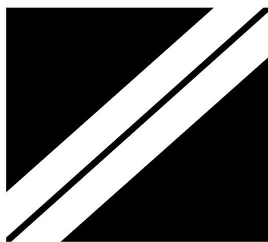


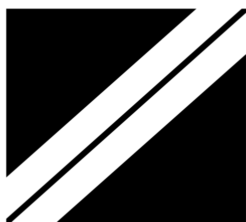
Motor Trades Association of Australia

Submission to:

Australian Competition and Consumer Commission Inquiry Into Grocery Prices

March 2008

Motor Trades Association House, 39 Brisbane Avenue, Barton ACT 2600
PO Box 6273, Kingston, ACT 2604
Telephone: + 61 2 6273 4333. Facsimile: + 61 2 6273 2738.
Email: mtaa@mtaa.com.au A.B.N. 66 008 643 561



Motor Trades Association of Australia

Mr Graeme Samuel
Chairman
Grocery Prices Inquiry
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Dear Mr Samuel

This submission to the ACCC's Grocery Prices Inquiry has been prepared by the Motor Trades Association of Australia (MTAA).

MTAA is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association is a federation of the various state and territory motor trades associations and automobile chambers of commerce, as well as the New South Wales based Service Station Association Ltd (SSA) and the Australian Automobile Dealers Association. Members of the MTAA Federation include:

- the Australian Automobile Dealers Association (AADA)
- the Motor Trades Association of the ACT (MTA ACT)
- the Motor Traders Association of NSW (MTA NSW)
- the Motor Trades Association of the Northern Territory (MTA NT)
- the Motor Trade Association of South Australia (MTA SA)
- the Motor Trade Association of Western Australia (MTA WA)
- the Service Station Association Limited (SSA Ltd)

MTAA also has a number of Affiliated Trade Associations (ATAs), which represent particular sub-sectors of the retail motor trades, ranging from motor vehicle body repair to automotive parts recycling and relevantly, for this Inquiry, the Australian Service Station and Convenience Store Association (ASSCSA). MTAA represents the interests, at the national level, of over 100,000 retail motor trade businesses with a combined turnover of over $120 billion and which employ over 316,000 people. The vast majority of businesses represented by MTAA employ five or less people.

MTAA's interest in this Inquiry arises from the reference in the ACCC Issues Paper to the 'shopper-docket' arrangements which exist between many supermarkets and petrol retailers. The most well known of those are of course the arrangements between Woolworths supermarkets and the Woolworths and Woolworths/Caltex branded petrol stations and the Coles supermarkets and the Coles/Shell branded petrol stations.

Many independent grocery retailers and service station operators also offer 'local' shopper docket arrangements. MTAA has expressed concern over the past few years about the operation of the alliances between the two supermarkets and their respective refiner/marketer partners. These

concerns were also addressed in the MTAA's submission to the recent ACCC inquiry into the petroleum market. A copy of MTAA submission to that inquiry is attached for your information.

It is arguable that the entry of the supermarket chains into the retail petroleum industry has seen the development of market circumstances that place 'independent' fuel retailers at a competitive disadvantage - even collectively – in their dealings with the major oil companies. The entry into the market of Coles and Woolworths has seen a large concentration of market volume and market power fall into their control, along with a demonstrated willingness to exercise it on occasion. Independent operators have been removed from their position of price leaders, and now have to maximise their retail price to remain afloat. In effect, independent operators have become – in the main – price takers rather than price makers.

It ought to be hardly surprising, then, that as the Association understands matters, the two supermarkets' market share of petrol retailing has reached close to 50 percent. In a price-driven consumer market with a large uptake and utilisation of the 'shopper-docket' concept, it is understandable that the supermarket fuel retailers have attained such dominance in the market. It also reinforces, however, the difficulties involved for the non-supermarket aligned sites to be competitive on price. It has long been the Association's view that the supermarkets interest in petrol is not as a product itself, but because of the frequency and, mostly, necessity of its purchase, as a 'device' through which consumers' buying patterns can be influenced (that is, to ensure a greater flow of customers to their respective supermarket).

At Attachment 1 is a copy of a paper prepared for MTAA by Professor Joshua Gans on the shopper docket schemes. MTAA records here its concern that shopper docket promotions which provide large discounts (up to 20 cents per litre) for motorists who purchase other goods (such as wine) from supermarket owned outlets are contributing to the decline in the numbers of retail sites. Non-supermarket branded retail outlets cannot compete against service stations where motorists can present a docket and secure up to 20 cents per litre off the price of the fuel. Either the supermarket outlets are making a substantial loss on those retail sales (and thus one would wonder how they remain in business; if not for cross-subsidisation) or the wholesale price paid by those sites is significantly lower than that available to franchised and independent operators. This distortion of the retail market is of real concern to the Association and is not in our view conducive of long-term sustainable retail competition.

MTAA strongly supports the view that the best outcomes for consumers and society, are delivered by strong competition in the marketplace. To achieve this requires, however, a diversity of outlets/ownership with freedom of access to a number of competing and competitive suppliers. Another requirement, if this ideal is to be met, is for the market and its conditions to characterise a level playing field, and for the existence of stable and fair rules for activity between all parties. This latter aspect can be obtained through the operation of a strong Trade Practices Act, for which the MTAA has a long history of support and advocacy.

In the connection I have attached a copy of the MTAA Small Business Charter of Fairness which sets out the Association's objectives in relation to a strengthening of the Trade Practices Act in support of small business. You will note from that Charter that MTAA believes that there is a need for the introduction of measures within the Trade Practices Act to deal with 'creeping acquisitions'. MTAA does not believe that the Trade Practices Act is currently able, under the merger provisions, to deal with small acquisitions over time which might ultimately lead to a reduction in competition in a market.

In conclusion, it is a fair assessment to say that the entry of the supermarket chains into the retail petroleum sector has – in conjunction with the introduction of 'shopper docket' schemes –

significantly altered the characteristics of a substantial portion of the Australian retail market. Financial outlay for food and fuel combined represents a major part of most Australian's non-discretionary spending. In such a highly competitive and concentrated market, it is understandable that there is a strong motivation for a market participant to optimise its share of it.

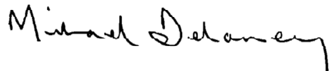
MTAA does not accept, however, that this optimisation needs to come at the expense of small, independent businesses that are equally entitled to be participants in the same competitive market. Indeed, it is these very participants that play a vital role in maintaining market competitiveness, which is to the ultimate benefit of consumers.

MTAA Chairs and Convenes the Fair Trading Coalition. A number of Members of that Coalition have a specific interest in the supermarket supply chain and I would expect that they will be making substantial submissions to this Inquiry in their own right.

MTAA is also supportive of the efforts of organisations such as the National Association of Retail Grocers of Australia (NARGA) to represent the interests of independent retailers. NARGA has also in the past advocated for a strengthening of the Trades Practices Act provisions that have the ability to afford greater rights and redress for small, independent businesses against the concentrated market power possessed by the dominant supermarket chains.

I would be happy to clarify any issues raised in this submission.

Yours sincerely



MICHAEL DELANEY
Executive Director

11 March 2008

CoRE research
Competition & Regulatory Economics
MELBOURNE - AUSTRALIA

The Competitive and Welfare Implications of Shopper Docket Schemes in Petrol and Grocery Retailing

A Report on behalf of the Motor Trades Association of Australia

Professor Joshua Gans

The analysis here represents the views of CoRE Research Pty Ltd (ACN 096 869 760) and should not be construed as those of the MTAA.

16th August, 2004

Executive Summary

This report examines the competitive and social welfare implications of the shopper docket schemes entered into recently by Coles/Shell and Woolworths/Caltex. The schemes each allow consumers a 4 cent per litre discount on petrol if they redeem a recent docket for groceries of more than $30 spent at the allied supermarket chain.

While at first blush, these schemes appear to represent a favourable deal for consumers, current economic research suggests that there are some important reasons for concern:

- *Exclusivity*: while many consumers purchase both petrol and groceries, the schemes are between particular chains in each sector. This means that only those consumers who happen to shop at two allied chains will benefit from the discount. For the remainder, the discount is not available or alternatively, their behaviour will be distorted towards allied chains (perhaps incurring other costs such as travel and inconvenience to achieve this).

- *Headline price changes*: while a discount is offered, headline prices are likely to adjust to compensate. A discount allows a competing chain to raise its headline prices without fear of loss of customers who shop at its ally. Given this, it is likely that, even in the short-run, headline prices of allied chains will rise. This will lead to some consumers who purchase from only one of them paying higher prices. Moreover, it will put increasing pressure on non-allied chains to either ally if possible or, in the alternative, scale down their operations (over the long-run).

- *On-going ramifications*: if the effects on consumer behaviour of these exclusive shopper docket schemes become large, then in the long-run, independents will be more likely to exit, competition will be reduced, and even consumers obtaining a discount may end up paying higher prices for groceries and petrol. In addition, as the alliances involve closer operations of convenience stores in petrol outlets, the competitive pressure from these stores on supermarket chains is likely to be reduced.

In the end, we may be left with a picture of a retail economy, where consumers must ally themselves with a group of retailers in each sector and where competition in each falls to its lowest common denominator. The great Australian duopoly may become a reality over many previously competitive retail sectors.

