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Mergers & Market Power
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Mergers and Big Business

The Australian Competition and Consumer Commission has persistent critics who claim that merger policy is harming the Australian economy. It is a policy, they argue, that it is driving company headquarters offshore and preventing the development of large Australian companies that, in the words of one commentator, can "punch above their weight" on the Australian market and beyond.

Let me begin with two very pertinent points. First, the Commission is not anti-merger. Second, strong merger law is essential to the development of strong, internationally competitive Australian companies. I want to spend some time on both these points.

In regard to the Commission's supposed anti-merger bias, the fact is that it only opposes those mergers, which lead to a substantial lessening of competition. Very few have this effect.

In 1997-98 the Commission reviewed 176 mergers and opposed five. It was a similar story the following year: 185 mergers and seven opposed. Last financial year, 1999-2000, the figures were 208 and four. It is hardly a tale of outright rejection or a vendetta against big business.

The virulence and persistence of the attacks on the Commission raises the question of motive. Do the attackers want the unfettered right to establish monopolies so they can dominate the market and, by raising prices, earn greater profits? This may bring cheers from CEO's and some shareholders but not necessarily from consumers or other companies that buy inputs from the monopolies. Australia is far from alone in its interest in mergers and the Commission's critics should realise that governments worldwide have created strong laws to prevent the creation of cosy cartels. They have also empowered strong anti-trust agencies to enforce laws to protect consumers and small business from anti-competitive mergers.

If the big business critics were serious about promoting the development of large internationally competitive Australian companies it would acknowledge the benefits of competition. Would Australia's big companies be internationally competitive if they had to secure their raw materials, such as coal and petrol, from a monopoly supplier? How would they fare if they had to export their goods through a monopoly transport company and raise finance from a monopoly bank? Would they be better off if they purchased their products from a monopoly retailer, "Colesworth"?

The firms the big business represents are the major winners from more competitive markets. Strong domestic competition has lowered their costs and enabled them to compete internationally.

National Champions

It is claimed that if we don’t change the merger provisions of Section 50 of the Trade Practices Act then Australian companies will be prevented from reaching a size big enough to compete in global markets. Some of you will have heard this called the "critical mass" or "national champion" argument.

One response to the national champion argument is that obstacles to export growth are not necessarily overcome by firms developing dominance in the domestic market or foreign market entry. A certain size is not a prerequisite to export success, a fact often demonstrated by the overseas success of moderate-sized and even small Australian firms. Observers of the rural economy following the dismantling of compulsory marketing schemes have noted the drive and initiatives of rural cooperatives and individual farmers.

Interesting data from the Australian Bureau of Statistics shows that between 1994-95 and 1997-98 the value of export revenue earned by small firms (less than 20 employees) rose by an annual average of 15 per cent while for medium firms (20 to 200 employees) exports increased by an average 5.1 per cent. For large firms, there was a slight decline of 0.2 per cent.

Here are several examples of smaller companies achieving great export success. Cowan Manufacturing at Warners Bay NSW, supplies recompression chambers to export markets including the United States navy This year it expects to double exports to around $1.2 million. Compumedics makes computer based medical monitoring and diagnostic equipment at its Melbourne plant. Last year it earned $7 million on export markets. Perini & Scott Masterman is a small Sydney firm supplying electrical control systems for cranes. Its exports of $2 million constitute approximately two thirds of its annual turnover.

This is not to dispute the fact that large firms earn the bulk of export income. But the figures do show that exporting is not the exclusive preserve of big business and that small and medium sized firms can be and are very successful exporters.

Being Internationally Competitive

Domestic rivalry is the critical factor in export success. It is more important than rivalry with foreign competitors because strong domestic competitors create highly visible pressures on each other to improve. Domestic firms are under pressure to export so they can grow. There is also pressure to innovate.

The research by Professor Michael Porter in his study the Competitive Advantage of Nations strongly supports the view that the key to success in foreign markets is exposure to, "blooding" in domestic markets.

Where local companies have faced significant import competition the Commission has not opposed mergers. Take the following example: Email’s acquisition of Southcorp’s whitegoods manufacturing facilities. In this case, the presence of imports was sufficient to alleviate any competition concerns.

