frontier economics

Report in reply

A report for Ashurst | 19 May 2023

Information that is confidential to ANZ is highlighted in yellow; and information that is confidential to Suncorp is highlighted in green.

Contents

1 Introduction

1.1 This report

1. My name is Philip Williams. I have been retained by Ashurst, lawyers for Australia and New Zealand Banking Group Limited (ANZ), for the purpose of providing my expert opinion in the form of written reports in connection with its application (Authorisation Application) to the Australian Competition and Consumer Commission (ACCC) for authorisation of its proposed acquisition of SGBH Limited, the holding company for Suncorp Bank, from Suncorp Group Limited (Suncorp Group) (Proposed Transaction).

2. I wrote a report for Ashurst dated 1 December 2022 (my First Report). More recently, Ashurst have provided me with a Framework for assessing coordinated effects prepared by Nicolas de Roos. They have also provided me with a Submission by Bendigo and Adelaide Bank dated 3 March 2023 (BEN Submission) and an Expert Economist's Report dated 3 March 2023 (the King Report). I have been asked for my response to the analysis of competition in these documents.

3. I have read, understood and complied with the Federal Court of Australia's Expert Evidence Practice Note and Harmonised Expert Witness Code of Conduct (GPN-EXPT).

4. As with my First Report, I have been assisted in preparing this Report by Mr David Kontrobarsky.

5. All the opinions expressed in this Report are my own.

1.2 The King Report

6. Professor King criticises the method by which I approach the definition of markets. In section 2.1 below, I explain why I reject this criticism.

7. Despite this disagreement about the method by which markets should be defined, the markets to which Professor King and I direct our attention are reasonably similar. Professor King states that the most likely anticompetitive impacts of the acquisition of Suncorp Bank by ANZ arise in the supply and demand of home loans and agribusiness banking services. I agree that these are these product markets are those that are most likely to be appropriate.

8. Professor King adopts a national market for retail home loans – as do I. Whereas I direct my attention to agribusiness banking services in Queensland as a whole, he directs his attention to local/regional agribusiness banking markets either fully located or substantially located within Queensland. I discuss this difference in section 2.2 below; and I explain in section 3.1 why I disagree with the reasoning in the King Report.

9. Professor King has been instructed to consider two counterfactuals when analysing the competitive impacts of the acquisition of Suncorp Bank by ANZ:

    a the status quo counterfactual, under which Suncorp Group would continue to operate Suncorp Bank; and b the alternative buyer counterfactual, under which Suncorp Bank would be acquired by another mid-tier bank, specifically Bendigo and Adelaide Bank.[1]

10. When I wrote my First Report, I assumed that the relevant counterfactual was the status quo. In writing this reply report, I shall consider the two counterfactuals that Professor King was instructed to consider.

11. Professor King's analysis of the likely effects of the Proposed Acquisition on the state of competition in Queensland agribusiness banking analyses the likely unilateral effects of the Proposed Acquisition by considering the structure of the market(s) and the likely effects of the Proposed Acquisition on the structure of the market(s). This is somewhat similar to the method I adopted in my First Report, although I did not consider the alternative buyer counterfactual. As I explain in section 3.3.2 below, the alternative buyer counterfactual makes little difference to the analysis of the effects of the Proposed Acquisition on competition in Queensland agribusiness banking.

12. Professor King's analysis of the likely effects of the Proposed Acquisition on the state of competition in the national market for retail home loans applies the theory of coordinated effects. The theory is explained in textbooks and in a report by Professor Nicolas de Roos.[2] Professor King's application of the theory relies on his assumption that the four largest banks are currently charging monopoly-like prices on housing loans. In section 4.1.2 below I explain why I consider this assumption to be unjustified. It is based on:

a evidence of the market shares of the four-largest banks when the better evidence is the HHI of the relevant market; and

b the Productivity Commission's comparison of the average margins and average rates of return of the four largest banks rather than the margins and rates of returns in the market as a whole.

[1] King Report, para 49.

[2] Nicolas de Roos, *Framework for assessing coordinated effects*, April 5, 2023.

2 Market definition

2.1 Principles of market definition

13. In my First Report, I expressed the opinion that the initial candidate market should assist in analysing the issue of market power or harm to competition that is at the heart of the dispute.[3] Because I did not know what harm to competition might be caused by the Proposed Acquisition, I used the HHI as an initial sorting device to determine the relevant initial candidate market(s).[4]

14. Professor King states that this approach is inconsistent with standard economics and makes no economic sense because it conflates the definition of the market and the analysis of competition. He states:

> The approach used by Dr Williams to determine the markets relevant for analysing the competitive effects of the acquisition of Suncorp Bank by ANZ is inconsistent with both the approach outlined in the ACCC's Merger Guidelines and the standard economic approach adopted in merger analysis. ...
>
> Dr Williams then uses the HHI, a measure of market concentration, to define the relevant markets for competition analysis. However, this approach makes no economic sense. The HHI can only be used after a relevant market is defined. Put simply, the HHI, and other concentration measures, are tools for competitive analysis of a market. They are not able to be used in any coherent way to define a market for competition analysis.[5]

15. I reject this criticism. In my opinion, the process of defining the market is inextricably linked to the analysis of competition. Unless one knows what competition problem one is analysing, one is unable to determine what market is appropriate. When I taught market definition to LLM students, I always prescribed as reading for the class the decision of the Full Federal Court (per French J) in *Singapore Airlines v Taprobane*. I respectfully agree with the following words of French J:

> There is necessarily a close relationship between the delineation of a market and description of the distribution of power within it. The first process is logically anterior to the second and is frequently so expressed as the Tribunal did in BHP/Koppers at 42,828:
>
> "... the delineation of relevant markets is but a first and preliminary step to enable the identification of relevant elements of market structure and associated processes of competition."
>
> But that does not mean that market definition may be settled without resort to a consideration of structure and power distribution. It is a focussing process and the Court must select what emerges as the clearest picture of the relevant competitive process in the

[3] My First Report, para 20.

[4] My First Report, para 35 b.

[5] King Report, paras 196 and 197. Professor King makes a similar point at para 203 when he states that my use of concentration both for defining markets and for analysing competition is 'circular'.

> light of commercial reality and the purposes of the law. There is a feedback between any proposed market and the structure and power distribution which that proposal throws up.[6]

16. Professor King, quite rightly in my view, chooses markets contingent upon the competition problems he is seeking to analyse. In his report, he chooses as his relevant markets:

    a the national market for retail home loans; and

    b local/regional agribusiness banking markets, particularly those local/regional agribusiness banking markets either fully located or substantially located in Queensland.[7]

17. Professor King was a co-author of the Productivity Commission Report, Competition in the Australian Financial System.[8] That Report elected to focus on the products and product markets where, in his opinion, there was most apparent need for a boost to competitive behaviour — which could be from the demand side (consumers) or from the supply side (banks or insurers). The markets chosen were nation-wide markets for:

    a personal banking

    b business banking

    c funds management and financial planning

    d general insurance

    e the payments system.[9]

18. The markets defined in the Productivity Commission Report may well have been appropriate for the task of reviewing the state of competition in Australia's financial system as a whole. These markets may not be those that are most-appropriate to assessing the effects on competition of the Proposed Acquisition. I re-affirm my opinion that the initial candidate market(s) should be chosen to assist in analysing the issue of market power or harm to competition that is at the heart of any dispute.

