

Submission to the Competition Policy Review

Re: Competition, Mergers and 'National Champions'

Summary

This submission is about impressions and conclusions that could arise from reading the Competition Policy Draft Review.

In particular, it requests that Section 15 of the Competition Policy Draft Review be rewritten to correct the false impression created that the formation of 'National Champions' must in some way be unfavourable to Australia, due to issues involving competition restraints and/or other economic considerations.

The Review describes 'National Champions' as national firms that are large enough to compete globally and argues against changing competition laws for the formation of 'National Champions'. Changing competition laws is of course only one of the many ways in which a 'National Champion' could arise. Although later in Section 15, the Review states that the subject of 'National Champions' can be adequately addressed by the existing CCA framework, the impression is left, whether intentionally or not, that somehow the formation of 'National Champions' must disadvantage suppliers and consumers in the Australian market.

Media headlines that followed release of the draft report, such as "*Aussie calls to form Fonterra-style dairy giant 'not soundly based'*" (Astley 2014), illustrate this misinterpretation of the report findings. A number of recent reports, including government reports, have thrown cold water on the concept of 'National Champions' and the need for scale in Australian manufacturing. In the opinion of this writer these show poor understanding of the global market and there is need for more serious consideration of the topic.

It would be highly unfortunate if these opinion pieces were to influence decision makers such as the ACCC and government and inhibit Australian firms from investigating options for achieving globally competitive scale.

Accordingly Section 15 should make it very clear that the formation of 'National Champions' can be in accord with current competition policy and that as for any firm operating in the market, the CCA framework will address any negative competitive issues.

Secondly, in reviewing the outcomes from competition policy, it would be particularly useful to consider the rapidly diminishing competitiveness of the total Australian food processing industry (Potard 2014) and the role competition policy plays in this.

While it is easy to point at the ACCC's review of the Murray Goulburn bid for Warrnambool Butter and Cheese as an example of negative effect, the writer does not regard this as a failure of competition policy. It seems rather a failure of market understanding and market knowledge. The writer believes that the opinion offered by the ACCC represents unfortunate interference in a process of consolidation that has gone on in the dairy industry for over one hundred years and that it will distort the market accordingly and that it is unlikely to be in the long-term interests of Australian milk suppliers.

When reviewing competition policy the Panel must consider how this situation arose and whether in the broadest outcome sense, competition policy is in fact “driving efficient, competitive and durable outcomes, particularly in light of changes to the Australian economy in recent decades and its increased integration into global markets...”.

The observations made are based on the writer’s 44 years involvement with the dairy industry; as a dairy company executive, as the international head of a company supplying dairy and food ingredients in Australasia, Europe and the Americas, and involvement in formulation of national food research and development policy.

What the Review says about ‘National Champions’

The Competition Policy Review draft report states that “From time to time there are calls for competition policy to be changed to allow the formation of ‘national champions’ — national firms that are large enough to compete globally. While the pursuit of scale efficiencies is a desirable economic objective, it is less clear whether, and in what circumstances, suspending competition laws to allow the creation of national champions is desirable from either an economic or consumer perspective.” The wording incorrectly implies that “suspension of competition laws” is a necessary condition for the formation of ‘National Champions’. Firms will achieve scale of operation in many ways and in fact increased scale of physical operation may not always be necessary to form a ‘National Champion’. Additionally, as the report notes “In many markets in Australia achieving efficient scale will not substantially lessen competition because of the constraining influence of imports. Such mergers are allowed under the CCA.” Why would ‘National Champions’ not fall within this category?

The report notes that: “Porter and others have noted that the best preparation for overseas competition is not insulation from domestic competition but exposure to intense domestic competition. Further, the purpose of the competition laws is to enhance consumer welfare through ensuring that Australian consumers can access competitively priced goods and services. Allowing mergers to create a national champion may benefit the shareholders of the merged businesses but could diminish the welfare of Australian consumers.”

As Porter says companies that are not competitive within the Australia market are highly unlikely to become ‘National Champions’! But why single out ‘National Champions’ as potentially diminishing the welfare of consumers? Particularly given there was no consideration of the form that such a ‘National Champion’ might take.