Given this worrisome assessment, it is my opinion that the ACCC too quickly lauded the apparent benefits of shopper docket arrangements without considering the potential competitive effects. In particular, the ACCC conducted no assessment of the exclusivity of the arrangements, the effect of the large installed base of the participants of the schemes in their respective sectors nor of the implications for pricing as conducted by independent firms. These features drive the potential competitive and social welfare concerns of shopper docket schemes. For this reason, the ACCC should revisit their authorisation – particularly of the exclusive nature of these schemes – as well as their third line forcing guidelines that give the impression that such schemes (even though potentially prohibited by the *Trade Practices Act*) would never raise a competition concern.

Contents

Page

1 Background 3

2 The Incentives to Introduce Shopper Dockets5

2.1 Shopper Docket Schemes versus Straight Rebates.. 5

2.2 Exclusive versus Non-Exclusive Arrangements . 7

2.3 Why Petrol? 8

2.4 Summary 10

3 The Short-Run Effects of Shopper Docket Schemes 11

3.1 Competition Without Shopper Dockets 11

3.2 Unilateral Introduction of Shopper Dockets.... 12

3.3 Competing Shopper Docket Schemes........... 15

3.4 Summary 16

4 The Long-Run Effects of Shopper Docket Schemes 17

4.1 Exit and Entry Decisions 17

4.2 The Petrol Discount 18

4.3 Location Decisions 19

4.4 Convenience Stores.................................. 19

4.5 More Alliances to Come............................. 20

4.6 Summary 20

5 Where the ACCC Erred 22

5.1 Is it really a discount? 23

Contents

Page

5.2 Exclusivity 24

5.3 Integration Matters 25

5.4 Summary 26

References 28

1 Background

In the past year, both of the Australia's major supermarket chains (accounting for almost 80 percent of the market) have moved to form exclusive alliances with major petrol chains. The Coles/Shell and Woolworths/Caltex[1] have differing governance (one is a co-branding arrangement, the other is a joint venture) but each has a similar offering for the customer: buy $30 or more of groceries at a supermarket outlet and you can redeem the docket for a certain period of time for a 4 cent per litre discount at the petrol outlet. While these schemes are still rolling out, there is considerable anecdotal evidence that their utilisation has been significant and many analysts have attributed the sales and profit growth of Coles-Myer to the existence its arrangement with Shell.

What is interesting about these schemes is that there is no obvious customer-side or supply-side driver of the arrangement. There are no shared inputs (e.g., a shared distribution network) nor is there an obvious intrinsic relationship between customer demands for particular brands of petrol and groceries. To be sure, most households consume both petrol and groceries but that is a very different proposition from a relationship between one brand of each. As such, the usual efficiency arguments for product bundling do not appear to apply (see Gans and King, 2004c).

Nonetheless, in 2004, the Australian Competition and Consumer Commission (ACCC, 2004) cleared both shopper docket schemes. These schemes potentially raised issues of third line forcing and joint venture concerns. On each, however, the ACCC did not see any harm to the competitive process and saw potential consumer benefits. While acknowledging that the schemes could harm smaller independent retailers, the ACCC could not separate this from other pressures that were rationalising that sector.

It is in this context, that the Motor Trades Association of Australia have asked me to take a closer look at shopper dockets. Prior to this, Stephen King (now a member of the ACCC) and I conducted independent academic research on this topic (Gans and King, 2003,

[1] Coles includes the BiLo and Liquorland chains and Woolworths also includes the Safeway chain of supermarkets.

2004a, 2004b).[2] We examined shopper docket and related arrangements in a formal set of economic models and derived a number of results strongly indicating poor competitive and social outcomes that might arise from these schemes. The purpose of the present paper is to translate that work to understand the full competitive and welfare implications of shopper docket schemes and also evaluate whether the ACCC has properly assessed them in this regard.

The remainder of this paper proceeds as follows. In the next section, I examine why supermarket and petrol chains have chosen to introduce shopper docket schemes as opposed to straight discounts and non-exclusive arrangements. Section 3 then considers the short-run implications of the scheme for prices, competition and social welfare. Section 4 then turns to the long-run issues of entry, location choice and the evolution of both sectors. Section 5 then evaluates the ACCC's analysis and argues why it has erred in its quick clearance of the scheme. That section offers suggestions as to how to flag problematic shopper docket schemes over those that would not raise competitive concerns.

[2] While the research underlying the findings in the present paper reflect work with Stephen King, all views and conclusions here are strictly my own.

2 The Incentives to Introduce Shopper Dockets

To understand the competitive and welfare implications of shopper dockets, it is useful to begin by considering why a pair of firms would choose to introduce them in the first place. Specifically, (1) we must ask why a shopper docket scheme would be preferable to a straight discount? (2) why a shopper docket scheme should be an exclusive arrangement between specific chains rather than a broader arrangement? and (3) why supermarket chains should align themselves with petrol retail chains rather than alternative consumer arrangements?

2.1 Shopper Docket Schemes versus Straight Rebates

Recall that an offer to reduce petrol prices by 4 cents per litre in exchange for the presentation of the $30 or higher supermarket receipt is, at first glance, equivalent to offering to reduce a consumer's supermarket bill by roughly $2.[3] For a $30 purchase, this represents a discount of 6.67%. Of course, for larger supermarket bills the discount is more modest. For a $200 docket, the discount would be just 1%. Nonetheless, it is important to ask why giving this discount in the form of a discounted petrol price would be preferred to a straight rebate of $2 for every purchase of $30 or more?

There are, of course, several key differences between a straight rebate of $2 and a 4 cent per litre discount on petrol.

- *Differing preferences for petrol relative to groceries*: not all consumers have the same level of petrol purchases per dollar spent at the supermarket. Some consumers – those without cars – consume no petrol at all and would not benefit from this discount. Even amongst those with cars, some consumers have large supermarket bills relative to their petrol purchases. Finally, some consumers will purchase very high volumes of petrol relative to their supermarket bills (e.g., single individual

[3] Based on filling a 50 litre tank.

households who commute by car). Thus, a petrol discount will disproportionately attract 'large tank, small shopping cart' consumers relative to 'small tank, large cart' consumers.

- *Consumer gaming*: if a $2 rebate was offered for each purchase of $30 or more, some consumers may divide their grocery purchases so as to maximise the total discount. To be sure, this is also possible for a petrol discount. However, the shopper dockets usually expire a few weeks after they are issued. There is only so much petrol some consumers can purchase in that time and therefore, a limited incentive to divide the bill.

- *Higher transaction costs*: to obtain a docket, hold on to it, and then redeem it at a petrol station, involves some consumer costs relative to a simple rebate paid at the supermarket check-out.

- *Shared costs*: if the petrol discount brings new customers to the petrol retailer, that retailer is likely to want to share the costs of the discount with the supermarket. From the supermarket's perspective, this means that they receive all of the benefits of a discount on their own goods at only a fraction of the cost.

Of these four key differences, higher transaction costs are a clear disadvantage[4] to petrol discounts over direct rebates while shared costs are a clear advantage. While a petrol discount may have an advantage in reducing consumer gaming, this may be limited as one could imagine other ways of packaging a rebate to achieve a similar effect.[5] As such, it seems unlikely that this issue is a driving force behind the use of shopper docket schemes.

In terms of differing consumer preferences, the profitability of using a petrol discount depends upon each consumer types' price sensitivity with regard to the supermarket's products. In principle, a firm can improve profits by charging its customers who are less price sensitive a higher price than those who are more sensitive to price. This allows them to attract more sales from the latter without losing sales revenue from the former.

---

[4] Of course, this disadvantage may become an advantage if some consumers forget to utilise their dockets at the petrol pump. Nonetheless, if this were the case, issuing a redeemable coupon of any kind – such as a mail-in rebate – would confer the same advantage.

[5] Indeed, if shopper dockets could be traded (as in principle they could be), there may be no assistance in diminishing consumer gaming.

Therefore, if the 'large tank, small cart' consumers were more price sensitive than the 'small tank, large cart' consumers, then a petrol discount – by reducing the grocery bill of the former type – can improve a supermarket's profits. On the other hand, if the reverse were true, then a straight rebate would be preferable to a petrol discount as a means of attracting customers.

I do not have at hand any evidence to suggest what the relative price sensitivities of different types of customers are. Moreover, it is not difficult to envisage situations in which either customer class could be more or less price sensitive than the other. Nonetheless, exploiting these differences could be a driving force of the current schemes.

2.2 Exclusive versus Non-Exclusive Arrangements

The above analysis of why to offer a petrol discount over some more direct rebate does not take into account a key feature of the two major petrol-grocery schemes introduced in Australia: that they are *exclusive* arrangements between a particular supermarket and petrol retail chains.

To see why this is an issue, contrast the Coles/Shell and Woolworths/Caltex arrangements with the shopper docket scheme introduced by Metcash – a group of independent supermarket outlets. In early 2004, IGA stores in Queensland offered to pay shoppers, who purchased $30 or more, 4 cents per litre for petrol purchased regardless of where that petrol was purchased. This stands in contrast to the other schemes where a discount applied only at specific petrol stations.

Apart from the operational detail that for IGA the discount was redeemed at the supermarket checkout rather than the petrol pump, the IGA scheme was dramatically non-exclusive. However, because it was a petrol discount on essentially the same terms as Coles/Shell and Woolworths/Caltex, it shared (almost) all of the advantages of providing this type of discount over a direct debate. The only advantage IGA did not appear to receive was any sharing of the discounted costs. Nonetheless, in exchange for this, they received a key advantage: consumers did not have to worry about where they bought their petrol.

