



AUSTRALIAN
FOOD AND GROCERY
COUNCIL

AFGC SUBMISSION TO CREEPING ACQUISITIONS

October 2008

PREFACE

The Australian Food and Grocery Council is the peak national organisation representing Australia's packaged food, drink and grocery products industry.

The membership of the AFGC comprises more than 150 companies, subsidiaries and associates which constitutes in the order of 80 per cent of the gross dollar value of the highly processed food, beverage and grocery products sectors. (A list of members is included as Appendix A.) The AFGC represents the nation's largest manufacturing sector. By any measure Australia's food, drink and grocery products industry is a substantial contributor to the economic and social welfare of all Australians. Effectively, the products of AFGC's member companies reach every Australian household.

The industry has annual sales and service income in excess of \$70 billion and employs more than 200 000 people – almost one in five of the nation's manufacturing workforce. Of all Australians working in the industry, half are based in rural and regional Australia, and the processed food sector sources more than 90 per cent of its ingredients from Australian agriculture.

The AFGC's agenda for business growth centres on public and industry policy for a socioeconomic environment conducive to international competitiveness, investment, innovation, employment growth and profitability.

The AFGC's mandate in representing member companies is to ensure a cohesive and credible voice for the industry, to advance policies and manage issues relevant to the industry and to promote the industry and the virtues of its products, enabling member companies to grow their businesses.

The Council advocates business matters, public policy and consumer-related issues on behalf of a dynamic and rapidly changing industry operating in an increasing globalised economy. As global economic and trade developments continue to test the competitiveness of Australian industry, transnational businesses are under increasing pressure to justify Australia as a strategic location for corporate production, irrespective of whether they are Australian or foreign owned. In an increasingly globalised economy, the ability of companies to internationalise their operations is as significant as their ability to trade globally.

Increased trade, rationalisation and consolidation of businesses, increased concentration of ownership among both manufacturers and retailers, intensified competition and dynamic, increasingly complex and demanding consumers are features of the industry across the globe. Moreover, the growing global middle class of consumers is more sophisticated and discerning, driving innovation and differentiation of products and services.

The AFGC is working with governments in taking a proactive, even tactical, approach to public policy to enable businesses to tackle the threats and grasp the dual opportunities of globalisation and changing consumer demands.

1 EXECUTIVE SUMMARY

The AFGC is highly supportive of the National Competition Framework and the Trade Practices Act (TPA) as mechanisms to ensure markets in Australia are competitive.

With respect to mergers and acquisitions enforcement of the provisions of the TPA through structured assessments such as the Net Public Benefit test provided some objectivity in what might otherwise be very subjective assessments of the impacts on competition.

The AFGC notes the Government's intention to address concerns about creeping acquisitions on competition, and the possible inadequacy of the current provisions of the TPA to address them. Of the two options presented to address the putative TPA shortcomings the AFGC prefers the second, which considers the market power of an acquiring party and the lessening of competition. The AFGC notes, however, that some definitions will need to be developed around these parameters.

The food and grocery manufacturing sector is reliant upon opportunities to both acquire and disinvest businesses in order to maintain competitiveness, although the general pattern has been towards consolidation. Industry restructuring and consolidation has allowed it to remain competitive against increasing pressure from imports and such processes are critical for its future competitiveness. Any additional regulatory impost on those processes has the potential to undermine the industry's long term competitiveness.

The AFGC has concerns that although the issue of creeping acquisitions has a focus on the retail sector, changes to the TPA will affect other sectors and industries.

The AFGC notes, however, that even in the retail sector no evidence has been presented which demonstrates that creeping acquisitions have diminished competitiveness between companies, but the ACCC has identified a potential concern.

The AFGC considers that a full regulatory impact statement should be prepared prior to the introduction of any new provisions into the TPA to provide not only the appropriate rationale for an increased regulatory impost, but also to identify the consequences for other industries.

The AFGC supports high levels of competition between food and grocery retailers. Changes to the TPA made on this basis to protect competition from creeping acquisitions in the retail sector would be supported by the AFGC, but the arguments for such changes must be compelling.

