offer a competitive constraint on existing or new ALDI, Superbarn and other independent supermarkets. That's the nature of competition where the diversity of players means that each different player offers varying degrees of competitive constraint on other players in the market for the benefit of consumers. In other words, it is the existence of a diverse range of Coles, Woolworths, ALDI and independent supermarkets that keeps everyone of those supermarket players honest and vigorously competitive for the clear benefit of consumers.

In short, maintaining the ACT supermarket policy can be completely justified from a competitive and consumer point of view as the policy is expertly designed to promote the entry of more independent players into the ACT supermarket sector. Diversity, with additional players such as ALDI, Costco, Superbarn, and other independent full line supermarkets, collectively puts downward pressure on prices in the ACT and offers consumers wider product choices and service levels. Individual players may have higher prices in some instances but that may simply reflect a higher service level or greater product quality or choice.

Similarly, it cannot be assumed that Coles and Woolworths always have the lowest prices on all products. While Coles and Woolworths have made much of price reductions on upwards of 5,000 products, it certainly needs to be remembered that there are up to 20,000 products or more in a typical Coles and Woolworths supermarket. Not only don't we know the precise amount of any price cuts from an historical point of view, but we don't know what's happened to the price of the other 15,000 products that have not been reduced.

With Coles and Woolworths estimated to have upwards of 90% or more of the full line supermarkets in the ACT, it doesn't take much to realise that competitors have been taken out of the ACT market over time. Nor can it be assumed that it is sufficient to have just have a Coles and Woolworths supermarket as any competition between the two is not as deep or sustained as it would be if there was, for example, an ALDI in the local market as clearly demonstrated by the evidence from the ACCC's 2008 Grocery Report.

In short, the ACT supermarket policy promotes competitive diversity and, in turn, competitive diversity promotes consumer welfare by not only putting downward pressure on prices across the full range of the supermarket products, but also by delivering a much wider range of product choices to consumers and offering them a wide range of service options.

Preventing the anti-competitive creeping acquisitions of potential supermarket development sites by Coles and Woolworths

In the absence of an ACT supermarket policy there is no doubt that Coles and Woolworths would engage in a process of creeping acquisitions of potential supermarket development sites. Across Australia Coles and Woolworths engage in a coordinated and incessant pattern of directly acquiring all possible supermarket development sites or acquiring such sites through strategic arrangements with friendly property developers or local councils. Through this pattern of conduct Coles and Woolworths have accumulated significant land banks either directly or through arrangements with friendly property developers or local councils.

At the very least, these land banks will inevitably have the effect of deterring or preventing the entry of independent competitors into the supermarket sector. By traditionally securing many development sites before they come onto the public market Coles and Woolworths are able to protect and extend their dominance of the supermarket sector across Australia. By raising barriers to entry Coles and Woolworths can distort the market in their favour and to the ultimate detriment of consumers.

Indeed, if Coles and Woolworths were able to continue acquiring all potential supermarket development sites they would be increasingly able to monopolise the supermarket sector thereby allowing them over time to raise consumer prices or reduce product choice to the obvious detriment of consumers.

The ACT supermarket policy lowers barriers to entry into the ACT supermarket sector by providing a reasonable opportunity for independent supermarkets to enter the ACT supermarket sector for the benefit of consumers. The ACT supermarket policy allows the opportunity for a diverse and vigorously competitive supermarket sector in circumstances where in the absence of that policy Coles and Woolworths would do everything in their power to secure all possible new supermarket development sites in the ACT so as to exclude the possibility of any new independent supermarket operators challenging the dominance of Coles and Woolworths in the ACT supermarket sector.

The ACT supermarket policy allows for supermarket development sites to be made available in a manner that encourages new independent supermarket operators into the ACT supermarket sector thereby offering consumers a diversity of prices, products and service options and which can keep Coles and Woolworths honest.