To be sure, having a non-exclusive arrangement with a number of petrol chains is not a barrier to cost sharing. Coles or Woolworths could have made a similar offer to IGA – to redeem petrol dockets – subject to have coming to an agreement with particular petrol chains.

This may have entailed additional negotiation costs but it also might have been able to encompass all petrol chains and not simply those with a more limited market share. Moreover, petrol chains would have wanted to agree to share costs so as not be left out of a wider arrangement.

Given this, what are the advantages to exclusivity? It all comes down to whether more costs would be borne by the petrol chain in an exclusive versus a non-exclusive arrangement. A petrol chain is likely to share more costs associated with a shopper docket scheme if the net advantage of so doing is large. This net advantage is the number of additional sales it expects to receive less than sales it will lose by not being part of the scheme.

In a non-exclusive arrangement, the potential loss in sales might be large but the gain is relatively small as many chains have a similar shopper docket arrangement. An exclusive arrangement reverses this on one front with a larger movement in expected sales gain from being the only chain part of the scheme. On the other, however, the potential loss in sales from not being part of the scheme is probably similar to the loss that would be incurred when arrangements are non-exclusive.

Thus, exclusivity potentially allows the supermarket chain to reduce its burden of cost sharing of the discount scheme. So long as the petrol chain it has an arrangement with is ubiquitous, then the potential detriment from exclusivity – less convenience to customers – may not be large.

Indeed, exclusivity can work both ways. By tying in a ubiquitous petrol chain, this prevents other supermarket chains from reaching an agreement with it. Given this, the burden of cost sharing is likely to flow in favour of the supermarket or petrol chain that has the greatest market power in its respective market. For Australia, there is good reason to suppose that that favour lies with supermarkets.

Nonetheless, as I will explain later, exclusivity is likely to impose more costs and fewer advantages on consumers than non-exclusivity.

2.3 Why Petrol?

The final issue that is useful to consider is why a supermarket chain like Coles and Woolworths would choose to discount its products through an arrangement with petrol retailers rather than some other means?

It should be noted that there are other arrangements in place. There are credit card alliances and also loyalty points schemes. Flybuys offers a range of consumer benefits in travel and consumer products. Indeed, a few years ago it offered redemption vouchers at Shell (but no longer). In this respect, petrol is yet another alliance rather than something new.

What makes the current alliances more unique is: (a) its transparency and (b) its regularity. The transparency arises because it is very clear what discount will be payable for what level of purchases. Loyalty points tend to require the accumulation of a large number of purchases and it is difficult for an individual consumer to compute the precise discount they are receiving. In contrast, if you know your petrol consumption (in litres per week) you can work out how much you are saving each week from purchasing at a particular supermarket chain.

In addition, loyalty points generally allow redemptions fairly infrequently. The shopper dockets schemes are utilised weekly and so can be more easily built into the habits of consumers. For this reason, as petrol purchases match the regularity of grocery purchases, there is an advantage to linking the two.

However, petrol is also a natural candidate for an exclusive arrangement; allowing the supermarket to bear a smaller share of the discount. Petrol retailing involves the sale of a relatively homogeneous product – consumers care little about the brand of petrol they purchase – in a segment that is broadly competitive.

What this means is that petrol retailing margins are thin while consumer price sensitivity (at a brand level) is high. Thus, if one petrol chain can develop an advantage in attracting consumers – after all, once you have a docket you might as well use it – then those consumers' behaviour is likely to change dramatically. And consumers do care about petrol prices. It was only a few years ago that a 1.5 cent per litre tax was a major back-down issue for the Federal government. Think about what 4 cents per litre can do.

Moreover, when margins are thin because of competitive pressures, any change that makes one customer segment more loyal can tip the balance towards being able to raise prices. If a large number of your outlet's customers shop at one of the major supermarkets, then even if you discount 4 cents per litre to them, you are able to raise your pump price by a similar amount without losing too many sales. Even if the increase in margin is nominally slight (say 1 cent) that means a very high boost to outlet profitability.

For these reasons, petrol can be seen as a desired candidate for this type of alliance. However, there are other industries with similar characteristics – electricity and gas retailing, some aspects of telecommunications, and water – all of whom might be future sources of shopper docket schemes.

2.4 Summary

While there are possible explanations of the current arrangements in terms of exploiting heterogeneous customer preferences and sharing costs, this does not explain why the schemes were exclusive and involved a relationship between supermarket and petrol retailing.

On exclusivity, supermarket chains (who have a relatively large installed retailing base relative to particular petrol chains) potentially benefit from using their size to obtain the benefits of the discount without bearing as much of the costs. However, this private benefit is not a benefit to consumers of either groceries or petrol.

On the relationship with petrol, both share a habitual purchase nature. However, petrol demand is also highly inelastic at the product level even if it isn't at the brand level. This means that any discount is likely to flow to greater supermarket sales rather than greater consumption of petrol over the entire market. However, as the discount is effectively a rebate over the entire cart of grocery purchases, it is unclear that this will lead all but marginal customers to consume more groceries.

What this suggests is that the incentives to introduce such schemes are more strategic as opposed to some broader product or marketing innovation that would lead directly to consumer benefits. Strategic benefits may impact upon the nature of competition but do not necessarily translate into higher social efficiency. Nonetheless, this is admittedly a starting point and in Sections 3 and 4 a more complete competitive analysis is described.

3 The Short-Run Effects of Shopper Docket Schemes

The above analysis of the incentives to introduce shopper docket schemes is partial in the sense that it neither includes changes in the prices of groceries and petrol by participants to the scheme nor price reactions by others in the industries concerned. Gans and King (2004a) provide a complete analysis of the oligopolistic outcomes of shopper docket schemes. In this section and the next I translate those technical results, describe and explain the short and long-run effects of such schemes on prices, competition and social welfare.

3.1 Competition Without Shopper Dockets

The appropriate starting point for analysis is to consider what happens in the absence of shopper docket schemes. In this situation, we have numerous brands of both supermarkets and petrol. While most consumers tend to purchase groceries *and* petrol, the co-branded alliances that have formed between Coles/Shell and Woolworths/Caltex do not appear to be related to some intrinsic affinity on the part of consumers to purchase from those groups. That is, a current shopper at Woolworths (Coles) is no more likely to purchase petrol at Caltex (Shell) as opposed to any other petrol chain.[6]

Given this, competition and pricing is confined to particular markets. Supermarkets set their prices with regard to the prices set by other supermarkets. Petrol outlets set their prices with regard to the prices set by other petrol outlets. The pricing decisions of participants in the other market do not feature and do not influence competition or consumer behaviour.

What this means is that consumers will choose their brand in each market with regard to their preferences over those brands. For the

[6] The FlyBuys scheme which is available for purchases at both Coles and Shell does create some relationship in consumer preferences. Given the broader nature of that scheme I am going to assume throughout this analysis that this factor is not the main driver of individual choices. Of course, nothing in the analysis below hinges upon this assumption.

most part, this will be based on locational convenience. Consumers will tend to shop at supermarkets and purchase petrol from locations closest to them or on their commuting paths. For this reason, we would expect to see Coles and Woolworths consumers purchasing petrol from all chains roughly in proportion to their market shares. And we would expect to see Shell and Caltex consumers shopping at supermarkets according to their market shares.

Importantly, this state of affairs constitutes a good social advantage. From a social welfare perspective, for regular purchases, we want consumers to be making purchases at their most preferred locations and brands. This minimises the costs of 'shopping' and travel.

3.2 Unilateral Introduction of Shopper Dockets

Now consider what happens when one pair of supermarket and petrol chains introduces a shopper docket scheme. If the firms are independent – as they are with Coles and Shell (Woolworths/Caltex is murkier) – then what they do is set the petrol discount[7] and then choose on a weekly and sometimes daily basis, their prices for their respective products.

3.2.1 Pricing Impacts

However, while a supermarket would have previously set its prices only with regard to the prices of other supermarkets, now it realises that in the eyes of some consumers – those who purchase or intend to purchase from its allied petrol chain – its products are more valuable. Consequently, the supermarket can afford to raise its own prices without losing as many customers.

The same is true for the petrol chain offering the docket discount. It now knows that some of its customers will still come to it even if it charges up to 4 cents per litre more than rival chains. Thus, the headline price of petrol will rise as well.

What is interesting about this situation is that the prices set by the allied supermarket and petrol chains are now related to one another. The higher the price charged by the allied petrol chain, the lower the incentive of the supermarket chain to raise its prices. Similarly, the

[7] Of course, it could easily be a grocery discount but this is harder to measure given the multi-product nature of supermarkets.

higher the supermarket price, the lower the incentive of the allied petrol chain to raise its prices. However, as they are independent firms, each will, in its own pricing, neglect the effect of their actions on the other. For this reason, the allied supermarket and petrol chain will end up with a higher headline price than before – although after the discount – for those consumers who take advantage of it – prices will be lower.

Thus, from each firms' perspective, where before they sold unrelated products, the existence of the shopper docket scheme between them makes their products *complements*. Not surprisingly, this will mean that consumers treat them like complements as well and become more likely to buy from one when they buy from the other. But this also has an impact on the pricing decisions of other firms.