2 RECOMMENDATIONS

- A. The AFGC recommends that, if a compelling case for a change to the Trades Practices Act to address the issue of ‘creeping acquisition’ is made:**
 - 1. consideration of market power be adopted, rather than development of an ‘aggregate model’; and**
 - 2. some definitions around ‘market power’ and ‘lessening of competition’ be developed so that assessments can, at least, be semi-objective**

- B. The AFGC recommends that a full regulatory impact statement be developed prior to any changes in the Trades Practices Act to address ‘creeping acquisitions’.**

3 INTRODUCTION

The Australian Food and Grocery Council (AFGC) welcomes the opportunity to make a submission to The Treasury in response to the *Creeping Acquisitions Discussion Paper* (“the Discussion Paper”).

The submission is presented in three parts:

- 1) some general comments on competition policy;
- 2) comments relating to the food and grocery manufacturing sector ; and
- 3) comments relating to food and grocery retail sector.

4 GENERAL COMMENTS ON COMPETITION POLICY

The AFGC supports the overarching policy framework of the National Competition Policy and specific legislation to ensure markets work efficiently and effectively to deliver its primary objective - a competitive Australian economy.

The AFGC’s competition policy makes no distinction between the size and ownership of businesses, but rather the extent of competition in any particular market, recognising the critical necessity to define the market and its commercial boundaries, and not geographic boundaries.

The AFGC is highly supportive of the Trades Practices Act (TPA) as an appropriate regulatory measure necessary to ensure competitive markets operate. Furthermore, the Trades Practices Act has evolved over time in response to short comings or changing market conditions and community expectations.

The AFGC notes, however, that in the final analysis the enforcement of the TPA relies upon the subjective assessment of intangibles in the market place such as equity, levels of competitiveness, the definition of the market (and potentially therefore market share), identified barriers to entry and potential imports and exports. The corollary is that whilst gross distortions in the operation of a competitive market are easily detected through such subjective assessment, there is difficulty ‘at the margin’ where only minor, if any, impacts on competition exist.

The AFGC contends therefore that all deliberations by the Australian Competition and Consumer Commission (ACCC) be guided as far as possible by application of structured assessment approaches such as the Net Public Benefit test tempered by the reality that many acquisitions will have some impact on competition in the market, in the broadest sense. Markets do, however, have the capacity to adjust to reduced or elevated levels of competition – particular when barriers to entry or exit are low. Markets are best viewed, therefore as being self-adjusting, with a capacity to find new points of equilibrium if any characteristic including competition becomes distorted – particularly so when they exist in an appropriate regulatory framework.

The AFGC considers that the TPA in its current form does provide an appropriate regulatory framework. With regards to acquisitions it already effectively limits the extent to which markets can be dominated by individual parties. Notwithstanding that, the AFGC recognises that there may be opportunities to improve the effectiveness of the TPA and presents the comments below in that context.

4.1 CREEPING ACQUISITIONS

The AFGC notes the Government's intention to address concerns about creeping acquisitions on competition, and the possible inadequacy of the current provisions of the TPA to address them. The Discussion Paper proposes two possible approaches:

- 1) utilising an 'aggregation model' where assessment of an acquisition would take into account previous acquisitions by the corporation; and
- 2) adding consideration of the market power of the corporation to the current consideration of the potential for a substantial lessening of competition.

The AFGC does not favour the first approach.

The 'aggregation model' approach proposes a test which;

*"..would be applied to a combination of acquisitions made by the corporation within a specified period"*¹.

The model implies that it is the rate of expansion of market power and rate of diminution of competition in the market rather than the quantum of market power (of parties) or quantum of competition which is the concern of the TPA – and this is not case. An unintended consequence of the aggregation model approach is that corporations could simply slow down their pace of acquisitions to a level tolerated by the ACCC in its enforcement of the TPA.