A more difficult subject for the Panel to address is competition between companies outside Australia and the effect on Australian consumers. The newly affluent Asian markets for the first time provide Australia with large neighbouring consumer markets and the prospect of new zones of competition (Ball 2012). This parallels for instance adjacent European markets where fierce cross border competition overrides the artificial boundaries of national markets. It is not hard to envisage where firms competing for example across the scale of the Indonesian and Australian markets might provide new levels of scale, efficiency and competition to the benefit of all consumers.

The Panel which “considers that in order to protect the welfare of Australians, the competition laws are correctly focused on conduct that damages competition in markets of Australia, but recommends that actual and potential competition from overseas be considered” might also consider the benefits of Australian companies competing across multiple markets in competition

with overseas providers. To do so may require larger scale operations than are currently found in Australia.

“Box 15.1: Fonterra and calls for national champions in Australian agriculture” correctly points out that the merger of Fonterra was facilitated by special legislation that provided safeguards for consumers and farmers. There is absolutely no evidence given in this Review, or even an argument, which supports that the conclusion of those who suggest emulation of Fonterra in Australia is not soundly based! Again, to those who may have suggested that competition policy and laws should be amended, this is not a necessary condition for formation of a ‘National Champion’. Box 15.1 led to headlines suggesting the Panel is opposed to formation of a ‘National Champion’, which I am sure is not the case.

Later the draft report says: “The Panel considers that issues concerning the creation of ‘national champions’ can be addressed under the existing CCA framework. It is appropriate that a competition regulator, whether the ACCC or the Tribunal, adjudicate such issues as they arise from time to time.”

This is the real message for this section; it should be given prominence and Box 15.1 eliminated in its present form.

Productivity Commission views on ‘National Champions’ in the dairy industry

The motivation to write this submission is a response to the inconsistent analysis that the idea of ‘National Champions’ has received from a number of directions and a wish to prevent unintended consequences from these views. A report relevant to this discussion is the Productivity Commission Interim report *“Relative Costs of Doing Business in Australia: Dairy Product Manufacturing”* (Productivity Commission 2014) which also takes a view on the formation of ‘National Champions’.

The Commission finds that the Australian industry is competitive internationally but must improve productivity into the future. It discounts achieving this by a “larger, ‘Fonterra like’ dairy’ on the basis that “the business case for plant consolidation in Australia is limited by the geographically diverse location of dairy farms, given the significant transport and storage costs”. It discounts “that formation of a large ‘champion’ manufacturer would place Australia in a stronger position in global markets”, adding that “A belief that such an entity could exert market power on global markets does not seem consistent with market realities. The Australian dairy industry is a price taker on global markets and has no real capacity to alter this.” It postulates that the “development of a powerful player as providing increased scope to develop distinctive Australian branding” and achievement of a brand premium could be achieved equally by a national ‘Trust Australia’ brand, backed by the Australian Food and Grocery Council and government. It suggests that there are benefits from the current fragmented industry structure which “brings stability, processing and R&D capabilities which benefit the industry”. It suggests that New Zealand’s success as a dairy exporter relates more to the weather while conceding trade agreements...“may have also played a role”. While some commentators “could see Australia become a ‘branch office’ of global firms” resulting in underinvestment, the commissioner “understands there is a widespread perception in the global dairy industry that investing in Australia represents a strong potential springboard for exporting into growing markets in the Asia Pacific region. Improving the efficiency and competitiveness of the Australian dairy industry is likely to be a priority for these foreign investors.”

It is the writer’s opinion that each of the views expressed above are contentious and need close examination. It is surprising to see them listed together in a one sided argument against ‘National Champions’.

On the other hand in the same report the Commissioner very reasonably reports that “Many studies have shown that larger farms tend to perform better than smaller farms. Reasons for this include enhanced ability to exploit economies of scale, marketing advantages (including enhanced ability to enter into long-term supply chain arrangements with customers), greater bargaining power when purchasing inputs, scope for increased specialisation, and potentially greater scope to adopt new technologies.”

It is clear that there is considerable confusion about the role of competition in the dairy market. The Australian dairy industry diminished by 10 to 20 per cent over the same period the New Zealand industry grew by 50 per cent under the auspices of ‘National Champion’ Fonterra.