3.2.2 Competitive Impacts

What impact does this scheme and its resulting price changes have on the behaviour of other firms? In both supermarkets and petrol, those firms will find their market shares eroded as consumers who previously did not purchase from both chains, start to purchase from the allied chains. This means that, at the margin of competition, the discount is putting pricing pressure on other firms. As a result, they will reduce their prices to protect the erosion of their market share.

In the eventual equilibrium, the profits and headline prices of the allied petrol and supermarket chains will be higher while the prices and profits of non-allied chains will be lower. Indeed, according to the calculations in Gans and King (2004a), the margin earned by allied chains on their headline price could rise by 22 percent while those earned by non-allied chains could fall by 6 percent. In terms of market shares, perhaps 3 percent will shift in favour of the allied chains. Finally, on the profit side, taking into account the discount paid, the allied firm's profits may rise by 4 percent while those of non-allied firms may drop by 8 percent.[8]

3.2.3 How Large a Discount?

Of course, the above calculations include a consideration of the setting of the discount itself. Recall that this discount is set prior to

[8] It should be emphasised that these calculations, while based on an equilibrium model, should be considered very sparingly as the model itself has key assumptions regarding the number of competing chains as well as their differentiation in the eyes of consumers.

prices being determined by all firms. In effect, one would expect that the discount itself will be set far less frequently than the headline prices of petrol and groceries.

As the allied chains raise the discount, their market share rises but there is also a stronger pricing response from non-allied chains. For this reason while some discount is desirable, going too far (a) intensifies price competition and (b) reduces the overall revenue received by the allied chains from consumers who purchase both of their products. A greater discount increases that set of consumers but at the same time diminishes the allied chains' incentives to set the discount even higher. Thus, in equilibrium, only some portion of the petrol chain's average mark-up over the wholesale cost of petrol will be discounted. Indeed, if that mark-up is m, then according to Gans and King (2004a), the unilateral discount will be about $m/2$.

3.2.4 Welfare Impacts

What are the welfare impacts of all of this? On the winning side, consumers who previously purchased from both allied chains are better off. Even though the headline prices they pay are higher, with the discount, their overall expenditures are lower. Similarly, those consumers who previously purchased from neither of the allied chains are better off as the prices charged by non-allied chains fall.

Alongside them, the shareholders of the allied chains will be better off as their profits rise.

On the losing side are the non-allied firms whose profits and market shares diminish. More significantly, however, are the consumers who purchase from only one of the allied chains. Those consumers will not receive the benefit of the discount but will pay a higher headline price. Overall, Gans and King (2004a) demonstrate that their total expenditures on both groceries and petrol will be higher.

Finally, however, as noted earlier, the discount will mean that some consumers who previously purchased from only one (or neither) of the allied chains will be motivated by the discount to purchase from both of them. This is the source of the increase in the allied chain's market shares. However, with this comes a social cost. Absent any increase in grocery or petrol purchases, those consumers are no longer purchasing from their preferred mix of petrol and supermarket brands. Those will be the consumers who travel further to purchase petrol or groceries.

3.3 Competing Shopper Docket Schemes

The existence of one shopper docket alliance will create pressure for others to form. However, for these to be worthwhile – especially on an exclusive basis – the alliance must involve at least one participant who has a high market share in their respective market. This is because the consumers it will attract through the alliance will only be significant if at least one chain already has a substantial customer base. It is only by doing this that an additional alliance could counter the competitive effects of any first movers in this regard.

In Australia, this appears to mean that only two petrol-grocery alliances will be developed on an exclusive basis. While there are four large petrol retailing chains, there are only two major supermarket chains. The smaller chains have individual market shares far smaller than the large petrol retailers and so do not represent a natural fit: that is, a large petrol retailer who is not part of an alliance will do little to protect its market share by allying with a smaller supermarket chain. The customers it could attract through this would be limited and so it would be merely offering a discount to its own more loyal customers.

3.3.1 Effect on Prices

To see what will happen if there are two shopper docket alliances rather than one, note that for any given set of petrol discounts, this will allow allied chains to raise their headline prices and will lead to more consumers purchasing both products from one allied chain or the other rather than from one of them alone. The higher the discount offered, the more likely consumers will sort themselves into these two classes.

From the perspective of the remaining non-aligned petrol and supermarket chains, the existence of two schemes rather than one will put further pressure on market shares, causing them to reduce their prices even further in order to compete. Their profitability will diminish further.

3.3.2 Effect on the Discount

Not surprisingly, the existence of two competing shopper docket schemes creates pressure on each to offer a higher petrol discount. Recall, however, that this will still lead each to raise its headline prices for petrol and groceries. In this respect, setting a higher petrol discount, allows an allied chain to soften price competition overall.

Gans and King (2004a) demonstrate that, in the extreme, all consumers may end up purchasing from one set or the other of allied chains. At this point, the discount is substantial, equal to the entire petrol margin, m. However, the overall price (including the discount) they pay for petrol and groceries ends up being exactly the same as it was before any shopper docket scheme was introduced. It may well be that the discounted price of petrol is lower than before (by about $m/2$) but this is made up for in higher grocery prices.

3.3.3 Welfare Implications

Of course, this extreme outcome is not necessarily something we would observe in the short-run. What will occur is an increasing disadvantage to consumers who purchase only a single product from any one allied chain (e.g., Coles customers who don't purchase from Shell, etc.) will face much higher prices than before. However, the existence of two schemes may well reduce the pricing benefit otherwise realised by some consumers when there was only one scheme.

In addition, the presence of two schemes will put further pressure on non-allied grocery and petrol chains in terms of market share and profits.

However, the main welfare cost will be a continued distortion of consumer shopping behaviour away from their most preferred product bundles. More travel time, more shopping time and even some change of consumption away from what those consumers would otherwise have preferred. All this for a highly ambiguous benefit in terms of price competition.

3.4 Summary

Shopper docket schemes will have an immediate impact on consumer behaviour and market shares and will, as a consequence, lead to welfare losses as consumer behaviour moves away from what would otherwise be the case. The pricing benefits will be mixed. Some consumers will gain while others will lose.

Importantly, however, pressure will be put on the profitability of non-allied firms. While in the short-run this is a problem for them, in the long-run, it becomes a problem for competition; something I turn to consider next.

4 The Long-Run Effects of Shopper Docket Schemes

While shopper docket schemes have immediate impacts on pricing and consumer behaviour, their longer-term impacts will involve potential changes in the structure of petrol and grocery retailing as well as habitual changes in consumer behaviour.

In this section, I outline some of the long-run decisions that will be impacted upon by shopper docket schemes if they persist. To be sure, given the myriad of factors that impact upon long-run decisions, this analysis is inherently more speculative. However, what it does suggest is that there are real long-term competitive implications of these schemes and that they cannot be simply dismissed by policy-makers and regulators.

4.1 Exit and Entry Decisions

Given the impacts upon the profitability of non-allied supermarket and petrol chains, the existence of shopper docket alliances will contribute to decisions by such chains to exit their respective industries. At the same time, it will make it more difficult for new entrants to build the necessary market share to cover the costs of entry. Because most areas include one or both of a Coles or Woolworths outlet, entry into either supermarkets or petrol retailing will be more difficult.

What this means is that most new outlets will tend to be associated with one alliance or the other. Moreover, there will be some upstream impacts. Shell and Caltex are vertically integrated into petrol refining and beyond. As is often the case, internal trade within a vertically integrated organisation involves more favourable terms than external trade. Thus, as BP and Mobil lose market share, their upstream entities will have to rely increasingly on external trade. Given the existence of imports, this will increase pressures to rationalise those upstream operations. It will also make it more difficult for independent terminals that compete with such refineries to continue and also expand capacity. As the total supply of petrol in and into Australia is a key determinant of downstream petrol prices, this type of rationalisation is a concern. This is especially so given that it may

be driven by the exclusivity of shopper docket arrangements and the relatively higher concentration of Coles and Woolworths in the supermarket industry.[9]

4.2 The Petrol Discount

The ACCC (2004) argued that independent petrol retailing was subject to continual rationalisation even without shopper docket arrangements. My view is that such arrangements will accelerate such rationalisation and exit. Importantly, regardless of how it occurs, on-going movements towards branded chains in groceries and retailing will have an impact on the petrol discount itself.

As I noted earlier, the petrol discount that is part of shopper docket alliances, is limited by the fact that allied chains are able to command a higher headline price and indeed secure that price from some sets of consumers. Those consumers are more likely to be present where non-allied alternatives exist. As those independent alternatives are increasingly marginalised, then the allied chains themselves would be more likely to compete head-on in any given location.

The allied chains will be able to move to soften that head to head competition by increasing the petrol discount and reducing their own incentives to compete on price. Thus, the petrol discount will rise but at the same time, the rise in petrol and grocery prices will outweigh this. So far from a fear being that, following rationalisation, the discounts would go away. The explicit discount will likely become higher but overall price paid (including the discount) will become higher itself.

The end result of this will be closer to the extreme outcome forecast in Gans and King (2004a) whereby most consumers make their grocery and petrol purchases from one allied chain or the other with some consumers going to great lengths to avoid paying significantly higher headline prices. Again, this is where significant social cost from such schemes could be realised.

---

[9] Note that it is unlikely that the schemes will ever be clawed back even if there is substantial exit. This is because the presence of the schemes acts as an entry barrier – requiring an alliance in both grocery and petrol retailing. In any case, Gans and King (2004a) demonstrate the equilibrium incentives to have such exclusive shopper docket schemes even where potential exit and entry is not a consideration.