The AFGC considers that the TPA should address market implications at the time of acquisition and beyond. In doing so, it will account for aggregation effects as the acquiring corporation will be assessed against the totality of its market position and share.

The AFGC is more in favour of the second option proposed. Notwithstanding this, the AFGC is concerned that the Discussion Paper canvasses changes in the TPA which introduces a concept for rulings which may well prove difficult to assess either objectively or subjectively *viz*:

*"29. An alternative model is to add a new prohibition to Section 50. A corporation would be prohibited from making and acquisition if it already has a substantial degree of power in a market, and the acquisition would result in any lessening (as opposed to a substantial lessening) of competition in that market"*².

The phrase 'any lessening' has the potential to cause problems if this proposal is adopted. It will almost certainly be possible to demonstrate some degree of lessening of competition as a result of a merger or acquisition. An alternative form of words is required to capture the intention of this approach.

The AFGC is concerned therefore that there is a vagueness in the parameters described under this option (i.e. 'substantial degree of market power' and 'any lessening of competition') in this option which would need to be addressed if the concepts were included in the TPA to address creeping acquisitions.

¹ Discussion Paper. p6.

² Discussion Paper. p6.

Recommendation

The AFGC recommends that, if a compelling case for a change to the Trades Practices Act to address the issue of ‘creeping acquisition’ is made:

3. consideration of market power be adopted, rather than development of an ‘aggregate model’; and
4. some definitions around ‘market power’ and ‘lessening of competition’ be developed so that assessments can, at least, be semi-objective.

5 FOOD AND GROCERY MANUFACTURING SECTOR

The food and grocery manufacturing sector operates in an extremely competitive market. There are a large number of products, many manufacturers and no import barriers to imported manufactured products. In fact the latest figures³ show that imports of processed foods and beverages into Australia continues to climb (from \$6.0billion in 2001-02 to \$8.2billion in 2005-06) which not only imposes competitive pressure on Australian manufacturers, but demonstrates the high level of competition in the Australian market.

The grocery supply industry, in Australia and in many other countries, consists of large international companies and local companies of varying size. Companies tend to concentrate on particular product categories. They do so to achieve economies of scale and competitiveness in the development, manufacture, marketing and distribution of their products and to counter the strength of their retail customers in those markets. The international nature of the industry and its products means that for everything other than short life products, it is exposed to imported competition and loss of market share if it becomes less value-competitive. Even for the fresh, short life products, the prices of many raw materials are influenced by world markets.

A feature of the last ten years for both the supply and retail sectors is the ongoing process of rationalisation through mergers, acquisitions or internal restructure. The driving forces for this activity have been to realise scale economies and efficiencies, better brand management, range extension for some suppliers and supply chain efficiency for the major retailers.

The recent *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (2008) reported no evidence that concentration of market power among manufacturers was diminishing competition and elevating prices for consumers. The issue of creeping acquisitions appears centred on concerns regarding the retail sector. Any regulatory measure, however, is likely to affect other sectors including the food and grocery manufacturing sector.

The food and grocery manufacturing sector is reliant upon opportunities to both acquire and disinvest businesses in order to maintain competitiveness. Although the general pattern has been towards consolidation in manufacturing there are many examples of businesses selling part of their brand portfolio if the strategic fit with the company is not optimal.

There is no evidence that barriers to entry to the market are too steep. This is not to say that competition is not fierce within the market, but rather because of its very diverse nature, there are opportunities for companies to enter the market if they can present the right consumer/customer

³ Australian Food Statistics 2007. Department of Agriculture, Fisheries and Forestry.

value proposition for their products (which requires efficient production, distribution and marketing).

In short, food and grocery manufacturers compete strongly and fairly amongst themselves. Industry restructuring and consolidation has allowed it to remain competitive against increasing pressure from imports and such processes are critical for its future competitiveness. Any additional regulatory impost on those processes has the potential to undermine the industry's long term competitiveness.

The AFGC considers it critical that any changes to the TPA which are contemplated to address the "creeping acquisitions" issue are fully evaluated for their effects on all industries including the food and grocery manufacturing sector.