The case for National Champions

The point is that Fonterra is the only example in the Australasian agricultural market of a ‘National Champion’. Fonterra has provided leadership for the New Zealand market and its strategy of controlling a large worldwide milk supply has provided New Zealand farmers with the stability and confidence to invest and expand production. New Zealand farmers control Fonterra while the Australian agricultural industry supply chains are controlled by overseas multinationals. Most of these firms are based in countries that are also Australia’s main competitors and will have less interest in Australia’s long-term situation and requirements. Australia would seem in great need of its own ‘National Champion’.

The ACCC issues paper

Murray Goulburn (MG) filed application with the Australian Competition Tribunal (the Tribunal) for authorisation to acquire rival manufacturer Warrnambool Cheese and Butter (WCB), suggesting that the merger would provide a number of benefits in terms of scale, synergies, operational efficiencies, and product optimisation and production flexibility. The Australian Competition and Consumer Commission (ACCC) prepared an issues paper relating to the Murray Goulburn bid which raised:

1. “Doubts about whether some of the claimed benefits from synergies or operational efficiencies would actually emerge”

Here we have the world’s 35th largest dairy firm Murray Goulburn endeavouring to takeover Warrnambool Cheese and Butter, which might not make the top 100, in an endeavour to achieve scale. Market forces will dictate that Murray Goulburn expand and achieve synergies and operational efficiencies if it is to survive. The issue statement by itself is trite and even if some of the actual synergies identified by Murray Goulburn were unlikely to be achieved, it is likely that necessity would make this statement untrue in a general sense.

2. “Doubts about the competitiveness of the market for farmgate acquisition of raw milk in South Eastern Australia in the absence of an independent WCB”

A century ago there were hundreds of small butter factories serving the dairy producing areas around the world. Milk was separated on the farm and the cream carted to the factory for processing. Factories were positioned close to the farmer so that unrefrigerated cream milk could be processed into butter before it spoiled. At this time the number of potential processors close enough to take any one farmers’ milk was always very small, usually between one and three. As new technologies developed the total number of processors shrank rapidly but that relationship remained, excepting when market regulations distorted supply. Variations in purchase price seem

also to have been relatively small and when serious imbalances arose the result was that new arrangements to supply more distant processors were made and/or new processors created. The co-operative structure of dairy companies generally gave farmers input to pricing policy. Dairy processors cannot operate without milk – while the farmer must sell his milk daily he has always had power in the medium to long term.

As technology and milk collection improved the factories have amalgamated continually. It is hard to see why the ACCC would interfere now with this process and it is hard to not to believe that distortion of the market has occurred.

We can be sure that the international market will provide enormous competition to Australia's dairy industry. Other than in fresh milk we have already seen imports of cheese, butter, baby foods and even ice cream. Australian companies will not survive by simply displacing imports unless they are internationally competitive themselves.

Food processing industry issues

The writer contends that there are only a handful, perhaps as few as three or four food processing firms in Australia that have anywhere near the scale to operate successfully in the global market (Ball 2012). They have a small window of opportunity to establish themselves in the developing Asian markets. Murray Goulburn is one of these. At such times it is particularly important that regulatory organisations fully understand the forces at play and make decisions in the long-term interests of all Australians.

(Productivity Commission 2014) (Competition Policy Review Draft Report September 2014)

Bibliography

Astley, Mark. "Aussie calls to form Fonterra-style dairy giant 'not soundly based'." *foodnavigator-Asia*. September 22, 2014. www.foodnavigator-asia.com.

Ball, Geoff. "Whole of Value-Chain Scenario for Asia-Pacific food leadership." *Farm Policy Journal* (Farm Policy Journal) 9, no. 4 (2012): 1-9.

Competition Policy Review Draft Report. Canberra: The Australian Government, September 2014.

Potard, Gaetane. "The Declining Competitiveness of Australian Food Processing." *Farm Policy Journal* 11, no. 2 (2014): 1-13.

Productivity Commission. "Relative Costs of Doing Business in Australia: Dairy Product Manufacturing." Interim Report, Canberra, 2014.