4.3 Location Decisions

It might be argued that over the long-term, allied petrol and supermarket outlets may locate closer together. As the ACCC (2004) noted, many supermarkets and petrol stations used to be on the same premises and in the UK, this is becoming an increasingly popular practice. That said, in each of those cases, the outlets were also co-owned providing a markedly differing set of incentives than the current shopper docket schemes.

Upon closer examination, the shopper docket schemes, if anything, work against than towards co-location. Recall that part of the scheme's profitability comes from being able to charge higher prices to those customers who do not take advantage of the petrol discount. By co-locating, the petrol and supermarket chain reduces their revenues from this source, turning the shopper docket into a straight discount to many customers. Thus, even if in the absence of such schemes, co-location may have been a trend, the existence of the schemes would likely work against rather than towards convergence on this front.

4.4 Convenience Stores

Given this, it is instructive to consider the role of convenience stores that have begun to co-locate with petrol outlets in recent times. One thing that stands out is that even though the convenience stores located on allied petrol outlets have begun to be operated by the supermarket chains – and in the case of Coles Express – branded as such, the shopper docket schemes do not apply to them. Again this is confirmation of my hypothesis that such schemes will not foster co-location. But it also rules out a supply-side synergy from these schemes in terms of utilising a common distribution network. Put simply, a customer is better off spending $30 of groceries at Coles and driving to a Shell petrol station than going simply to that station and shopping at Coles Express.

Nonetheless, the increasing presence of convenience stores at petrol outlets appears to be a new source of competition for services traditionally covered by supermarket chains. While the alliances do not at present appear to cover this, it is unclear what the new developments represent in this regard. It is possible that, in part, the new branding of convenience stores at petrol outlets is itself a defensive reaction on the part of supermarket chains to a growing competitive threat. If so, then that threat and the level of future

competition may in some respects be diminished as a result of shopper docket alliances.

4.5 More Alliances to Come

While petrol represents a natural means of focusing supermarket shoppers, it is not the only industry that matches both habitual consumer purchases with a fundamental inelasticity of demand. Basic household services such as gas, electricity and water, share these characteristics. For this reason, Coles and Woolworths may find it desirable to form exclusive alliances with competing retailers in these sectors. The retailers themselves may see such exclusivity as attractive as customers could be motivated to incur once-off switching costs to switch in their favour. However, in this case, discounts may not be likely to be on-going as they are with petrol.

In addition, there is a strong possibility that other sectors where market power is present and purchases are regular – such as telecommunications, pay TV and internet services – may approach petrol chains for alliances similar to those struck with supermarket chains. It is not clear whether these alliances would be struck with Shell or Caltex or other retailers such as Mobil and BP. A company such as Telstra may be able to assist in consolidating the position of Shell or Caltex or assisting Mobil and BP in restoring theirs. In any case, there would be social costs associated with unwelcome distortions in consumer behaviour. However, further alliances with Shell or Caltex may harm competition in petrol retailing more than the alternatives.

4.6 Summary

Shopper docket alliances between petrol and grocery chains are still in their infancy. While there are intentions to employ them throughout Australia, this is taking some time. Nonetheless, in many respects the short-term impacts on market shares and profitability are being felt.

This section has outlined some long-run implications of these schemes. In a worst case, the market structure of grocery and petrol retailing may converge to the lowest common denominator: a duopolistic structure in each industry. This arises as failure to access such schemes deters entry and accelerates the departure of smaller chains and independent outlets. Moreover, there would be flow on effects upstream as downstream markets rationalise.

It is important to emphasise that this outcome would be to the long-term detriment of most consumers. Consumers would find themselves habitually aligned in their grocery/petrol shopping with one alliance or the other. This is likely to impose travel and preference 'costs' on a significant proportion of them. Finally, as a duopolistic structure emerges, it is not clear even discounted prices will be lower than prior to such alliances establishing themselves.

That said, this outcome may not arise. The shifts in market share may be temporary and consumer preferences for particular chains may be stronger than any incentive to the contrary given by shopper docket schemes. In this case, the schemes will be relatively short lived. The main danger for competition arises as those schemes persist and expand in both size of discount and breadth across Australia.

5 Where the ACCC Erred

The ACCC has evaluated the shopper docket schemes. In the late 1990s, the ACCC approved Woolworths' entry into petrol retailing with Petrol Plus; fully-owned outlets of the supermarket chain that offered petrol discounts in return for Woolworths shopping receipts. The ACCC saw this development as a significant boost for independent entry into petrol retailing.

In 2003, the ACCC evaluated the Coles/Shell scheme in the context of third line forcing notifications and the Woolworths/Caltex arrangements as a joint venture. Some of the criterion for evaluation differed because of the differing governance arrangements of the two schemes – Coles and Shell remained independent while Woolworths and Caltex operated the scheme through a joint venture in Australian Independent Retailers (AIR). Nonetheless, many of the issues considered by the ACCC were similar.

The third line forcing claim is instructive. This issue potentially arises whenever two independent firms offer pricing discounts, vouchers or other bundled arrangements. In evaluating this, the ACCC will have regard to both negative competitive effects as well as potential public benefits that may offset these.

The ACCC saw the main detriment of these schemes falling on independent retailers; something consistent with the analysis in Section 3 above. However, they did not regard this is a key concern as it was, in their view, the result of competitive pressure and that there was on-going rationalisation in the industry in any case. In addition, the ACCC concluded that any price rise that would occur in groceries as a result of the scheme would be limited by competition in that sector. This is, of course, in distinct contrast to the analysis in Section 3 (something I comment on below).

The ACCC approved the scheme ultimately because it saw two potential benefits. First, it argued that petrol prices for consumers would be lower for both Shell and Caltex but also others as they respond. Second, the ACCC saw the potential for an increase in non-price competition as other retailers responded with their own schemes to attract consumers.

In making these claims, the ACCC applied what is termed the 'future with and without' test. This requires looking at the proposed conduct and assessing its outcomes with what would otherwise occur. In so

doing, it looked at a world with and without shopper docket schemes. In this regard, given the analyses in Sections 3 and 4, I believe the ACCC has only partially considered the full impact on consumers. Moreover, I am not at all sure that the 'without' part of the test should be a counterfactual exercise in terms of a world without shopper dockets. As I have already noted above, shopper dockets can be introduced with or without exclusivity and by integrated and non-integrated firms. Consequently, had the ACCC compared the current exclusive arrangements with alternative non-exclusive arrangements that could have been put in place, it would likely have reached a different conclusion as to their desirability. In what follows, I explain each of these points in more detail.

5.1 Is it really a discount?

The ACCC treat the shopper docket scheme as if it is offering consumers a real discount. What this neglects, however, is that if headline prices of groceries or petrol change, the 'discount' may quickly evaporate (see Gans and King, 2003).

On one level, this issue was considered by the ACCC:

> It was contended by some interested parties that petrol discount schemes would mean some corresponding increase in the price of groceries. The ACCC is satisfied that competition the retail supply of groceries would constrain the ability of grocery retailers to do this. Consumers tend to be very conscious of price competition when shopping for petrol and groceries, and will shop around for the best deals. (ACCC, 2004, p.46)

Upon closer examination, the ACCC's conclusion is not valid. Consider a situation where grocery competition was fierce and consumers shopped for the best price. A savvy consumer who intended to purchase petrol at Shell, for example, would bear up to $2 more in supermarket checkout bills before switching away from Coles to another chain. If there were sufficient numbers of Shell customers around, then Coles could – especially in a competitive market – get away with charging a higher price.

The ACCC then go on: "The ACCC considers that any detriment arising in the petroleum markets as a result of the notified conduct will be limited." (p.46) But in this case, the homogeneity of petrol products makes adverse price changes more likely. A consumer with a shopper docket will go to a Shell or Caltex outlet (as the case may be) over another petrol outlet even if the pump price was up to 4 cents

higher at Shell or Caltex. If there are sufficient numbers of Coles and Woolworths customers, then Shell and Caltex outlets will be able to raise headline prices – despite competitive conditions – and not lose many sales. In such a low margin business, there is a clear incentive to do this.

To be sure, the precise price rises under the current schemes are difficult to pin down. However, a petrol discount makes price rises possible in both groceries and petrol despite any strong price competition that may or may not exist. To simply dismiss the possibility suggests a very cursory economic analysis. Moreover, the greater the petrol discount offered, the more likely headline prices will rise. Thus, there is considerable danger that further petrol 'discounting' could bring price rises that harm a sizeable segment of the consumer population.

In reaching this conclusion, it is important to contrast this outcome with a situation where, instead, petrol stations offered a discount if purchases were made at their own convenience stores. In this situation, when someone comes to purchase petrol, the outlet can boost competition from convenience stores in the overall grocery market. In this case, because the products are related from a consumer perspective (i.e., the co-location makes them convenient) encouraging that behaviour is the interests of the firms involved and in the interests of competition. However, as noted earlier, this type of relationship is not part of the current schemes.

In my opinion, it is not appropriate to lump shopper docket schemes in the same class as petrol-grocery co-location. The latter yields a real consumer benefit and is a product innovation while the former is merely a form of pricing without apparently the creation of any new consumer benefit.[10]

5.2 Exclusivity

As noted earlier, a distinguishing feature of the shopper docket schemes is their exclusivity. It is not necessary for such agreements to be exclusive if the goal is to merely link petrol discounts with grocery purchases. Metcash's offer demonstrates this.[11] However, in its

[10] See Chen (2004) for a discussion of market innovations and their social costs.