2.2 Application of these principles to defining banking markets

19. In writing my First Report I was asked to respond to the question: what is/are, in your opinion, the relevant product and geographic dimensions of the market or markets for the purposes of assessing the likely competitive effects of the Proposed Transaction in relation to the supply of banking products, and specifically commercially banking products, in Australia?

20. The areas of overlap between the activities of the ANZ and Suncorp Bank are very broad. The Application for Authorisation para 10 states that:

    > With some exceptions, ANZ and Suncorp Bank are active in the markets to supply the following products and services:
    >
    > a to retail banking customers:

[6] *Re Singapore Airlines Limited v Taprobane Tours WA Pty Ltd* [1991] FCA 621 (1992) per French J, para 43.

[7] King Report, para 7 b.

[8] Productivity Commission Inquiry Report, No 89, 29 June, 2018.

[9] Productivity Commission Inquiry Report, No 89, 29 June, 2018, p 77. See also p 64.

   i home loans in Australia;

   ii deposit products (including transaction and savings accounts, and term deposits) in Australia; and

   iii personal lending (including credit cards and secured and unsecured loans in Australia);

b to business customers (including SME, commercial property and agribusiness customers), commercial banking products and services, including:

   i deposit products (including transaction and savings accounts, and term deposits) in Australia;

   ii commercial lending products in Australia;

   iii merchant services in Australia; and

   iv risk management products in Australia.

21. Because of the wide range of overlap between the activities of ANZ and the activities of Suncorp Bank, I was faced with the problem of choosing activities on which to focus my analysis of competition. As the above quotation from *Singapore Airlines v Taprobane* makes clear, that choice must be based on those activities where one is most likely to discover anti-competitive detriments arising from the Proposed Acquisition.

22. As I explained in my First Report, I began with wider markets and narrowed the focus until I found a market (the market for the supply of loans to Queensland agribusiness) that the ACCC might consider to be adversely impacted by the Proposed Acquisition.

23. Professor King criticises my failure to consider markets narrower than the market for the supply of loans to Queensland agribusiness. He states:

> ... because Dr Williams starts at a broad state level and does not consider either demand-side or supply-side substitution he fails to consider local/regional agribusiness markets in Queensland. Indeed, his approach to market definition appears to be driven by the availability of measures of product shares, regardless of whether the product shares have a competitive relevance or are robust.[10]

24. Professor King suggests that one is more likely to discover that the Proposed Acquisition causes a substantial lessening of competition if one analyses the effects of the Proposed Acquisition on narrower geographic markets. He states:

> The purposive nature of market definition indicates that competitive analysis of the acquisition of Suncorp Bank by ANZ for agribusiness banking should focus on regional markets where the two banks' agribusiness operations directly overlap. It is in these local/regional markets where the acquisition of Suncorp Bank by ANZ is most likely to substantially lessen competition. At a minimum analysis should consider the local/regional agribusiness markets centred on each of Cairns, Townsville, Mackay, Rockhampton, Emerald, Roma, Dalby, Toowoomba, Goondiwindi and Ayr.[11]

[10] King Report, para 199.

[11] King Report, para 153.

25. I agree with the general proposition that one is more likely to uncover competition problems if one narrows the scope of markets. Because of the exceedingly large number of possible markets, when I wrote my First Report I had to select markets in which "*the substantive criteria for the particular contravention in issue* are satisfied".[12]

26. At this stage, there is no contravention in issue: the ACCC is considering an application for authorisation of the Proposed Transaction. Nevertheless, the same principle applies. In considering whether the Proposed Transaction is likely to substantially lessen competition, I tried to select that market to which the ACCC would be most likely to direct its focus. I did this by assessing the impact of the Proposed Acquisition on the HHI, which led me to consider the market for agribusiness banking services in Queensland as a whole. Professor King provides no evidence that the acquisition of assets in particular regional/local agribusiness markets in Queensland might satisfy the substantive criteria for a contravention. If there is such evidence, one cannot define markets.

27. As I indicated above, when I wrote my First Report, I had to try to discern what might be the particular contravention in issue. At the time, I did not consider that the ACCC might focus on local/regional agribusiness markets. In my opinion, if the ACCC has evidence that the acquisition of assets in particular regional/local agribusiness markets in Queensland might satisfy the substantive criteria for a contravention, they should present the evidence and I could consider whether those areas might constitute appropriate markets in which to analyse the effects of the Proposed Acquisition on competition.

[12] The words and italics are those of Gordon J in *Flight Centre*, quoted in my First Report, para 20.

3 Likely effects on competition in agribusiness banking

3.1 Relevant markets

28. Professor King states:

> The information available to me clearly indicates that there are **local/regional agribusiness banking markets**. These markets involve the supply and demand of a range of financial products relevant to agriculture-based businesses. The relevant agribusiness markets involve the supply and demand of a 'cluster' of banking products. The geographic dimensions of the agribusiness markets are relatively narrow, and in general should be considered 'regional markets' that may involve only parts of a state and are in general no broader than a state (although a regional market may overlap state borders).[13]

29. Professor King's reasons for his opinion that agribusiness banking markets are local/regional are given in paragraph 65 c of his Report. The reasoning is based on evidence from Mr van Horen and Mr Bennett to the effect that the relationships between borrowers and their local relationship managers constitute an important element of competition between banks in serving agribusiness customers.

30. I do not share Professor King's opinion that this evidence clearly indicates that there are local/regional agribusiness banking markets. I have formed this opinion for three reasons. The first reason is that, as I observed in the preceding section, local/regional markets can only be defined if there is evidence that the acquisition of assets in particular regional/local agribusiness markets might satisfy the substantive criteria for a contravention. Professor King has provided no such evidence.

31. My second reason is that competition in agribusiness does not occur only at a local level. Although relationships between borrowers and their local managers are one element of competition in agribusiness markets, I understand that ANZ makes decisions concerning agribusiness at a national level, at a State level, and at a regional level. Mr Bennett explains the structure within ANZ of agribusiness banking. He is Head of Specialised Agribusiness and Commercial (SA&C); and he is referred to within ANZ as "Head of Agribusiness". However, customers who have a turnover in excess of [redacted] per annum or have particularly complex banking needs, are generally managed by ANZ's Institutional Division.[14]

32. Mr Bennett's direct reports seem to reflect management within boundaries determined by:

    a size of business (Small Business Banking – SBB, Business Banking – BB, Specialist Distribution – SD and Private Banking);[15] and

[13] King Report, para 65.

[14] Statement of Mark Stephen Bennett Statement dated 1 December 2022 (First Bennett Statement), paras 122 and 23.