Submission to the Competition Policy Review

Re: Competition, Mergers and 'National Champions'

Summary

This submission is about impressions and conclusions that could arise from reading the Competition Policy Draft Review.

In particular, it requests that Section 15 of the Competition Policy Draft Review be rewritten to correct the false impression created that the formation of 'National Champions' must in some way be unfavourable to Australia, due to issues involving competition restraints and/or other economic considerations.

The Review describes 'National Champions' as national firms that are large enough to compete globally and argues against changing competition laws for the formation of 'National Champions'. Changing competition laws is of course only one of the many ways in which a 'National Champion' could arise. Although later in Section 15, the Review states that the subject of 'National Champions' can be adequately addressed by the existing CCA framework, the impression is left, whether intentionally or not, that somehow the formation of 'National Champions' must disadvantage suppliers and consumers in the Australian market.

Media headlines that followed release of the draft report, such as "*Aussie calls to form Fonterra-style dairy giant 'not soundly based'*" (Astley 2014), illustrate this misinterpretation of the report findings. A number of recent reports, including government reports, have thrown cold water on the concept of 'National Champions' and the need for scale in Australian manufacturing. In the opinion of this writer these show poor understanding of the global market and there is need for more serious consideration of the topic.

It would be highly unfortunate if these opinion pieces were to influence decision makers such as the ACCC and government and inhibit Australian firms from investigating options for achieving globally competitive scale.

Accordingly Section 15 should make it very clear that the formation of 'National Champions' can be in accord with current competition policy and that as for any firm operating in the market, the CCA framework will address any negative competitive issues.

Secondly, in reviewing the outcomes from competition policy, it would be particularly useful to consider the rapidly diminishing competitiveness of the total Australian food processing industry (Potard 2014) and the role competition policy plays in this.

While it is easy to point at the ACCC's review of the Murray Goulburn bid for Warrnambool Butter and Cheese as an example of negative effect, the writer does not regard this as a failure of competition policy. It seems rather a failure of market understanding and market knowledge. The writer believes that the opinion offered by the ACCC represents unfortunate interference in a process of consolidation that has gone on in the dairy industry for over one hundred years and that it will distort the market accordingly and that it is unlikely to be in the long-term interests of Australian milk suppliers.

When reviewing competition policy the Panel must consider how this situation arose and whether in the broadest outcome sense, competition policy is in fact “driving efficient, competitive and durable outcomes, particularly in light of changes to the Australian economy in recent decades and its increased integration into global markets...”.

The observations made are based on the writer’s 44 years involvement with the dairy industry; as a dairy company executive, as the international head of a company supplying dairy and food ingredients in Australasia, Europe and the Americas, and involvement in formulation of national food research and development policy.

What the Review says about ‘National Champions’

The Competition Policy Review draft report states that “From time to time there are calls for competition policy to be changed to allow the formation of ‘national champions’ — national firms that are large enough to compete globally. While the pursuit of scale efficiencies is a desirable economic objective, it is less clear whether, and in what circumstances, suspending competition laws to allow the creation of national champions is desirable from either an economic or consumer perspective.” The wording incorrectly implies that “suspension of competition laws” is a necessary condition for the formation of ‘National Champions’. Firms will achieve scale of operation in many ways and in fact increased scale of physical operation may not always be necessary to form a ‘National Champion’. Additionally, as the report notes “In many markets in Australia achieving efficient scale will not substantially lessen competition because of the constraining influence of imports. Such mergers are allowed under the CCA.” Why would ‘National Champions’ not fall within this category?

The report notes that: “Porter and others have noted that the best preparation for overseas competition is not insulation from domestic competition but exposure to intense domestic competition. Further, the purpose of the competition laws is to enhance consumer welfare through ensuring that Australian consumers can access competitively priced goods and services. Allowing mergers to create a national champion may benefit the shareholders of the merged businesses but could diminish the welfare of Australian consumers.”

As Porter says companies that are not competitive within the Australia market are highly unlikely to become ‘National Champions’! But why single out ‘National Champions’ as potentially diminishing the welfare of consumers? Particularly given there was no consideration of the form that such a ‘National Champion’ might take.