Here is another: in November1993 the Commission did not oppose the acquisition by Amcor Ltd. of Associated Pulp and Paper Mills Ltd. despite the fact that it made Amcor the only domestic manufacturer of paper (other than newsprint) and gave it ownership of four of the five largest paper merchants in Australia. The Commission, after extensive inquiries, concluded that strong import competition at the manufacturing end of the market put substantial downward pressure on prices.

Amcor argued that it needed the acquisition to achieve economies of scale. But later, it appeared to negate its own argument by splitting into two companies; Amcor took the packaging manufacturing assets, PaperlinX took the paper assets.

When PaperlinX proposed the acquisition of the fine paper firm, Spicers, it was considered likely to lessen competition in the supply of fine paper. However, PaperlinX overcame the Commission’s concerns by undertakings that included the divestiture of two paper merchant businesses, Edwards Dunlop and Commonwealth Paper.

Often a merger is allowed to proceed if undertakings are given. Without the undertakings the Commission will seek to stop the merger proceeding. In May last year the Commission decided not to oppose the acquisition of Colonial Limited by the Commonwealth Bank subject to significant undertakings to minimise any decline in competition.

It is possible to satisfy merger ambitions by applicants amending the original proposal. There is the example of the merger between British American Tobacco’s Australian subsidiary WD and HO Wills and Rothmans. With only three cigarette manufacturers in Australia (the other being Philip Morris) and imports accounting for less than one per cent of the market, the initial ACCC reaction was "no". The two companies responded by selling 17 % of their combined brands to Imperial Tobacco, which became a strong competitor on the Australian market. The merger went ahead with no resort to the courts and increased market competition.

Whatever the claims of by big business, the merger provisions of the Act are not an obstacle to firms achieving a size that will bring the economies of scale needed to be internationally competitive. The key is that there must be public benefits.

In deciding whether to authorise a merger the Commission considers all the potential public benefits. Under the Trade Practices Act, public benefits are specified as a significant increase in the real value of exports and significant import substitution. The Commission must also take into account all relevant matters relating to the international competitiveness of Australian industry. They include where a proposed merger would have an adverse impact on the ability of smaller companies to expand or develop export markets.

The authorisation provisions of the Act are available to those firms that want to ensure international competitiveness through acquisition. A merger can be authorised despite that fact that it will lessen competition providing there are compensating public benefits. Since 1993, the Act has explicitly stated that export generation, import replacement or contributions to the international competitiveness of the Australian economy are public benefits.

I believe the Commission can clearly demonstrate that the Trade Practices Act is not a barrier to company growth. However, this has not stopped the Business Council trying to water down merger law at every opportunity. The latest tactic is to claim that Australia will develop a branch office economy as firms shift head offices off shore.

Moving Offshore

It’s inevitable that more Australia companies will move offshore. Afterall, we have moved into the era of globalisation. But I would like to point out that the company names supplied to the media by BCA sources, as likely to decamp for overseas have had few problems with the Commission. They include BHP that acquired New Zealand Steel without objection from the Commission, AMP that acquired GIO, NAB that acquired MLC. Brambles and Lend Lease have never had a merger blocked. Pioneer is also mentioned but it never put any proposal to the Commission to acquire CSR, despite the issue being raised around 1995.

Preventing mergers, it is claimed, will force companies to re-locate overseas. There is no evidence that companies have been forced overseas because the Commission knocked back their mergers.

There are a variety of reasons why firms go offshore and merger policy is at the bottom of the list. A major reason for decamping is taxation policy, others are the need to get closer to your customers and that gaining market entry may be difficult for offshore suppliers.

There is another claim, namely that many company chiefs, who would like to merge, will not come forward because they fear an inevitable knockback. The figures on mergers I mentioned earlier put paid to this. With a rejection rate of less than five per cent of the mergers considered, arguments that companies will not come forward are clearly wrong. In addition, we know that the CEOs of large firms are not shrinking violets. If they are interested in a merger they will quickly sound out the Commission in one way or another.

Quick Decisions

It has been claimed that it takes too long to have a merger proposal assessed. The Commission normally deals with most merger applications within a period of four weeks with some complex applications taking around six to eight weeks. We do not let merger decisions take more than eight weeks. In addition, applications for the authorisation of mergers must be considered within 30 days; or 45 days if the merger is complex. There is, however, a right of appeal to the Australian Competition Tribunal, which effectively has no time limit.