[15] The size limits are explained in the Rankin Statement, para 15.

b the State for which they are responsible.[16]

33. Mr Bennett is responsible for:

a directly managing the SA&C team,

b shaping and executing ANZ's agribusiness strategy through the SD Segment (via four State Directors), and the BB and SBB segments via the State Agribusiness Managers;

c setting and managing the risk policy settings for ANZ's agribusiness portfolio with ANZ's Commercial's Agribusiness and Commercial Risk teams;

d controlling the agribusiness marketing budget;

e overseeing ANZ's strategic external sponsorships and partnerships in relations to agribusiness;

f overseeing ANZ's agribusiness graduate program, and for ANZ's agribusiness training and capability development for ANZ's frontline agribusiness bankers;

g overseeing ANZ's insights and research capability, publication and internal commodity price analysis relevant to agribusiness;

h overseeing compliance obligations for agribusiness customers in the SD segment; and

i representing ANZ regarding agribusiness banking, for example, in government enquiries concerning agribusiness.[17]

34. Mr Bennett explains that frontline bankers operate within credit limits and have to refer larger loans to higher levels. He states:

> Frontline bankers are supported by generalist Credit Coaches to ensure alignment with DOLs [Agribusiness Direction of Lending], they must also operate within ANZ Commercial's Credit Approval Discretion (CAD) framework, which identifies the level of approval required for different types of loans based on value and risk profit. As a general proposition, loans of over [redacted] require approval by both a frontline banker and a member of the ANZ Commercial Risk team, and the higher the loan's value or risk, the higher the level of approval required.[18]

35. I requested, and was provided with, ANZ's discretion framework.[19] I was instructed that the Lending Discretion Framework for Agribusiness is the page headed "Lending Pricing Discretions: Specialist Distribution – Corp Agri". This page outlines four levels of discretion:

a Relationship Manager has the least discretion;

b Level 1 escalation is to Director of Corporate Agri;

c Level 2 escalation is to Head of Corporate Agri; and

d Level 3 escalation is to GM, Specialist Distribution.

[16] First Bennett Statement, para 24.

[17] First Bennett Statement, para 25.

[18] First Bennett Statement, para 73.

[19] ANZ, *Business and Private Banking Pricing Discretions*, Updated 21 July 2022.

36. I was also provided with an ANZ document headed Australia Agribusiness Direction of Lending.[20] This document sets out guidance and rules under which relationship managers operate.

37. For the above reasons, I have formed the opinion that competition in lending to agribusiness takes place at many levels within ANZ. It is too simple to infer from statements about the importance of relationships between borrowers and their local managers that agribusiness banking markets are clearly local/regional. In my opinion, the geographic boundaries to markets when evaluating potential acquisitions should be drawn so as to focus on problems of competition that the proposed acquisition is likely to cause.

38. The third reason I disagree with Professor King's opinion that the importance of relationships between borrowers and local relationship managers clearly indicates that there are local/regional agribusiness banking markets is that bankers seek to mitigate risk by developing a loan book that is geographically diverse. For this reason, one element to competition in agribusiness banking is securing a diverse loan portfolio. Mr Bennett states:

> ... to provide agribusiness customers with an attractive offering, an agribusiness bank needs to demonstrate commitment to, and investment in, agribusiness banking by having bankers with the requisite experience and expertise, and the financial wherewithal to support the customer over the long term.
>
> That financial wherewithal comes from having a diverse customer base across different geographic regions and agribusiness sub-sectors within agribusiness, and then more broadly as a full-service bank. If a bank is too exposed to a particular region or sub-sector, then if that region of sub-sector experiences headwinds, such as a regional issue like a drought or a sectoral issue like a ban on exports, then the bank will have less capacity to support customers in the way they would expect and appreciate. It is easier for a diversified bank to take a long-term view and to better support customers for circumstances that are beyond their control and expectation.[21]

39. I disagree with Professor King's opinion that the importance of relationships between borrowers and local relationship managers clearly indicates that there are local/regional agribusiness banking markets.

3.2 Competition in the agribusiness banking market(s)

40. Professor King's analysis of the state of competition within agribusiness is structured under the headings of:

   a Market shares;

   b Entry and expansion; and

   c Switching costs.

Market shares

[20] Version 8.4, September 2021, ABG.5001 0011.2076 ff.

[21] Bennett Supplementary Statement, paras 35 and 36.

41. My First Report presented some data concerning the likely effect on the HHI of the Queensland Agribusiness market.[22] The data suggested a post-merger HHI of 2,143.4 and a delta of 553.9. I compared these numbers with the ACCC Merger Guidelines which state that the ACCC will generally be less likely to identify horizontal competition concerns when the post-merger HHI is (i) less than 2,000, or (ii) greater than 2,000 with a delta less than 100.[23] That is, the data I presented suggested that the Proposed Merger would just contravene the ex post HHI standard of the ACCC Merger Guidelines.

42. Professor King acknowledges that he has no data that would reveal the effect of the Proposed Acquisition on market concentration in any of his suggested local/regional agribusiness markets.[24] Then he states the following:

> I would note that any conclusions drawn on the basis of state-wide shares of agribusiness in Queensland may understate (and potentially significantly understate) the competitive impact of the acquisition on certain regional agribusiness banking markets, such as those listed in paragraph 153.[25]

43. I agree with this proposition: whenever one looks at a part of a larger market, one may find particular segments that are more concentrated (and some that are less concentrated) than the average degree of concentration in the market as a whole. However, Professor King refers to no evidence of the extent to which degrees of concentration might vary across regions within the supply of loans by banks to Queensland agribusiness.

Entry and expansion

44. Professor King's discussion of entry and expansion in agribusiness is restricted to local/regional markets rather than state-wide or national markets. This is consistent with his preference for local/regional markets when discussing market definition. As with his discussion of market definition, his analysis of the condition of entry is concerned principally with relationships between borrowers and their local relationship managers. He argues that the relationship-focussed nature of agribusiness banking means that there exist substantial barriers to entry for a bank wishing to enter a local or regional agribusiness banking market.[26]

45. Professor King states that, to successfully enter and compete in a regional agribusiness banking market would require significant investment in human resources by a bank and is likely to require a significant lead-in period to establish relevant relationships. This would involve a banker-by-banker approach. Professor King suggests that building up banker-by-banker cannot be avoided because there is considerable competition for agribusiness bankers making it difficult for a new entrant to gain appropriate staff.[27]

46. Professor King's analysis of the possibility of barriers to entry seems to contrast with Mr Bennett's analysis of Rabobank's entry. Mr Bennett suggests that the initial success of Rabobank came from their poaching experienced agribusiness bankers. He states:

[22] My First Report, para 49, Table 3.

[23] Referred to in My First Report, para 35 d.

[24] King Report, para 159.

[25] King Report, para 160.

[26] King Report, para 168.

[27] King Report, para 166.