6 FOOD AND GROCERY RETAIL SECTOR

Changes in the Australian food and grocery sector have placed continuous pressure on food and grocery suppliers to improve efficiencies and maintain the profitability of their businesses. Undoubtedly the market power of the retailers and wholesalers has increased, in a market among the most concentrated in the world. As a result, there is substantial and increasing buying power of retailers and wholesalers in the Australian grocery sector. Suppliers seeking to have competitive economies of scale must have a business relationship with all major retailers and wholesalers.

The AFGC considers as ideal a level of competition within the retail sector which mitigates opportunities for market power abuse, and yet continues to allow greater efficiencies in the supply and distribution of food and grocery products.

The last decade has been a period of rapid change for the Australian food and grocery sector which has confirmed the highly concentrated nature of the wholesale and retail sector. The increased vertical integration of the two major retailers, the growth of the wholesale sector and the arrival of *Aldi* confirm the strength of the market.

Suppliers have borne the brunt of competition in the market based very heavily on consistently low prices, reinforced by regular discounted price promotions which have further reduced consumer expectations (on prices, not quality) and average sales revenues. The increased role of private label in the marketing strategy of retailers and wholesalers, in competition with branded products, has provided consumers with additional low price purchase options. The inescapable conclusion is that the market power of retailers and wholesalers has increased substantially in recent years and is intense.

The AFGC has not examined the issue of 'creeping acquisition' in sufficient detail to determine whether this is a substantial threat to competition in the retail sector, but it notes the findings of the *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (2008) which suggest there is no cause for concern – most expansion of the large grocery chains in the last five years were reported to come from new stores.

Should the issue of 'creeping acquisition' be addressed through a change to the TPA, the AFGC would expect a full regulatory impact statement to be developed. This will provide further evidence of the magnitude of the issue being addressed, and also provide the rationale for the regulatory response.

The ACCC report stated⁴:

“The ACCC considers that such acquisitions do not appear to be a significant current concern in the supermarket retailing industry. Most of the new growth by MSCs in recent years has not come from acquisitions of independent supermarkets. No specific evidence has been provided to show that acquisitions of existing businesses have caused significant competitive detriment in the grocery industry in recent years. Although such acquisitions do not appear to be a significant current concern in the supermarket retailing industry, the ACCC maintains its support for the introduction of a general creeping acquisition law. The ACCC considers that the supermarket industry is one where creeping acquisitions could potentially become a concern, due to particular structural features of the market.”

It seems incongruous that the TPA should be amended to address a potential concern in a single industry – the Discussion paper certainly doesn’t identify other industries where creeping acquisitions are a concern.

Recommendation

The AFGC recommends that a full regulatory impact statement be developed prior to any changes in the Trades Practices Act to address ‘creeping acquisitions’.

7 CONCLUSIONS

The AFGC strongly supports the TPA as the primary regulatory instrument securing high levels of competition in the retail sector. Creeping acquisition has been identified as having the potential to diminish competition. It is appropriate, therefore to assess the TPA’s effectiveness in this regard.

The issue requires a careful examination before the TPA is amended. Stronger arguments for changes to the TPA need to be developed than have so far been presented in the debate. This is important not only to ensure that the retail sector issues are dealt with appropriately, but also to guard against unintended, and indeed potentially damaging, consequences flowing onto other sectors.

⁴ Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries. July 2008 p429.