Preventing the anti-competitive offering of artificially inflated financial premiums by Coles and Woolworths to acquire potential supermarket development sites

Importantly, the ACT supermarket policy does not prevent Coles and Woolworths from growing organically where they genuinely provide consumers with a better 'offer' in their ACT supermarkets. The ACT supermarket policy simply seeks to ensure that Coles and Woolworths do not use their substantial market power or deep financial pockets in an anti-competitive manner to prevent the entry of new independent supermarkets into the ACT supermarket sector.

Indeed, where Coles and Woolworths are allowed to bid for a new supermarket development site there is no doubt that Coles and Woolworths would not hesitate in artificially inflating the financial premium they would offer to secure the particular site. For Coles and Woolworths it is essential to stop a competitor from getting the site and, in that context, Coles and Woolworths would not hesitate in paying an artificially inflated financial premium to secure the site knowing full well that they can recoup the payment of the premium through higher prices to consumers in that or their other supermarkets once the site is developed.

There is obviously a legitimate concern where a particular player's strident and potentially anti-competitive efforts to artificially bid up the price of a parcel of land results in the particular supermarket eventually built on the land having a higher cost structure even before it starts trading. A higher or inflated price for a parcel of land means a higher or inflated cost structure for the supermarket to be built on the parcel of land, and a higher or inflated cost structure needs to be recovered somehow in order for the investment in the parcel of land to make an economic return. A higher or inflated cost structure

runs the risk of higher consumer prices in any supermarket built on the land or in nearby supermarkets operated by the same company.

There is no such thing as a free lunch and where Coles and Woolworths pay an inflated price for a development site that higher price needs to be recouped somehow and, sadly, it is consumers that end up paying higher prices and/or getting less quality or service levels as Coles and Woolworths shareholders need to get a commercial return from the inflated price paid for the development site.

In short, artificially bidding up the price of a parcel of land will not only have the effect of excluding a competitor from entering a particular market, but Coles and Woolworths paying an artificially inflated financial premium for that site runs the very real risk of consumers paying higher consumer prices either in the supermarket built on the site or across the other Coles or Woolworths supermarkets in the ACT.

The ACT supermarket policy as a cornerstone of additional policy initiatives by the ACT Government to promote a more diverse and truly competitive market place for ACT consumers

A truly competitive market place requires that market failures or distortions are effectively dealt with through appropriate and carefully tailored policy initiatives by the ACT Government. At present there are a number of market failures or distortions directly related to the growing dominance of Coles and Woolworths in not only in the ACT supermarkets sector, but also the ACT petrol market.

In dealing with these market failures or distortions it is essential to promote full pricing transparency in the ACT supermarkets sector and petrol market, as well having an Independent Statutory Officer holder such as a Small Business Commissioner able to assist small independent competitors in their dealings with larger businesses.

Within this context, it would be respectfully submitted that the Committee consider recommending that an inquiry be held into the need to promote full pricing transparency in both the ACT supermarkets sector and petrol market, as well re-establishing an ACT Small Business Commissioner. Brief reasons for doing so are provided below.

Require all ACT supermarkets over 2,000 square metres to publish all their shelf prices online in near real time

ACT consumers remain the ongoing victims of “information asymmetries” in relation to supermarket retail pricing. In particular, ACT consumers like all

Australian consumers are being denied full price transparency by the major supermarket chains.

So while there is information online regarding weekly specials at a Coles and Woolworths, the real question is what are the prices of the many thousands of other products sold at a Coles and Woolworths supermarket that are not found online. Clearly, Coles and Woolworths continue in their failure to provide full price transparency to ACT consumers.