In my experience, bankers are competitive in the sense that they strive to be well known for delivering great outcomes for customers and operate a successful and profitable portfolio of customers. Bankers will leverage their market acumen and network to grow their customer set, making them an integral asset to growing an agribusiness portfolio. Their customer set can be grown even if the bank they work for do[es] not have a physical presence in the relevant local area, provided the banker has the requisite experience, expertise, and relationships. For example, Rabobank's success started by Rabobank recruiting agribusiness bankers, who were based in the capital cities, and who were able to build a portfolio of clients quickly across Australia by being mobile and developing relationship with agribusiness customers. Rabobank's success is reflected in their high rust scores among farmers, reflected in the Roy Morgan Survey. [28]

47. In my opinion, the experience of Rabobank is important evidence – not so much of barriers to entry but of barriers to expansion/mobility across regions. As I stated in my First Report, the advantages of the larger banks in dealing with larger agribusiness customers coupled with the trend to consolidation of farms might suggest that new entry is very unlikely – except at the margin for internet-based lenders. However, the success of Rabobank suggests that, although barriers to entry might be quite high, barriers to expansion/mobility among lenders are not high.[29]

Switching costs

48. Professor King's discussion of switching costs reflects his concern with relationships between agribusiness borrowers and their relationship manager. He states that the relationship-focused nature of agribusiness banking creates significant switching costs for customers.[30] He observes, however, that these barriers to switching in agribusiness, although high, are not insurmountable.[31] It is unclear whether Professor King has any evidence of the extent of switching between ANZ and Suncorp Bank; but his observations of the market suggest that he would expect low levels of switching.

49. The standard analysis of the unilateral effects of a merger in a differentiated product market places great importance on the degree of switching between the merging parties. It produces the result that the merger is more likely to cause prices to increase the greater is the degree of switching between the parties to the merger. The analysis is based on the assumption that firms set their prices so as to maximise their profits both with and without the merger. Without the merger, firms set their prices taking into account the trade-off between their profit margins and the volume of their sales: the larger the profit margin, the lower will be the number of units they sell. However, if firm A and firm B were to merge, this trade-off would change – because some of the sales that firm A would have lost to firm B when they were independent will not be lost if both firms are under common ownership.[32] The change in the trade-off creates the (unilateral) incentive for the merged firm to increase prices compared with the profit-maximising prices set by the firms without the merger.

[28] Bennett Supplementary Statement, para 32.

[29] My First Report, para 112.

[30] King Report, para 171.

[31] King Report, para 175.

[32] Joseph Farrell and Carl Shapiro, "Upward Pricing Pressure and Critical Loss Analysis; Response", *CPI Antitrust Journal*, February 2010.

50. The magnitude of any possible increase in prices will depend on the extent to which the trade-off changes; and the extent to which the trade-off changes depends, in turn, on the degree of switching between firm A and firm B. The trade-off changes because if one of the firms had increased prices without the merger, it would have lost customers to the other firm. If no customers had been lost, the trade-off would not have changed and there would be no incentive to increase prices. If switching between ANZ and Suncorp Bank is low, the merged ANZ/Suncorp will have little or no incentive to increase prices.

51. As I observed above, Professor King states that barriers to switching in agribusiness are 'high'. I am not sure what Professor King means when he characterises barriers to switching in agribusiness as high. The Supplementary Statement of Mark Stephen Bennett (Bennett Supplementary Statement) presents evidence concerning switching of ANZ agribusiness customers. He indicates that, each year, ANZ Agribusiness loses (and must replace) about [redacted] per cent of its total lending FUM due to paydowns, natural amortisation or customers refinancing.[33] In my opinion, this number gives a better indication of the fluidity of agribusiness markets than statements such as switching costs in agribusiness are 'high'.

3.3 The likely effect of the Proposed Acquisition

52. Professor King's opinions of the likely effects of the Proposed Acquisition on competition in agribusiness reflect his approach to defining agribusiness markets and his analysis of patterns of competition within those markets.

53. As I observed in my First Report, any analysis of the effect of the Proposed Acquisition should consider its effects on the structure, the conduct and the performance of the relevant markets.

3.3.1 Comparison with the status-quo counterfactual

54. Professor King argues that, compared to a status-quo counterfactual, the Proposed Acquisition would eliminate an effective and independent competitor in a range of local/regional agribusiness markets across Queensland.[34] He considers that it is unlikely that entry, expansion or customer switching will offset any substantial lessening of competition.[35]

55. I do not accept Professor King's characterisation of the status-quo counterfactual for the Queensland agribusiness banking market. Suncorp documents suggest that, in the future without the Proposed Acquisition, Suncorp Bank is unlikely to be an "effective and independent competitor in a range of local/regional agribusiness markets across Queensland."

56. [redacted][36]

57. [redacted]

[33] Bennett Supplementary Statement, para 25.

[34] King Report, para 182.

[35] King Report, para 183.

[36] First Johnston Statement, para 71.

[redacted][37]

58. [redacted]

[redacted][38]

59. In my First Report, I considered only the status-quo counterfactual. I expressed the opinion that the Proposed Transaction is likely to cause a slight lessening of competition in the supply of loans to Queensland agribusiness; but this is unlikely to cause any increase in prices or decrease in the quality of service to agribusiness borrowers. I said this for the following reasons.

a The market is relatively unconcentrated compared with most of the markets that are subject to detailed consideration by the ACCC: the best available estimates put the post-merger HHI at 2,143.4.

b the proposed merging parties are not particularly close competitors. Suncorp does not have the [redacted] to satisfy the needs of larger customers. For this reason, Suncorp [redacted] whereas ANZ serves the complete range of sizes; and this difference is likely to become increasingly important in the future because of the long-term trend to larger farms.

c The performance of the market is reasonably dynamic due, in no small part, to the activity of Rabobank.

60. For these reasons, I concluded that the Proposed Transaction is unlikely to substantially lessen competition in the market for the supply of loans to Queensland agribusiness. I still hold that opinion.

3.3.2 Comparison with the alternative buyer counterfactual

61. Professor King's comparison with the alternative buyer counterfactual is somewhat difficult to follow because he does not compare the alternative buyer counterfactual with the factual of the Proposed Acquisition. Instead, he compares the alternative buyer counterfactual with the current state of various markets. Nevertheless, his implicit argument seems to be that, compared with the alternative buyer counterfactual, the Proposed Acquisition would lead to a substantially

[37] SML.0003.0001.0168.

[38] First Johnston Statement, para 72.

larger increase in concentration – in some or all of his local/regional markets and within Queensland as a whole.

62. Although I have no data to assess the likely effects of the Proposed Acquisition on regional/local markets, I can show the effects on HHIs of the Proposed Acquisition compared with Professor King's alternative buyer counterfactual. The alternative buyer counterfactual will change the HHI in the future without the Proposed Acquisition. **Table 1** below shows the difference between HHIs using the status quo counterfactual compared with the alternative buyer (that is, acquisition by Bendigo and Adelaide Bank) counterfactual.