[11] The ACCC (2004, p.45) claims to have 40 other similar petrol-grocery schemes notified to it since 1996. It is not clear if any of these other arrangements are exclusive or not.

analysis, the ACCC makes no mention of this and draws no distinction between exclusive and non-exclusive arrangements.

This lack of distinction is a serious omission. The above concerns I have expressed about the welfare implications of these schemes are related wholly to exclusivity. The costly changes in consumer behaviour to take advantage of the schemes, the potential rise in headline prices, as well as the impact on non-allied chains in both markets all arise because of the exclusive nature of the arrangements. Had Coles or Woolworths followed the Metcash path in providing a link between petrol and groceries, there may have been some headline price changes but from a consumer perspective net prices would have fallen. Only those consumers who purchased groceries and did not drive might be potentially harmed. However, this type of distributional concern arises from other decisions as well, such as discounts on bread or nappies to attract shoppers.

In my opinion, it is critical for the ACCC to consider carefully the details of shopper docket arrangements before clearing them. It did not ask: what if these schemes were non-exclusive? It did not require the participants to be open to approaches by others for similar schemes, in the same way it might open up a telecommunications network for use by other firms. In its written decision, it has not raised the issue of exclusivity at all. Given that the potential detriments are much higher for exclusive schemes than non-exclusive ones, this is very problematic and also unfair to those innovative firms developing non-exclusive schemes.

To be sure, the main issues with regard to exclusivity also arise because of the high market shares – in terms of installed outlets – of Coles and Woolworths. The two issues go hand in hand. As noted earlier, an exclusivity arrangement is unlikely to be valuable or result in serious competitive harm, when undertaken by two firms, each of whom has limited market share or market power in their respective industries.

5.3 Integration Matters

The final matter the ACCC failed to consider at all was that in these types of schemes integration matters. The ACCC likened the shopper docket schemes in Australia to ones implemented in the United Kingdom by J Sainsbury, Safeway and Morrisons. It is my understanding that in each of these cases the supermarket operates the petrol retailer and they are commonly owned. In contrast,

although Woolworths and Caltex are operating a joint venture, prices in each of the schemes are set independently.

Gans and King (2004a) considered the integration case. An integrated firm has a more limited incentive to introduce a shopper docket scheme than a pair of non-integrated firms. Put simply, in the non-integrated case, the discount is an imperfect way of controlling the pricing decisions of petrol and grocery chains that are related by the shopper docket scheme. In contrast, this advantage is not present for the integrated case and so the petrol discount acts more like a straight rebate. As such, for an integrated firm it intensifies rather than reduces price competition. In the end, shopper dockets schemes by an integrated firm will result in a lower petrol discount, lower headline prices but a higher market share for the integrated firm than they would earn if they were implementing the same scheme as non-integrated firms.

As such, in this situation, integration that allows explicit price coordination between the petrol retailing and supermarket chain, creates fewer social costs than the same scheme implemented by non-integrated chains. However, the ACCC does not appear to distinguish – in an economic case – the degree of integration. Again, this is an omission that unfairly lumps pricing innovations within a single firm with those operating between independent firms.

5.4 Summary

The ACCC's analysis of shopper docket schemes is seriously incomplete. Specifically,

- The ACCC fail to consider the full extent of price changes that might occur as a result of shopper docket arrangements.
- The long-term implications of the scheme on entry and competition as a result of the exclusivity of those arrangements.
- The greater harm that potentially results from shopper docket schemes implemented by independent as opposed to integrated firms.

Nonetheless, there is a sense in which the ACCC's evaluation is consistent with its guidelines on third line forcing (ACCC, 1998). In those guidelines, the ACCC suggests that, unless there is a consumer-level transparency issue – that bundled discounts that are similar to

the shopper docket schemes would be unlikely have an anticompetitive concern.

That said, in the case of the shopper docket schemes here, the ACCC's arguments for offsetting public benefits are, at best, weak and, in my opinion, probably wrong and overly simplistic. As such, I am not convinced that they should have been given clearance. At a minimum, a more thorough investigation of the potential competitive concerns is needed as well other public detriments (e.g., increased travel time) that may result. Only by doing this might the ACCC identify undertakings that might be given by allied chains to minimise these adverse impacts.

However, there is also a sense in which the guidelines themselves may not be correct. The schemes here do have the potential to create anti-competitive harm. Indeed, I can think of no better example of the type of discounting conduct envisaged in the third line forcing provision of the *Trade Practices Act*, than the current petrol-grocery shopper docket schemes. Put simply, if those provisions weren't meant to capture this conduct – exclusive bundles of unrelated products by firms with some degree of market power – what conduct would be captured? At present, the ACCC appears to argue that only tying provisions,[12] whereby a consumer is forced to purchase from both firms, would be third line forcing against the public interest. This approach appears to me to significantly weaken the intended force of our current trade practices legislation.

[12] See also Tirole (2004).

References[13]

ACCC (1998), *Guide to authorisation and notification of third line forcing conduct* (www.accc.gov.au).

ACCC (2004), *Assessing shopper docket petrol discounts and acquisitions in the petrol and grocery sectors*, 6th February (www.accc.gov.au).

Chen, Y. (2004), "Marketing Innovations," *mimeo.*, Colorado.

Gans, J.S. and S.P. King (2003), "Petrol deals a blow to the average consumer," *Australian Financial Review*, 20th August.

Gans, J.S. and S.P. King (2004a), "Paying for Loyalty: Product Bundling in Oligopoly," *Working Paper*, No.2004-08, Melbourne Business School, Melbourne.

Gans, J.S. and S.P. King (2004b), "Supermarkets and Shopper Dockets: The Australian Experience," *Australian Economic Review*, forthcoming.

Gans, J.S. and S.P. King (2004c), "Potential Anticompetitive Effects of Bundling," *Australian Business Law Review*, forthcoming.

Nalebuff, B. (2004), "Bundling as an Entry Barrier," *Quarterly Journal of Economics*, Vol.111, No.1, pp.159-187.

Tirole, J. (2004), "The Analysis of Tying Cases: A Primer," *mimeo.*, IDEI/Toulouse.

[13] Many of these papers can be downloaded from www.core-research.com.au.

MOTOR TRADES ASSOCIATION OF AUSTRALIA

SMALL BUSINESS CHARTER OF FAIRNESS

1. The establishment of a Federal Parliamentary inquiry into market concentration.

2. The introduction of measures within the Trade Practices Act to address 'creeping acquisitions'.

3. The imposition of criminal sanctions for breaches of the price fixing provisions of the Trade Practices Act.

4. The introduction of an unfair business-to-business contracts regime.

5. The strengthening of section 51AC (unconscionable conduct) of the Trade Practices Act to proscribe 'take it or leave it contracts' and the termination of contracts at will without just cause.

6. The application of the Trade Practices Act to all government agencies where they engage in commercial activities.

7. Access to justice for small business.

8. The amendment of the Objects clause of the Trade Practice Act (Part 1 - Section 2) to include reference to small business and competitors.

9. The introduction of cease and desist orders for the Australian Competition and Consumer Commission and of a divesture penalty for the misuse of market power.

10. The strengthening of the Franchising Code of Conduct.

WHY A CHARTER?

The Motor Trades Association of Australia (MTAA) is the largest 'stand-alone' small business association in Australia, representing over 100,000 small to medium retail motor trade businesses with a combined turnover of over $120 billion, employing over 316,000 people. MTAA believes that a viable small business sector is essential if Australia is to sustain a competitive market at home and abroad. This Small Business Charter of Fairness aims to address the unfair and anti-competitive behaviour undertaken by big business in its relations with small business. To assist in that MTAA supports the appointment of a Small Business Advocate to ensure that the interests of small business are better represented to the Australian Government.

The relentless pursuit of the National Competition Policy objectives has resulted in an ever increasing concentration of business in the hands of big corporations in key sectors of the Australian economy. This has resulted in a gross imbalance of market power in favour of big business at the expense of family-owned small businesses. MTAA believes that National Competition Policy should recognise that we live in a society not just in an economy. Public interest should therefore be the sole determining factor for any decision relating to National Competition Policy.

MTAA believes that the adoption of the following recommendations would be a positive step towards securing a fairer and more competitive trading environment for all businesses, both big and small.

1. The establishment of a Federal Parliamentary inquiry into market concentration.

Several important markets in Australia are highly concentrated, with a small number of large companies dominating particular markets. This is the case in retail, petroleum and liquor markets in particular. Highly concentrated markets can be less competitive and this is not in the long-term interests of consumers. The Federal Government needs to conduct a Parliamentary inquiry into this issue to consider ways at overcoming the negative effects of market concentration for small business and consumers. The inquiry should also consider whether there is price discrimination in those markets and if so what might be done to overcome any negative effects of such conduct.

2. The introduction of measures within the Trade Practices Act to address 'creeping acquisitions'.

The current merger law does not generally cover 'creeping acquisitions'. Continued small acquisitions can over time lead to a substantial lessening of competition within a market. The Trade Practices Act should be amended to allow the ACCC to adequately address the issue of 'creeping acquisitions' to ensure that small acquisitions over time by one corporation do not substantially diminish competition.