AFGC MEMBERS LIST AS AT 17 SEPTEMBER 2008

AAB Holdings Pty Ltd
 Arnott's Biscuits Limited
 Snack Foods Limited
 The Kettle Chip Company Pty Ltd
 Asia-Pacific Blending Corporation Pty Ltd
 Barilla Australia Pty Ltd
 Beak & Johnston Pty Ltd
 BOC Gases Australia Limited
 Bronte Industries Pty Ltd
 Bulla Dairy Foods
 Bundaberg Brewed Drinks Pty Ltd
 Bundaberg Sugar Limited
 Cadbury Schweppes Asia Pacific
 Campbell's Soup Australia
 Cantarella Bros Pty Ltd
 Cerebos (Australia) Limited
 Christie Tea Pty Ltd
 Clorox Australia Pty Ltd
 Coca-Cola Amatil (Aust) Limited
 SPC Ardmona Operations Limited
 Coca-Cola South Pacific Pty Ltd
 Colgate-Palmolive Pty Ltd
 Coopers Brewery Limited
 Dairy Farmers Group
 Danisco Australia Pty Ltd
 Devro Pty Ltd
 Dole Australia
 DSM Food Specialties Australia Pty Ltd
 DSM Nutritional Products
 Earlee Products
 Ferrero Australia
 Fibrisol Services Australia Pty Ltd
 Fonterra Brands (Australia) Pty Ltd
 Foster's Group Limited
 Frucor Beverages (Australia)
 General Mills Australia Pty Ltd
 George Weston Foods Limited
 AB Food and Beverages Australia
 AB Mauri
 Cereform/Serrol
 Don
 GWF Baking Division
 George Weston Technologies
 Jasol
 Weston Cereal Industries
 GlaxoSmithKline Consumer Healthcare
 Golden Circle Limited
 Goodman Fielder Limited
 Meadow Lea Australia
 Quality Bakers Aust Pty Ltd
 H J Heinz Company Australia Limited
 Hans Continental Smallgoods Pty Ltd
 Harvest FreshCuts Pty Ltd
 Heimann Foodmaker Group
 Hoyt Food Manufacturing Industries Pty Ltd

Johnson & Johnson Pacific Pty Ltd
 Pfizer Consumer Health
 Kellogg (Australia) Pty Ltd
 Day Dawn Pty Ltd
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 Kimberly-Clark Australia Pty Ltd
 Kerry Ingredients Australia Pty Ltd
 Kraft Foods Asia Pacific
 Lion Nathan Limited
 Madura Tea Estates
 Manildra Harwood Sugars
 Mars Australia
 Mars Food
 Mars Petcare
 Mars Snackfood
 McCain Foods (Aust) Pty Ltd
 McCormick Foods Aust. Pty Ltd
 Merino Pty Ltd
 Merisant Manufacturing Aust. Pty Ltd
 National Foods Limited
 Nerada Tea Pty Ltd
 Nestlé Australia Limited
 Nestlé Foods & Beverages
 Nestlé Confectionery
 Nestlé Ice Cream
 Nestlé Nutrition
 Foodservice & Industrial Division
 Novartis Consumer Health Australasia
 Nutricia Australia Pty Ltd
 Ocean Spray International, Inc
 Parmalat Australia Limited
 Patties Foods Pty Ltd
 Peanut Company of Aust. Limited
 Procter & Gamble Australia Pty Ltd
 Gillette Australia
 PZ Cussons Australia Pty Ltd
 Queen Fine Foods Pty Ltd
 Reckitt Benckiser (Aust) Pty Ltd
 Ridley Corporation Limited
 Cheetham Salt Limited
 Sanitarium Health Food Company
 Sara Lee Australia
 Sara Lee Foodservice
 Sara Lee Food and Beverage
 SCA Hygiene Australasia
 Sensient Technologies
 Simplot Australia Pty Ltd
 Specialty Cereals Pty Ltd
 Spicemasters of Australia Pty Ltd
 Stuart Alexander & Co Pty Ltd
 Sugar Australia Pty Ltd
 SunRice
 Swift Australia Pty Ltd
 Symrise Pty Ltd
 Tate & Lyle ANZ

The Smith's Snackfood Co.
 The Wrigley Company
 Unilever Australasia
 Waters Trading Pty Ltd
 Wyeth Australia Pty Ltd
 Yakult Australia Pty Ltd

Associate members

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 Amcor Fibre Packaging
 CHEP Asia-Pacific
 Concurrent Activities
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 Exel (Aust) Logistics Pty Ltd
 Focus Information Logistics Pty Ltd
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 Owens Illinois
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