Table 1: HHI estimates of lending in putative Queensland agribusiness market

	Status Quo Counterfactual	Alternative Buyer Counterfactual
Without merger	1,589.6	1,618.5
With merger	2,143.4	2,143.4
Delta	533.9	524.9

Source: DBM and Frontier Economics

63. As **Table 1** indicates, the post-merger HHI is the same in the two counterfactuals. As I observed in my First Report, the Queensland agribusiness market post-merger would be relatively unconcentrated compared with most of the markets that are subject to detailed consideration by the ACCC.[39] The delta differs between the two counterfactuals: it reduces from 533.9 to 524.9 as one moves from the status quo counterfactual to the alternative buyer counterfactual. I conclude that consideration of the alternative buyer counterfactual does not change to any significant extent the analysis in my First Report of the likely effects of the Proposed Acquisition on the state of competition in the Queensland agribusiness banking market.

64. As I understand, the question for the ACCC may well be whether the Proposed Acquisition would be likely to cause a substantial lessening of competition in the Queensland agribusiness market. The likely effect on HHI is the same under both counterfactuals; but the delta is slightly larger under the status quo counterfactual than under the alternative buyer counterfactual. That is, in considering the application for the Proposed Acquisition (as distinct from which buyer the ACCC may prefer), the effect on seller concentration in the Queensland agribusiness market is much the same whether one is considering the status quo counterfactual or the alternative buyer counterfactual.

[39] My First Report, para 119.

4 Likely effects on competition for retail home loans

65. Professor King analyses competition for retail home loans within a national market for retail home loans.[40] This market is similar to that which I characterise in my First Report as the national market for the supply of loans to purchasers of housing.

66. Professor King proposes two reasons why the Proposed Acquisition is likely to lessen competition in this market. The first is that the Proposed Acquisition will stabilise existing coordinated conduct among the major banks. In his opinion, this concern applies whether the counterfactual is the status quo or whether it is an alternative buyer. His second reason applies if the counterfactual is the alternative buyer: he argues that the Proposed Acquisition will prevent the creation of a mid-tier challenger bank.[41] I shall consider these two arguments in turn.

4.1 The coordinated conduct argument

4.1.1 The economic theory of coordinated conduct

67. Economic theory analyses coordinated conduct as part of the theory of collusion. The theory of collusion attempts to explain why otherwise competitive firms are able to set prices close to, or equal to, monopoly prices.[42] Professor de Roos explains the essential elements of the theory in a report commissioned by the ACCC.[43] The theory teaches that, in order to be sustainable, collusion must incorporate two elements:

   a it must be possible to detect firms that deviate from the collusive price; and

   b there must be a credible mechanism to punish those who deviate.

68. The normal punishment mechanism is that all firms set low prices (closer to the competitive level). This punishment will reduce the margins of all firms – whether they have abided by the collusive price or whether they have deviated.[44]

69. The same two elements are required for coordinated conduct – that is, arriving at monopoly-type prices without explicit collusion. Motta gives the following example:

> Suppose for instance that there are two foodstalls in the market, they both sell pears of identical quality, and they are located in front of each other. Imagine that sellers pay 1$ per kilo to their suppliers. When seller A arrives in the morning at the market, he can see that the rival sells pears at, say, 2$ per kilo, which we can think of as the monopoly price.

[40] King Report, para 7 b.

[41] King Report, paras 7 d and 7 e.

[42] For this discussion, I shall assume that firms are setting prices rather than quantities.

[43] Nicolas de Roos, *Framework for assessing coordinated effects*, April 5, 2023.

[44] The seminal paper is George J Stigler, "A Theory of Oligopoly", Journal of Political Economy, Vol 72, 1964, pp 44-61. A readable exposition of the theory is provided by Robert C Marshall and Leslie M Marx, *The Economics of Collusion, Cartels and Bidding Rings*, MIT Press, 2012, chapters 5 and 6.

> When deciding his own price, he can either set the same price (that would be the collusive strategy) or he could deviate from it and set a lower price. He certainly understands that if he sets the price at, say, 1.9$, he will get more customers than the rival, and that for the time the price difference will last, he will get higher profits than if he "colluded" (he will make a "gain from the deviation"). However, he also knows that detection of a deviation is immediate in this situation, and he knows that the rival will react to such a deviation by "punishing" him, setting a price lower or equal to 1.9$. At best, both will charge 1.9$, so that both will end up by having lower profits than if they had both sold at 2$. But the rival might decide to give a harsher punishment, for instance setting a price close to 1$ to make it clear that she would not like " deviations", thus causing a much higher "loss from the deviation". Therefore, the expectation of the punishment (or of a price war) will make seller A quite willing to charge the monopoly price. Collusive prices will arise through non-cooperative behaviour of the sellers.[45]

70. In this example, Professor Motta assumes that the collusion (whether overt or tacit) occurs at a monopoly-like price. This is standard in economics. As Professor Kuhn stresses, when discussing the European notion of joint dominance (that is, the United States notion of coordinated conduct), the economic approach equates dominance and market power. " ... the only way to demonstrate dominance is to show that prices have been raised."[46] When Professor King refers to coordinated conduct among the largest banks, Professor King does not merely mean that banks change their interest rates on housing loans at much the same time in response to changes in the Reserve Bank's overnight rate. By coordinated conduct (or 'joint dominance' as the Europeans tend to call it) economists (including Professor King) mean that firms that would otherwise constrain the profits of each other gain the ability jointly to exercise dominance, that is, market power.

4.1.2 The assumption of coordinated conduct

71. Professor King states that the national market for retail home loans is characterised by dominance and coordinated conduct of the major banks.[47] By this, he means that the four largest home lenders set monopoly-like prices for housing loans and they do so because, if any of the four largest home lenders deviated from these monopoly-like prices they would be punished by the other home lenders embarking on a price war.

72. His assumption of monopoly-like prices is critical to his application of the theory of coordinated conduct because, if those engaging in coordinated conduct were not charging monopoly-like prices, the threat of punishing the deviating firm by charging competitive prices would be empty. The threat is the threat to reduce prices substantially from their current level to a more-competitive level.

73. Professor King justifies his assumption that the national market for retail home loans is dominated by the four largest home lenders principally with reference to market shares. He states:

[45] Massimo Motta, "Economic Analysis and EC Merger Policy", Robert Schuman Centre for Advanced Studies, European University Institute, EUI Working Paper rSC No. 2000/33, 2000, p 15.

[46] This is the principal theme of Kai-Uwe Kuhn, "An Economist's Guide Through the Joint Dominance Jungle", Michigan John M Olin Foundation, Paper #02-014, 2001, p 4.

[47] King report, para 64 a.