There four basic reasons why it is important for ACT consumers to get full retail price transparency from Woolworths and Coles:

- (i) Woolworths and Coles may still charge different prices for the same product in each of their respective stores in the same geographic area. This practice is known as 'geographic price discrimination.' In the absence of full online price transparency, consumers lack access to comprehensive and up to date pricing data on which to make informed pricing decisions. Indeed, in the absence of full online price transparency, the only way that consumers can ever know where to find the cheapest price for a particular product is to conduct their own "searches" or rely on emerging price comparison websites. Both alternatives fall well short. Given the many hundreds of supermarkets operated by Coles and Woolworths it is clear that consumer searches would be futile as the cost to the consumers of conducting their own searches would be prohibitive. Similarly, in the absence of cooperation from Coles and Woolworths, the cost to price comparison websites of conducting their own searches would also be prohibitive;
- (ii) By having access to full pricing information consumer can shop more efficiently and cost effectively. Having access to timely online pricing information in advance of a shopping trip means that consumers could, if they so wished, shop strategically so as to buy different products at the lowest price from different supermarkets within the same shopping centre or precinct;
- (iii) Having access to full pricing information allows consumers to track prices on an historical basis. In doing so, consumers would be able to identify trends in the pricing of particular products, as well as overall prices across the supermarket. In short, by having access to full pricing information consumers would be able to track the pricing of different products over time and across the supermarket so as to determine if they are better or worse off as a result of price changes on individual products or groups of products; and
- (iv) By requiring all ACT supermarkets over 2,000 square metres to publish online all their prices we would quickly see the development of smartphone apps that would automatically alert ACT consumers to the cheapest prices of particular goods in a particular area thereby

allowing ACT consumers to make price comparisons electronically and in real time.

The lack of full retail price transparency is just another example of where ACT consumers are well and truly behind overseas consumers. Indeed, United Kingdom consumers have the benefit of the mysupermarket website (<http://www.mysupermarket.co.uk/>). Consumers in the United Kingdom can access online pricing information that is wide-ranging and regularly updated.

In contrast, ACT consumers are currently being denied access to full pricing transparency by Coles and Woolworths, as well as other major full-line supermarket retailers. In such circumstances, the answer is simple. In the absence of the major supermarket chains and retailers voluntarily providing full pricing information online on a timely basis, that all supermarkets that are greater in size than 2,000 square metres be required to publish online on at least a daily basis on their website the prices of all products sold in each supermarket.

Consider extending the ACT supermarket policy to the ACT petrol market

With ACT motorists consistently paying more than Sydney motorists or even motorists in NSW regional centres, it is readily apparent that the ACT petrol market lacks the strong price competitive independents found in Sydney or in some NSW regional centres. Once again, it is the dominance of major retailers such as Coles and Woolworths that is leading to so-called 'workable competition' in the ACT petrol market rather than the vigorous competition in those Sydney or regional petrol markets where there is at least one strong price competitive independent in the market.

There can be no doubt that it is the diversity of competition that is essential to having vigorously competitive markets and given that the ACT supermarket policy is an appropriately tailored policy initiative for injecting diversity into the ACT supermarket policy consideration should be given to extending the ACT supermarket policy to the ACT petrol market.

Require on ACT petrol stations to publish all petrol shelf prices online in near real time

At its simplest, giving motorists full online access to retail petrol prices in near real time would allow motorists to find the cheapest prices throughout the day. Indeed, by requiring petrol retailers to publish online all their prices we would quickly see the development of smartphone apps that would automatically alert you via your GPS enabled mobile phone when you are approaching a cheap petrol retailer.

Consider re-establishing an ACT Small Business Commissioner to assist independent competitors in their dealings with larger businesses in highly concentrated markets such as supermarkets and petrol

The re-establishment of an ACT Small Business Commissioner would ensure that there was a suitably qualified and independent person with specific responsibility for (i) researching and identifying existing and emerging areas of disputation with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and (ii) assisting industry participants to resolve disputes.

In effect the ACT Small Business Commissioner would be a “trouble shooter” who would systematically investigate new and emerging areas of disputation in such areas as the ACT supermarket or petrol supply chain with a view to seeking to identify strategies, mechanisms or legal options for efficiently and effectively resolving such disputes.

An ACT Small Business Commissioner would be available to assist industry participants to reach a business solution to disputes that may arise between small businesses and larger businesses in the ACT. Importantly, an ACT Small Business Commissioner could be re-established in a low cost manner delivering considerable benefits to ACT small businesses with little cost to the ACT Government.