3. The imposition of criminal sanctions for breaches of the price fixing provisions of the Trade Practices Act.

The imposition of financial penalties does not sufficiently deter corporations from engaging in price fixing. Considering the negative impact that price fixing and other collusive behaviour has on small business and the Australian community, criminal sanctions, including jail terms, must apply to individuals where corporations engage in such behaviour.

4. The introduction of an unfair business-to-business contracts regime.

Some business-to-business contracts contain clauses, such as unilateral variation, unreasonable rent escalators and termination clauses where no breach is necessary, which tend to favour one party over another and thus giving one party an unfair advantage under the terms of the contract. An unfair contracts regime should be introduced which would provide that unfair clauses within a contract would be deemed null and void; but the contract would remain on-foot. The ACCC should be given the power to where necessary review and if appropriate rewrite contracts which it considers to be unfair.

5. The strengthening of section 51AC (unconscionable conduct) of the Trade Practices Act to proscribe 'take it or leave it' contracts and the termination of contracts at will without just cause.

Too many small businesses are subjected to unfair business practices, including the use of 'non-negotiable' contracts and termination of contracts at will without just cause. Section 51AC should be amended to proscribe these practices.

6. The application of the Trade Practices Act to all government agencies where they engage in commercial activities.

In order to maximise fairness in the trading environment, it is important that all government agencies are subject to the provisions of the Trade Practices Act in the same way as private corporations.

7. Access to justice for small business.

To ensure that small businesses have affordable access to the protection and remedies available under the Trade Practices Act:

* the jurisdiction of the Federal Magistrates Court should be extended to deal with contraventions of Part IV of the Trade Practices Act including misuse of market power, contravention of industry codes and unconscionable conduct matters; and
* the ACCC should be able to seek compensation for victims of breaches of the Trade Practices Act so that individuals don't have to take their own action and there should also be effective and inexpensive scope for victims of breaches of the Trade Practices Act to use sections 82 and 83 of the Act following successful prosecutions by the ACCC.

8. The amendment of the Objects clause of the Trade Practices Act (Part 1 – Section 2) to include reference to small business and competitors.

The important role of small business and competitors in our society is not adequately recognised in the Trade Practices Act. Therefore the Objects clause of the Trade Practices Act should be amended to read: "The object of this Act is to enhance the welfare of all Australians through the promotion of competition and fair trading and provision for consumer protection in order to ensure that all enterprises, including small business, have an equitable opportunity to participate in the Australia economy and to recognise that competitors provide consumers with competitive prices and product choices."

9. The introduction of 'cease and desist' orders for the Australian Competition and Consumer Commission and of a divestiture penalty for the misuse of market power.

The Trade Practices Act should be amended to enable the ACCC to issue 'cease and desist' orders and to enable the courts to order divestiture of relevant assets where a corporation is found to have breached the misuse of market power provisions or any new section introduced to regulate creeping acquisitions.

10. The strengthening of the Franchising Code of Conduct.

The Franchising Code of Conduct needs to be strengthened so that it adequately addresses issues such as minimum tenure, the universal coverage of franchise agreements, and to proscribe the termination of franchise agreements at will without due cause. The dispute resolution process under the Code should also be amended so that it allows 'class-type' actions and provides that parties to a dispute must mediate in good faith. The definition of a franchise agreement under the Code should also be reviewed.

MOTOR TRADES ASSOCIATION OF AUSTRALIA

Motor Trades Association of Australia

Australian Automobile Dealers Association

Service Station Association Ltd

The Motor Trades Association of the ACT

The Motor Traders' Association of NSW

The Motor Trades Association of the Northern Territory

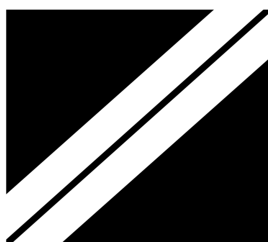
The Motor Trade Association of South Australia

The Motor Trade Association of Western Australia

The Victorian Automobile Chamber of Commerce

The Tasmanian Automobile Chamber of Commerce

Authorised by Michael Delaney
Motor Trades Association of Australia
PO Box 6273, Kingston, ACT, 2603
Telephone: (02) 6273 4333 Fax (02) 6273 2738



Motor Trades Association of Australia

Mr Graeme Samuel
Chairman
Petrol Price Inquiry
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Dear Mr Samuel

This submission to the ACCC's Petrol Price Inquiry has been prepared by the Motor Trades Association of Australia (MTAA).

Introduction

MTAA is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association is a federation of the various state and territory motor trades associations and automobile chambers of commerce, as well as the New South Wales based Service Station Association Ltd (SSA) and the Australian Automobile Dealers Association. Members of the MTAA Federation include:

- the Australian Automobile Dealers Association (AADA)
- the Motor Trades Association of the ACT (MTA ACT)
- the Motor Traders Association of NSW (MTA NSW)
- the Motor Trades Association of the Northern Territory (MTA NT)
- the Motor Trade Association of South Australia (MTA SA)
- the Motor Trade Association of Western Australia (MTA WA)
- the Service Station Association Limited (SSA Ltd)
- the Victorian Automobile Chamber of Commerce (VACC) [incorporating the Tasmanian Automobile Chamber of Commerce]

MTAA also has a number of Affiliated Trade Associations (ATAs), which represent particular sub-sectors of the retail motor trades, ranging from motor vehicle body repair to automotive parts recycling and relevantly for this Inquiry the Australian Service Station and Convenience Store Association (ASSCSA). MTAA represents the interests, at the national level, of over 100,000 retail motor trade businesses with a combined turnover of over $120 billion and which employ over 316,000 people. The vast majority of businesses represented by MTAA employ five or less people.

MTAA has had a long history of engagement with the issues associated with the retail petroleum sector, including petrol pricing. MTAA/ASSCSA represents, nationally, single site franchises, multi-site franchises, commission agents, branded independent operators and unbranded

Motor Trades Association House, 39 Brisbane Avenue, Barton ACT 2600
PO Box 6273, Kingston, ACT 2604
Telephone: + 61 2 6273 4333. Facsimile: + 61 2 6273 2738.
Email: mtaa@mtaa.com.au A.B.N. 66 008 643 561

independent operators. As a consequence of that representative role, the Association has a strong interest in matters relating to the price of petrol in Australia and has been actively involved in petroleum industry policy development for many years. This involvement might be evidenced by the number of submissions the Association has made to a number of fora that have conducted inquiries into the petroleum industry and pricing over the years; some submissions and executive summaries of others are attached to this submission at Attachment 1.

In this submission, MTAA intends on providing a broad view on petrol pricing based on its long involvement in petroleum policy debates and on information provided by its Members. The Association appreciates that there are other parties to the inquiry that possess more detailed specialist knowledge of each of the main areas of the inquiry's focus. Much of the detail sought by the ACCC in its Issues Paper is probably more appropriately and accurately provided by those other parties. However I have addressed a number of the points raised in the Commission's Issues paper and MTAA's views on those are set out below.

Import Parity Pricing and Singapore Benchmark

Australia introduced import parity pricing for all Australian-produced crude oil in August 1978. At that time it was said that import parity pricing was being introduced to encourage energy conservation, oil exploration in Australia and the development of alternative energy sources. It has also been argued that import parity pricing is needed to avoid potential fuel shortages in Australia as, without it, international prices may be higher than Australian prices and Australian refiners may, therefore, have an incentive to export their refined product overseas. Similarly, international refiners might, in the circumstances described, also have no incentive to export petroleum products to Australia. MTAA continues to support import parity pricing; but not on its present terms.

Singapore, as I understand, was chosen as the relevant price benchmark because at that time it was the major trading centre in Asia for petroleum products the most likely source of fuel imported into Australia and the closest major refining centre to Australia. While MTAA understands the reasons behind the use of import parity pricing, and the reasons leading to the Singapore price having been chosen as the benchmark, the Association has for some time held the view that the continuing appropriateness of the Singapore price as the Australian benchmark needs to be evaluated. There are a range of reasons for this, which in the main are concerned with more recent changes to Australian fuel standards, and the development of new refineries in Asia.

It is unclear to MTAA as to whether or not, or to what extent, Australia's introduction of fuel standards has been a factor contributing to increases in fuel prices in recent years. Some of the Association's Members are of the view, however, that the changes in Australian fuel standards that disallowed the use of Methyl Tertiary Butyl Ether (MTBE) may have removed the source of supply for viable importation of unleaded petrol by independent fuel suppliers. It should be recorded though that MTAA supports the Australian fuel standards on environmental and social grounds.

If Australian fuel standards do inadvertently create difficulties in sourcing fuel from overseas refiners, the volumes of fuel imported might suggest otherwise. It must be acknowledged, though, that the volumes of fuel imported represent about 25 percent of all Australian fuel sales and it is imagined that in terms of overseas refiners that the quantity of fuel produced by them meeting Australian import demands and fuel standards might not comprise a significant portion of their overall refining output. Production cost efficiencies according to scale could then become a

consideration. It might also be possible for there to be a number of refineries in other parts of Asia that are now capable of providing the Australian market with the fuel specification it requires.

Both of these aspects infer the need to re-evaluate whether the Singapore benchmark remains appropriate, or if there has been the development in the intervening years since parity benchmarking first commenced, within the Asia Pacific region, of a refining centre that better represents the circumstances appropriate for Australia's position in the market and its fuel import needs in terms of quantity and fuel standards. It might even be the case that the benchmark standard chosen employs an average of a 'basket' of ULP prices from around the Asia Pacific region – including Australia – thereby dampening any severe fluctuations in price that might be characteristic of any one nominated refining centre.