> As at December 2022, CBA had a 25.80% market share; Westpac had a 21.4% market share; NAB had a 14.8% market share and ANZ had a 13.14% market share. Together the four major banks had a 75% market share.[48]

74. Professor King claims that this small number of dominant banks is conducive to coordinated conduct among the four largest home lenders.[49]

75. However, Professor King presents no basis for stating that four is a small number of firms. Furthermore, as he indicates, the national market for retail home loans has undergone significant structural change over the last 10 years:

> The total market share of the four major banks has decreased by around 10% of market share over the decade from 2012 to 2022. Much of this loss of market share has been due to increased market share by Macquarie Bank (4.45%), BOQ (1%), Bendigo and Adelaide Bank (0.53%) and other mid-tier banks.[50]

76. These market shares reflect, in part, historic patterns of loans. If one considers new home loans (including refinancing), the latest data suggests that Macquarie Bank accounts for 12.13 per cent of new home loans.[51]

77. Professor King's proposition that the four largest home lenders are engaged in coordinated conduct does not rely solely on market concentration. It also relies on the findings of the Productivity Commission's 2018 Inquiry Report, *Competition in the Australian Financial System* and the findings of the ACCC's *Residential mortgage products price inquiry 2017-18* when Macquarie Bank had a market share of two per cent.[52]

78. Although the Productivity Commission (PC) does not explicitly state that the four largest home lenders were engaged in coordinated conduct, it did find that the major banks used market power to the detriment of consumers. It states:

> There is evidence that they have sustained prices above competitive levels, offered inferior quality products to some groups of customers (particularly those customers unlikely to change providers), subsumed much of the broker industry and taken action that would inhibit the expansion of smaller competitors in some markets. All are indicators of the use of market power to the detriment of consumers.[53]

79. In addition to data concerning the structure of the banking market as a whole, the Productivity Commission presented data on the performance of banks. The Productivity Commission claimed that these data showed that the four major banks as a group held substantial market power.[54] The data took three forms:

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[48] King Report, para 79 a.

[49] King Report, para 64 a referring to paragraphs 42 to 45.

[50] King Report, para 79 b.

[51] https://www.afgonline.com.au/wp-content/uploads/2023/02/AFG-Index-Q2-23.pdf, pp 3 and 10.

[52] King report, para 64 a, referring to earlier paragraphs 42 to 45.

[53] Productivity Commission, Competition in the Australian Financial System, Inquiry Report, no. 89, 29 June 2018, pp 4-5.

[54] Productivity Commission, Competition in the Australian Financial System, Inquiry Report, no. 89, 29 June 2018, p 37.

a the aggregate Lerner index of Australia's major banks is higher than the aggregate Lerner index for other Australian-owned banks and higher than aggregate Lerner indices from the World Bank;[55]

b the major banks have earned returns on equity after tax that are highly profitable – without significant loss of market share;[56] and

c the major Australian banks have higher net interest margins than other Australian-owned banks.[57]

80. The PC presents its comparisons between the various margin and profit measures as the average across the major Australian banks and the average across the other Australian-owned banks. There are two reasons why these comparisons do not support the proposition that the four largest home lenders are engaged in coordinated conduct. The first reason is that they mask a great deal of variation within the two groups. This can be seen for the case of return on equity (ROE) in **Table 2** below.

Table 2: ROE of Australian banks 2018 to 2022

Bank ROE	2018	2019	2020	2021	2022
CBA	14.3%	12.5%	13.6%	13.5%	14.2%
NAB	11.1%	9.1%	4.5%	10.4%	11.3%
WBC	12.9%	10.4%	3.4%	7.8%	8.0%
ANZ	10.8%	9.9%	5.9%	9.9%	11.0%
BEN	7.9%	6.7%	3.4%	8.6%	7.5%
BOQ	8.8%	7.7%	2.8%	7.1%	6.6%
SUN	10.5%	9.4%	6.1%	10.4%	9.0%

Source: Announcements by banks collected by ANZ

81. By grouping banks into the four largest and the rest, the Productivity Commission chose to present evidence in a way that confirmed its prior theory that the four largest banks sustained prices above competitive levels. As Mr Elliot points out, almost all of the difference between the average ROE of the four largest banks and the average ROE of the other Australian banks can be attributed to including the largest bank, CBA, within the group of the four largest banks.[58] If the

[55] Productivity Commission, Competition in the Australian Financial System, Inquiry Report, no. 89, 29 June 2018, pp 9 and 108.

[56] Productivity Commission, Competition in the Australian Financial System, Inquiry Report, no. 89, 29 June 2018, pp 10-11 and 116.

[57] Productivity Commission, Competition in the Australian Financial System, Inquiry Report, no. 89, 29 June 2018, p 116.

[58] Supplementary Statement of Shayne Cary Elliott dated 17 May 2023 (Elliott Supplementary Statement) para 29.

PC had allocated the banks between two groups in some other way, it is likely that the group which included CBA would have a higher average ROE than the other group.

82. The second reason the PC's comparisons between the various the profits of the major Australian banks and those of the other Australian-owned banks do not support the proposition that the four largest home lenders are engaged in coordinated conduct is that coordinated conduct among the four largest banks should show in monopoly-like profits for all the banks – not just the four largest. Firms producing near-homogeneous products will charge near-identical prices. Differences in profit margins will then be caused by differences in unit costs. These differences may be due to economies of scale-scope or differences in internal operating efficiency. These are the obvious sources of differences between the profit measures of the larger banks and those of the smaller banks.

83. Above-competitive pricing can only be sustained if all firms in the market adopt above-competitive pricing. If the PC wished to use reported profit measures as indicators of market power, it should have used the average rates of return across a market as a whole – and not take the average rate of return of a few large firms and contrast that with the average rate of return of smaller firms.

84. The Productivity Commission also offers international comparisons of profit measures. As the Productivity Commission acknowledged, these comparisons are tricky; and the PC suggested they were indicative only.[59] More-recent data is presented in **Table 3** below. The authors of the Table separate ROE for Australia–Majors and ROE for Australia–Regional, which makes comparisons with other countries problematic. Nevertheless, comparing the ROE for Australia–Majors with banks in other countries does not suggest that the rates of return of Australian banks are particularly high.

Table 3: International comparisons of ROE

Geography	2018	2019	2020	2021	2022
AUSTRALIA-MAJORS	12.7%	11.0%	7.3%	10.3%	11.3%
AUSTRALIA-REGIONAL	8.3%	7.1%	3.1%	7.8%	7.1%
CANADA	14.8%	14.1%	11.9%	15.3%	16.1%
SCANDINAVIA	12.2%	10.2%	7.7%	11.5%	10.7%
SINGAPORE	11.5%	12.2%	8.2%	11.1%	12.8%
UK	7.1%	4.7%	1.8%	8.6%	3.5%

Source: Flagstaff data underlying tables in Global Banking Peers, 5 May 2023.

[59] Productivity Commission, Competition in the Australian Financial System, Inquiry Report, no. 89, 29 June 2018, p 108.

85. Apart from the Productivity Commission's Report, Professor King's proposition that the four largest home lenders are engaged in coordinated conduct also relies on the ACCC's Residential mortgage products price inquiry 2017-18.[60] Unlike the reference in the Productivity Commission Report to the market power of the four major banks, the ACCC Report concerns the five largest home lenders.