Frankly, I regard these time periods as fairly short. Evidence indicates that they compare very favourably with the time taken by overseas competition agencies to consider merger applications. When you consider that merger plans can be hatching for years, up to six-week or so for a decision from the Commission is not a long period .

An important point for business is that if it provides early confidential advice about a merger well before it becomes public the Commission can normally deal with it much more quickly once it becomes public.

The Big Business Agenda

In general, the big business's agenda over the years has been to weaken and water down the merger law at every opportunity. Some CEOs want a soft merger law others want no law even if this means an economy made up of monopolies that cannot compete internationally. However, the big business agenda receives little or no support and often strong opposition from small business.

The impact of anti-competitive mergers and joint ventures can be profound with costs to the economy such of a loss of consumer welfare and an adverse impact on the costs of affected industries. It must be kept in mind that once industry structures are in place, they are difficult to alter and may lead to higher prices, lower quality, poor service and a dearth of innovation.

A merger might create in certain cases supply bottlenecks for smaller companies and may restrict market entry or access to crucial facilities. Third parties must have access to supplies at a competitive price.

Merger Guidelines

Australia's CEOs would be aware of the Merger Guidelines that streamline the process of informal consideration to reduce costs and the regulatory burden.

The Guidelines do not bind the Commission but indicate what it considers important in decision making.

In examining proposals the Commission assesses market concentration ratios and will examine the matter further if the combined market of the four largest firms is greater than 75 per cent and the merged firm will supply at least 15 per cent of the relevant market. Alternatively, if the merged firm will supply 40 per cent or more the Commission will give the merger further consideration.

The potential or real import competition is considered an important factor because of the globalisation of markets. If import competition is an effective check on the exercise of market power, it is unlikely the Commission will intervene in a merger. The Commission has not rejected any merger where imports, independent of the merged parties, have been sustained at more than 10 per cent of the market.

Barriers to market entry are examined. If there are no significant barriers to new entry, incumbent firms are likely to be constrained by the threat of entry and behave as if the market is competitive. A concentrated market often indicates high barriers to new entrants.

We also look at "other factors" including whether the merged firm will face countervailing power in the market, whether the merger will remove a vigorous and effective competitor or whether the merger is pro or anti - competition.

Globalisation and Mergers

In applying the guidelines, the Commission recognises that many Australian firms operate in a global environment and must consider the global competitive conditions applying in Australian markets. Domestic mergers of Australian firms have not been opposed where there is a clear and identifiable constraint from offshore.

The Commission has taken action to prevent anti-competitive effects of an international merger surfacing in Australia. However, this does not mean the merger is always blocked. Take the case I gave earlier of the W.D. and H.O. Wills takeover of Rothmans. This was approved when some brands were sold to a third party. But the proposed acquisition of Schweppes soft drink brands by Coca-Cola did not proceed because the merged entity would have commanded over 70 per cent of the Australian soft drink market and the undertakings offered did not meet our concerns.

The Consumer

The Trade Practices Act specifies that it is our role to "enhance the welfare of Australians through the promotion of competition and fair trading and the provision of consumer protection".

The consumer whether a household or a small business consumer is rarely in the forefront of the minds of those proposing mergers. What may be foremost in their minds is market domination, which can mean charging higher prices to consumers and paying less to suppliers.

The Commission's relationship with big business is at times tense because it is there for the benefit of consumers and the public and indeed of the business community itself because it stands to lose from an uncompetitive economy.

Concluding Remarks

The anti-competitive conduct provisions of the Trade Practices Act, including the merger provisions, are an attempt to enact economics as law. For this reason, interpretation of the Act is always going to be somewhat controversial and the Commission's decisions on some mergers will attract criticism and debate.

What should be remembered is that the Commission is the administrator and enforcer of an Act of Parliament introduced to protect the public against anti-competitive forces. The Courts are the final arbiters on whether breaches of the Act have occurred. Further, the Commission's authorisation decisions can be appealed to the Australian Corporation Tribunal. There are ample safeguards for businesses who disagree with the Commission, in terms of appeal rights to courts and the Australian Competition Tribunal. Indeed in the former, that is the courts, the onus is on the Commission to prove its case if a business wishes to proceed with a merger considered anti-competitive by the Commission.