Imports of Fuel

An entity wishing to be an independent importer of fuel might need to overcome a range of challenges in order to establish a viable and competitive operation in Australia. MTAA understands that the majority of the infrastructure with the ability, or capacity, to be able to provide the services an independent importer might require is currently either owned or controlled by the major oil companies.

This control extends to aspects such as the locations at which fuel may be delivered at point of entry to Australia and access to the requisite tankage facilities. It is clear, therefore, that there would need to be either a massive investment made in those terms for an independent importation operation to be viable, or for there to be some form of regulatory control mandating a certain amount of tankage be made available for this purpose and for access to appropriate offloading and handling facilities to be made available under certain circumstances. This also suggests that the 'obstacles' that would need to be overcome for a truly independent fuel importer to establish operations in Australia would be considerable. The Association understands that there is a limited amount of independently controlled storage in Brisbane and Melbourne.

However the Association accepts that access to storage facilities alone will not be sufficient to sustain a viable independent sector. Importers need some certainty of distribution; in other words, access to retail outlets, at some scale. When considerations regarding available sources of fuel meeting Australian standards is added to this scenario, the 'obstacles' facing an potential independent importer become even more significant and, perhaps, insurmountable.

Competition in the Retail Petroleum Market

MTAA strongly supports the view that the best outcomes for consumers and society, are delivered by strong competition in the marketplace. To achieve this requires, however, a diversity of outlets/ownership with freedom of access to a number of competing and competitive suppliers. Another requirement, if this ideal is to be met, is for the market and its conditions to characterise a level playing field, and for the existence of stable and fair rules for activity between all parties. This latter aspect can be obtained through the operation of a strong Trade Practices Act, for which the MTAA has a long history of support and advocacy.

It is uncertain, however, if the retail petroleum market is one which exhibits characteristics aligned with this ideal. Superficial observations of the market might lead an observer to consider that this market offers a variety of choice to consumers, is highly competitive, and that it is under sufficient

scrutiny from a number of bodies as to render many of its functions transparent. The reality, in MTAA's view is quite different.

The retail petroleum market is highly complex, and in our view highly concentrated, lacking, at some levels, competition and transparency, is highly vertically integrated and it is at present questionable as to whether the best outcomes are being delivered to motorists. For example, while there appears to be adequate transparency in regards to retail pricing structures, the same can not be confidently said for wholesale pricing. Anecdotal evidence suggests that Terminal Gate Prices (TGPs) claimed by the major refiners may – in some manner – be 'contrived' by refiners so as to arrive at a particular market outcome in relation to purchasers from them. That is, TGPs may be set so as to 'encourage' franchisees, for example, not to move to the TGP arrangements available under the OilCode. Mandated TGP arrangements have not introduced either the wholesale pricing transparency or competition that the Australian market so requires. While MTAA is not privy to such information, it would be very interesting to note what proportion of fuel is sold at wholesale at the various posted terminal gate prices. MTAA suspects that a significant portion of fuel would be sold below the posted terminal gate prices.

Highly competitive markets also tend to be highly efficient markets. It might be argued, then, that the marked decline in the number of fuel retailers in past decades – from somewhere in the order of 20,000 in the 1970s to around 6,500 at the present – to be a market response from increased competition and efficiencies gains. While MTAA would agree that there was some need for a rationalisation of site numbers from the 1970s levels to allow for improvements in site throughput and scale of operations, anecdotal evidence suggests that there has been a marked decline in retail site numbers since the entry into, and increased prominence in, the market of the Coles / Shell and Woolworths / Caltex operations. It is this latter decline and the manner of it which concerns MTAA and its Members.

It is arguable that the entry of the supermarket chains into the retail petroleum industry has seen the development of market circumstances that place 'independent' fuel retailers at a competitive disadvantage - even collectively – in their dealings with the major oil companies. The entry into the market of Coles and Woolworths has seen a large concentration of market volume and market power fall into their control, along with a demonstrated willingness to exercise it on occasion. Independent operators have been removed from their position of price leaders, and now have to maximise their retail price to remain afloat. In effect, independent operators have become – in the main – price takers rather than price makers.

MTAA supports the views of its Member, the Service Station Association (SSA) that each supermarket company represents a large customer for its respective oil company supplier. The volume discounts that they are able to negotiate, therefore, are significant and larger than individual or small groups of independent fuel resellers are able to negotiate. Tied franchisees of course are completely unable to negotiate the terms of their supply arrangements and are thus 'price-takers'; irrespective of prices offered, by their supplier, to any other class of wholesale customer.

MTAA Members have observed circumstances in the market where the selling price, of a supermarket held site, for ULP, in a particular location was less than the posted TGP at which a nearby independent reseller could purchase at from the same fuel supplier. Circumstances such as these might suggest that the marked decline in independent fuel resellers since the entry into the market of supermarkets may be due less to matters of market efficiency and more to matters of simple viability and the exercise of market power by both the refiners and the supermarkets.

It ought to be hardly surprising, then, that as the Association understands matters, the two supermarkets' market share of petrol retailing has reached close to 50 percent; despite the fact that, combined, they account for only around 15 percent of the total number of sites in Australia. In a price-driven consumer market with a large uptake and utilisation of the 'shopper-docket' concept, it is understandable that the supermarket fuel retailers have attained such dominance in the market. It also reinforces, however, the difficulties involved for the non-supermarket aligned sites to be competitive on price. It has long been the Association's view that the supermarkets interest in petrol is not as a product itself, but because of the frequency and, mostly, necessity of its purchase, as a 'device' through which consumers' buying patterns can be influenced (that is, to ensure a greater flow of customers to their respective supermarket).

At Attachment 2 is a copy of a paper prepared for MTAA by Professor Joshua Gans on the shopper docket schemes.

MTAA records here its concern that shop-a-docket promotions which provide large discounts (up to 20 cents per litre) for motorists who purchase other goods (such as wine) from supermarket owned outlets are contributing to the decline in the numbers of retail sites. Non-supermarket branded retail outlets cannot compete against service stations where motorists can present a docket and secure up to 20 cents per litre off the price of the fuel. Either the supermarket outlets are making a substantial loss on those retail sales (and thus one would wonder how they remain in business; if not for cross-subsidisation) or the wholesale price paid by those sites is significantly lower than that available to franchised and independent operators. This distortion of the retail market is of real concern to the Association and is not in our view conducive of long-term sustainable retail competition.

Discount Cycles

One of the most frustrating elements of the retail petroleum market, for both retailers and motorists, is the price cycle and the difference (mostly significant difference) between the highs and the lows of the cycle. While MTAA supports competition, the opaqueness of wholesale pricing in Australia had lead to a system of selective retail price fluctuations and selective, at best, price support being provided by the oil majors, which confuses and frustrates both motorists and retailers. It is not clear to MTAA that motorists generally (as opposed to those 'locationally lucky' motorists) benefit from these price cycles.

Current Regulatory Regime

As is well know, the two Commonwealth Acts regulating the petroleum retail sector, the *Petroleum Retail Marketing Sites Act (1980)* and the *Petroleum Retail Marketing Franchise Act (1980)* were repealed on 1 March 2007 and a mandated (under the *Trade Practices Act 1974*) code of conduct for the oil industry (OilCode) was introduced. MTAA, has to date, been particularly disappointed with the operation of the OilCode. It is far from clear that the terminal gate pricing regime has increased transparency in the market and it most certainly has not proved to be an attractive or competitive alternative wholesale pricing arrangement for franchisees. Anecdotal reports to the Association indicate quite some concern about the manner in which at least one oil company has approached the dispute resolution process.

In addition the Association has significant concerns about some of the fundamental elements of OilCode, such as the tenure provisions and the lack of ability to address in either the OilCode or the Trade Practices Act the concerns about pricing behaviour mentioned earlier in this submission.

Conclusion

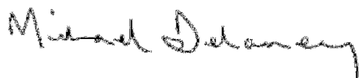
In summary it is a fair assessment that can be made that the theory of a fair an equitable playing field in the retail petroleum sector is, simply, and no more than, a theory. The four major oil companies in Australia control virtually the entire infrastructure and distribution network for the retail fuel market. In addition, Shell and Caltex combined with their supermarket partners' control (based on industry estimates) about 75 per cent of the retail market (by volume). This leaves the remainder of the retail market to be shared by Mobil (which in recent years has reduced its retail presence), BP and independent operations. However because the level of independent imports is relatively low, in reality the influence on the market of the four refiners is substantial.

In conclusion, MTAA is unsure if the Singapore benchmark price remains appropriate in light of the changes in Asia Pacific refining capacity since its introduction and the volumes of fuel imported compared to refining output. The Association suggests there to be the need to evaluate other regional markets with a view to identifying if there may be a more appropriate benchmark.

MTAA fully supports the sentiments expressed in the submission made to this inquiry by the SAA. In essence, that submission provides a very accurate depiction of the realities facing independent operators in the market as it currently operates. The SSA submission also provides an accurate assessment of the impact upon the market that has resulted as a consequence of the supermarkets' entry to it.

I would be happy to clarify any issues raised in this submission.

Yours sincerely



MICHAEL DELANEY
Executive Director

27 July 2007