86. The ACCC Report points to various features of the mortgage products market that diminished price competition among the five largest home lenders. These were:

a opaque discretionary pricing among the five-largest home lenders;

b APRA's interest-only benchmark rate; and

c various regulatory requirements that favour the five-largest home lenders.[61]

87. The ACCC Report places much emphasis on what it terms 'the opaque pricing practices' of the five largest home lenders.[62] By 'opaque pricing practices' the Report means the discounts from their stated rates offered by lenders in order to attract or keep their customers. The ACCC suggests that these 'opaque pricing practices' may explain what it considers to be low switching rates among home loan borrowers. It states:

> Moreover, for borrowers who are engaged and intend to shop around for a better deal within the next 12 months, the opaque pricing practices and unnecessary steps that they must follow to discover prices offered by other lenders is likely to deter some from searching as widely as they otherwise would. The ACCC considers that this may explain the low rates of borrower switching to another residential mortgage lender. As discussed in section 2.2, less than 4 per cent of residential mortgage borrowers switched lender during the 12 months to 30 June 2018.[63]

88. The Supplementary Statement of Mr Elliott contains more-recent data that is quite different from that in 2018.[64] But, even with the data available in 2018, the ACCC's criticism of 'opaque pricing' of housing loans was at odds with economic theory. "Opaque pricing practices" are good for competition. As Professor de Roos states: "The more easily interest rates are observed by rivals, the greater the ability of firms to coordinate and agree on interest rate setting strategies; and monitor adherence to those strategies."[65] It is a standard proposition from Stigler's seminal paper that secret price cuts make collusion difficult to sustain.[66] The "opaque pricing" in home lending is a key reason why coordinated conduct is unlikely to occur.

[60] King Report, para 44.

[61] ACCC, *Residential mortgage products price inquiry 2017-18* (2018) pp 7 to 10.

[62] ACCC, *Residential mortgage products price inquiry 2017-18* (2018) p 7. The Productivity Commission uses similar language to refer to discounts off the stated rates. See Productivity Commission, Competition in the Australian Financial System, Inquiry Report, no. 89, 29 June 2018, p 110.

[63] ACCC, *Residential mortgage products price inquiry 2017-18* (2018) p 33.

[64] Elliott Supplementary Statement, paras 23 and 24.

[65] Nicolas de Roos, *Framework for assessing coordinated effects*, April 5, 2023, p 5.

[66] George J Stigler, "A Theory of Oligopoly", Journal of Political Economy, Vol 71, 1964, pp 44 to 61.

4.1.3 The assumption of increased symmetry

89. As Professor de Roos explains, whether firms are able to initiate and sustain coordination will depend on a range of elements of market structure.[67] Professor King argues that the Proposed Acquisition is likely to change one of these elements so as to make the coordinated conduct that he detects among the four largest banks more secure. His reasoning is that the Proposed Acquisition will make the market shares of the four largest banks more symmetrical. He states:

> … anti-competitive coordinated conduct is more difficult to sustain when there are smaller businesses who may find that competition is more profitable than ongoing coordination. Reducing the dispersion in market shares between relevant businesses can either increase the likelihood of coordinated conduct or stabilise on-going coordinated conduct. This is particularly the case where a merger would increase the market share of a smaller business that might otherwise "have more to gain from competing rather than from refraining from competition". In this situation, a merger that reduces the disparity of market shares among businesses that are engaging in coordinated conduct will act to stabilise that conduct and reduce the likelihood that competition will increase in the foreseeable future. Such a 'stabilising' merger can lead to a substantial lessening of competition, relative to the counterfactual of increased competition.[68]

90. Economic theory supports the proposition that symmetry is one element of market structure that facilitates coordinated conduct. Professor Motta explains the intuition behind the various theoretical arguments in the following way:

> Consider the following example. There exist two firms, one with 70% and the other with 30% market share. The larger firm will find it less interesting to deviate: to capture a (relatively) small additional market share, it would have to reduce its price, but by doing so it would decrease its margins on all the large market share it has already. Therefore, deviating from a collusive outcome would certainly be less attractive than for its rival, which can hope to attract a relatively much larger share of the market by decreasing its prices. The large firm is less keen on punishing after a deviation, too. This is because when both firms set low prices the large firm will be more hit than the small one, as it foregoes larger profits. The small firm knows that after a deviation the punishment will not be as harsh as it could be, and will be less deterred from deviating.[69]

91. Professor King applies this argument to his perceived coordinated conduct among the four largest banks in the provision of housing loans. He suggests that, without the Proposed Acquisition, ANZ may well deviate from the monopoly-like interest rates that the four largest banks are setting through their coordinated conduct. Professor King claims that this incentive to deviate will be reduced as a result of the Proposed Acquisition – because it will increase the symmetry of the market shares of the four largest banks. He states:

> As noted in paragraphs 85 and 86, by raising the market share of ANZ, which currently has the smallest market share in home loans of the major banks, the acquisition will underpin the ongoing coordinated conduct between the major banks. It will enable this

[67] Nicolas de Roos, *Framework for assessing coordinated effects*, April 5, 2023, section 2.1.

[68] King Report, para 84.

[69] Massimo Motta, "Economic Analysis and EC Merger Policy", Robert Schuman Centre for Advanced Studies, European University Institute, EUI Working Paper rSC No. 2000/33, 2000, p 21.

by reducing asymmetry and dispersion between the major banks' market shares. It will also change the incentives of ANZ, as the smallest of the major banks, so that ANZ is more likely to support ongoing coordinated conduct among the major banks rather than engaging in independent active competition to arrest its declining market share in home loans.[70]

92. Professor King's principal argument concerning the likely effects of the Proposed Acquisition on coordinated conduct can be summarised as follows:

a the four largest home lenders dominate the national market for retail home loans;

b the four largest home lenders currently engage in coordinated conduct, that is, they set monopoly-like prices for housing loans and they do so because, if any of the four largest home lenders were to deviate from these monopoly-like prices they would be punished by the other home lenders embarking on a price war;

c because it is currently the smallest home lender of the biggest four, ANZ is the bank most likely to deviate from the monopoly-like prices that the four largest home lenders currently charge; and

d the incentive for ANZ to deviate from the current monopoly-like prices will be substantially lessened by the Proposed Acquisition because it will reduce the current asymmetry in the market shares of the four largest home lenders.

93. In my opinion, this argument is based on assumptions that have not been substantiated; and it focusses unduly on the effect of the Proposed Acquisition on one particular element of market structure.

4.1.4 My assessment of the coordination argument

94. As I observed above, Professor King's proposition that the national market for retail home loans is characterised by dominance and coordinated conduct of the major banks amounts to the proposition that the four largest home lenders set monopoly-like prices for housing loans and they do so because, if any of the four largest home lenders were to deviate from these monopoly-like prices they would be punished by the other home lenders embarking on a price war. He then reasons that, because ANZ is the smallest home lender of the largest four, it is likely in the future without the Proposed Acquisition to deviate from the monopoly-like price and that the Proposed Acquisition, by reducing the asymmetry among the four largest lenders, is likely to reduce the incentive for this deviation to occur.