A more difficult subject for the Panel to address is competition between companies outside Australia and the effect on Australian consumers. The newly affluent Asian markets for the first time provide Australia with large neighbouring consumer markets and the prospect of new zones of competition (Ball 2012). This parallels for instance adjacent European markets where fierce cross border competition overrides the artificial boundaries of national markets. It is not hard to envisage where firms competing for example across the scale of the Indonesian and Australian markets might provide new levels of scale, efficiency and competition to the benefit of all consumers.

The Panel which “considers that in order to protect the welfare of Australians, the competition laws are correctly focused on conduct that damages competition in markets of Australia, but recommends that actual and potential competition from overseas be considered” might also consider the benefits of Australian companies competing across multiple markets in competition

with overseas providers. To do so may require larger scale operations than are currently found in Australia.

“Box 15.1: Fonterra and calls for national champions in Australian agriculture” correctly points out that the merger of Fonterra was facilitated by special legislation that provided safeguards for consumers and farmers. There is absolutely no evidence given in this Review, or even an argument, which supports that the conclusion of those who suggest emulation of Fonterra in Australia is not soundly based! Again, to those who may have suggested that competition policy and laws should be amended, this is not a necessary condition for formation of a ‘National Champion’. Box 15.1 led to headlines suggesting the Panel is opposed to formation of a ‘National Champion’, which I am sure is not the case.

Later the draft report says: “The Panel considers that issues concerning the creation of ‘national champions’ can be addressed under the existing CCA framework. It is appropriate that a competition regulator, whether the ACCC or the Tribunal, adjudicate such issues as they arise from time to time.”

This is the real message for this section; it should be given prominence and Box 15.1 eliminated in its present form.

Productivity Commission views on ‘National Champions’ in the dairy industry

The motivation to write this submission is a response to the inconsistent analysis that the idea of ‘National Champions’ has received from a number of directions and a wish to prevent unintended consequences from these views. A report relevant to this discussion is the Productivity Commission Interim report *“Relative Costs of Doing Business in Australia: Dairy Product Manufacturing”* (Productivity Commission 2014) which also takes a view on the formation of ‘National Champions’.

The Commission finds that the Australian industry is competitive internationally but must improve productivity into the future. It discounts achieving this by a “larger, ‘Fonterra like’ dairy’ on the basis that “the business case for plant consolidation in Australia is limited by the geographically diverse location of dairy farms, given the significant transport and storage costs”. It discounts “that formation of a large ‘champion’ manufacturer would place Australia in a stronger position in global markets”, adding that “A belief that such an entity could exert market power on global markets does not seem consistent with market realities. The Australian dairy industry is a price taker on global markets and has no real capacity to alter this.” It postulates that the “development of a powerful player as providing increased scope to develop distinctive Australian branding” and achievement of a brand premium could be achieved equally by a national ‘Trust Australia’ brand, backed by the Australian Food and Grocery Council and government. It suggests that there are benefits from the current fragmented industry structure which “brings stability, processing and R&D capabilities which benefit the industry”. It suggests that New Zealand’s success as a dairy exporter relates more to the weather while conceding trade agreements...“may have also played a role”. While some commentators “could see Australia become a ‘branch office’ of global firms” resulting in underinvestment, the commissioner “understands there is a widespread perception in the global dairy industry that investing in Australia represents a strong potential springboard for exporting into growing markets in the Asia Pacific region. Improving the efficiency and competitiveness of the Australian dairy industry is likely to be a priority for these foreign investors.”

It is the writer’s opinion that each of the views expressed above are contentious and need close examination. It is surprising to see them listed together in a one sided argument against ‘National Champions’.

On the other hand in the same report the Commissioner very reasonably reports that “Many studies have shown that larger farms tend to perform better than smaller farms. Reasons for this include enhanced ability to exploit economies of scale, marketing advantages (including enhanced ability to enter into long-term supply chain arrangements with customers), greater bargaining power when purchasing inputs, scope for increased specialisation, and potentially greater scope to adopt new technologies.”

It is clear that there is considerable confusion about the role of competition in the dairy market. The Australian dairy industry diminished by 10 to 20 per cent over the same period the New Zealand industry grew by 50 per cent under the auspices of ‘National Champion’ Fonterra.

The case for National Champions

The point is that Fonterra is the only example in the Australasian agricultural market of a ‘National Champion’. Fonterra has provided leadership for the New Zealand market and its strategy of controlling a large worldwide milk supply has provided New Zealand farmers with the stability and confidence to invest and expand production. New Zealand farmers control Fonterra while the Australian agricultural industry supply chains are controlled by overseas multinationals. Most of these firms are based in countries that are also Australia’s main competitors and will have less interest in Australia’s long-term situation and requirements. Australia would seem in great need of its own ‘National Champion’.

The ACCC issues paper

Murray Goulburn (MG) filed application with the Australian Competition Tribunal (the Tribunal) for authorisation to acquire rival manufacturer Warrnambool Cheese and Butter (WCB), suggesting that the merger would provide a number of benefits in terms of scale, synergies, operational efficiencies, and product optimisation and production flexibility. The Australian Competition and Consumer Commission (ACCC) prepared an issues paper relating to the Murray Goulburn bid which raised:

1. “Doubts about whether some of the claimed benefits from synergies or operational efficiencies would actually emerge”

Here we have the world’s 35th largest dairy firm Murray Goulburn endeavouring to takeover Warrnambool Cheese and Butter, which might not make the top 100, in an endeavour to achieve scale. Market forces will dictate that Murray Goulburn expand and achieve synergies and operational efficiencies if it is to survive. The issue statement by itself is trite and even if some of the actual synergies identified by Murray Goulburn were unlikely to be achieved, it is likely that necessity would make this statement untrue in a general sense.

2. “Doubts about the competitiveness of the market for farmgate acquisition of raw milk in South Eastern Australia in the absence of an independent WCB”

A century ago there were hundreds of small butter factories serving the dairy producing areas around the world. Milk was separated on the farm and the cream carted to the factory for processing. Factories were positioned close to the farmer so that unrefrigerated cream milk could be processed into butter before it spoiled. At this time the number of potential processors close enough to take any one farmers’ milk was always very small, usually between one and three. As new technologies developed the total number of processors shrank rapidly but that relationship remained, excepting when market regulations distorted supply. Variations in purchase price seem

also to have been relatively small and when serious imbalances arose the result was that new arrangements to supply more distant processors were made and/or new processors created. The co-operative structure of dairy companies generally gave farmers input to pricing policy. Dairy processors cannot operate without milk – while the farmer must sell his milk daily he has always had power in the medium to long term.

As technology and milk collection improved the factories have amalgamated continually. It is hard to see why the ACCC would interfere now with this process and it is hard to not to believe that distortion of the market has occurred.

We can be sure that the international market will provide enormous competition to Australia's dairy industry. Other than in fresh milk we have already seen imports of cheese, butter, baby foods and even ice cream. Australian companies will not survive by simply displacing imports unless they are internationally competitive themselves.

Food processing industry issues

The writer contends that there are only a handful, perhaps as few as three or four food processing firms in Australia that have anywhere near the scale to operate successfully in the global market (Ball 2012). They have a small window of opportunity to establish themselves in the developing Asian markets. Murray Goulburn is one of these. At such times it is particularly important that regulatory organisations fully understand the forces at play and make decisions in the long-term interests of all Australians.

(Productivity Commission 2014) (Competition Policy Review Draft Report September 2014)

Bibliography

Astley, Mark. "Aussie calls to form Fonterra-style dairy giant 'not soundly based'." *foodnavigator-Asia*. September 22, 2014. www.foodnavigator-asia.com.

Ball, Geoff. "Whole of Value-Chain Scenario for Asia-Pacific food leadership." *Farm Policy Journal* (Farm Policy Journal) 9, no. 4 (2012): 1-9.

Competition Policy Review Draft Report. Canberra: The Australian Government, September 2014.

Potard, Gaetane. "The Declining Competitiveness of Australian Food Processing." *Farm Policy Journal* 11, no. 2 (2014): 1-13.

Productivity Commission. "Relative Costs of Doing Business in Australia: Dairy Product Manufacturing." Interim Report, Canberra, 2014.