95. I reject Professor King's proposition that the four largest banks are currently charging monopoly-like prices for housing loans. For the reasons I gave in section 4.1.2 above, this conclusion cannot be supported by reference to the evidence in the Productivity Commission Report and/or the evidence in the ACCC Report. Furthermore, Mr Elliott presents evidence which indicates that ANZ's ROE on its housing portfolio is not substantially greater than its cost of capital.[71]

[70] King Report, para 118 b.

[71] Elliott Supplementary Statement, paras 27 to 33.

96. Apart from relying on evidence from the Productivity Commission and the ACCC, Professor King presents evidence of market shares of the four largest lenders; and he claims that, from a competition perspective, the national housing market is dominated by the four major banks.[72]

97. In my opinion, one should only state that the market shares show market dominance if one states what market shares lead to dominance. Professor King does not state what market shares are required to infer dominance. In my First Report, I compared the HHIs of the national housing loan market with the thresholds in the ACCC Merger Guidelines. I observed that these HHIs failed to cross the thresholds in the ACCC Merger Guidelines.[73]

98. In my First Report I observed that Stigler's seminal paper on collusion finds that the HHI is the measure of concentration that is best related to collusion.[74] Professor King criticises my reference to HHIs on the grounds that they are not relevant in markets characterised by coordinated conduct. He states:

> Even if Dr Williams' approach to market definition was correct as a matter of economics (which, in my opinion, it is not) his use of HHI concentration measures is inappropriate and ignores the evidence on coordinated conduct by the major banks. As noted at paragraphs 87 to 93, competition analysis based on simplistic measures of concentration, such as the HHI, that are not adjusted for existing coordinated conduct will be misleading and will not provide any economically relevant insight into the nature of competition or the competitive impact of the acquisition on competition.[75]

99. I reject this criticism. Professor King argues that the national market for retail home loans is characterised by dominance and coordinated conduct of the major banks. For this reason, he suggests that HHIs for the national market for retail home loans should be calculated treating the four largest lenders as if they were one.[76] In contrast to Professor King, I reject the proposition that the national market for retail home loans is characterised by dominance and coordinated conduct of the largest lenders. Dominance and coordinated conduct cannot be proved by contrasting average margins and average rates of return of the four largest banks across banking as a whole with average margins and average rates of return for smaller lenders. In my opinion, a proper assessment of dominance and coordinated conduct in the supply of retail housing loans would require consideration of the structure, conduct and performance of the market as a whole.

100. One element of market structure is seller concentration. It is standard economics that collusion is more likely the more concentrated is the industry.[77] Indeed, this is the basis of Professor King's proposition that the high market shares of the four largest lenders are conducive to coordinated conduct among them. I agree with Professor King that concentration can facilitate coordinated conduct – and that lack of concentration is likely to militate against coordinated conduct. However, following Stigler, I use the standard measure of the HHI as a measure of concentration.

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[72] King Report, para 80.

[73] My First Report, para 42.

[74] George J Stigler, "A Theory of Oligopoly", Journal of Political Economy, Vol 71, 1964, pp 44 to 61.

[75] King Report, para 206.

[76] King Report, paras 87 to 93.

[77] Massimo Motta, *Competition Policy, Theory and Practice*, Cambridge University Press, 2004, p 142. Professor de Roos makes the same point. He states: "Generally, in more concentrated markets, it is easier for firms to initiate and sustain cooperative behaviour." See Nicolas de Roos, *Framework for assessing coordinated effects*, April 5, 2023, p 3.

I reject Professor King's proposition that the presence of coordinated conduct makes the HHI misleading and irrelevant.

101. Professor King argues that the acquisition will underpin what he characterises as the ongoing coordinated conduct between the major banks.[78] I find this argument unpersuasive for the following reasons.

a His analysis of market concentration is confined to evidence of the market shares of the four-largest banks when the better evidence is the extent of concentration in the market as a whole as indicated by the HHI. Furthermore, it neglects some elements of market structure which economic theory suggests are relevant to any inference of coordinated conduct.

b His analysis of market performance relies principally on the Productivity Commission's comparison of the average margins and average rates of return of the four largest banks with the average rates of return of the other Australian banks. A more appropriate measure would be the margins and rates of returns in the retail mortgage market as a whole.

c Professor King's proposition that the acquisition of Proposed Acquisition will substantially lessen competition relative to the status-quo counterfactual[79] places undue weight on the decrease in asymmetry of market shares among the four largest lenders. In my opinion, a detailed analysis of the structure, conduct and performance of the national market for retail home loans would suggest that the charging of monopoly-like prices was unlikely and that a decrease in asymmetry among the four largest lenders would be merely one factor among many to consider when assessing the likely impact of the Proposed Acquisition on the state of competition in the market as a whole.

4.2 Preventing the creation of a mid-tier challenger bank

102. As well as his argument that the Proposed Acquisition will reduce asymmetry, Professor King proposes a second reason for his opinion that the Proposed Acquisition is likely to substantially lessen competition in the national market for retail home loans. This second argument applies to his 'alternative buyer' scenario.

103. The second argument is that, if Suncorp Bank were acquired by another mid-tier bank, such as Bendigo and Adelaide Bank (BEN), then this would:

> Create a mid-tier bank that will have the size and scope to overcome the barriers that exist to competition in the national market for retail home loans, and as a result, will be able to vigorously compete in that market.[80]

104. Professor King argues that the advantage that BEN would gain from increased size and scope is principally increased access to lower cost funds such as deposit funding.[81] He quotes the Productivity Commission Report to the effect that the most powerful advantage that larger banks

[78] King Report, para 118b.

[79] King Report, para 136.

[80] King Report, para 123 b.

[81] King Report, para 125 b.

have over smaller ADIs, and one that gives them substantial market power, is their ability to raise funds at lower costs and that these lower costs of funding enable the bigger banks to maintain their profits.[82]

105. Professor King suggests that access to lower cost funds is a barrier to the expansion of BEN;[83] and he states that increased access to lower cost funds would increase the ability of BEN to effectively compete in the national market for retail home loans.[84] According to Professor King, the increased competition from BEN would substantially weaken the ability of the major banks to act as a group that controls the market.[85]

106. I do not agree with this argument. In my opinion, it is inconsistent with two pieces of evidence:

   a the comparison of rates of return that I discussed in section 4.1.2 above; and

   b the growth of the Macquarie Bank home loan business over the last decade.

107. The comparison of rates of return in **Table 2** above shows that some of the smaller home loan lenders have rates of return similar to some of the larger lenders. It is not true that all small lenders face a barrier to expansion because they do not have access to lower cost funds.

108. This point is illustrated by the growth of the Macquarie Bank in the national home loan market over the last decade. Macquarie Bank grew from a small base in the national home loan market. It has increased its share of the national home loan market principally through innovation rather than through having a pre-existing large market share.

[82] King Report, para 26.

[83] King Report, para 126 a.

[84] King Report, para 126.

[85] King Report, para 126.

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