CHANTICLEER | Apr 21 2015 at 5:33 PM | Updated Apr 21 2015 at 9:20 PM

The death of the oligopoly: Australia's incumbents face new rivals

There is growing evidence to suggest Australia's corporate oligoply industry structure is breaking down.

Telecommunications is an area where the power of the incumbent could be cracking. **Glenn Hunt**

by **Michael Smith**

Australia has traditionally been the home of the corporate oligopoly. Its major industries, telecoms, banking, supermarkets and insurance dominated by one, two or a small cluster of powerful players.

But there is growing evidence to suggest this industry structure is breaking down. After decades of high margins and excessive earnings, new players are moving in for a slice of the action as they take advantage of the digital economy and lower costs of entry.

It is trend fund managers with their eye on the long-term are watching closely.

"Australia was always referred to as the land of the duopolies and oligopolies. There are tentative signs of duopolies breaking down in other industries", the head of Australian equities at Goldman Sachs Asset Management, Dion Hershan, says.

"There are organisations and industry structures that pushed too hard, margins are too high and the invisible hand stepped in and attracted new competition."

Telstra, which holds its annual investor strategy day on Thursday, was the only major telecommunications company in Australia for years. It now shares the stage with Singapore Telecommunications-owned Optus and Vodafone Australia.

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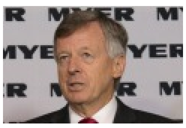

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While Telstra has enjoyed a good run over the last five years, dominating the mobile market, it is going to be increasingly challenged by its competitors.

AGGRESSIVE

SingTel might have announced on Tuesday it was delisting from the Australian stock exchange, but Optus is not going anywhere and is increasingly becoming a more aggressive and forthright competitor. Vodafone is also being taken seriously again now that it has resolved the network issues which saw millions of customers move carriers.

The potential $1.4 billion merger of TPG Telecom and iiNet is also threatening to shake-up the fixed-line business.

Pay-television monopoly Foxtel's business model is also under threat as new video streaming services lure away subscribers with cheaper alternatives.

Away from media and telecommunications, one of the most significant shifts is taking place in the general insurance market which has traditionally been dominated by Insurance Australia Group (IAG) and Suncorp.

"The general insurance market is the standout duopoly in Australia with extraordinary pricing power. The incumbents are starting to lose share to challengers, pricing is going down and they are yet to address the issue," Hershan says.

Analysts say the incumbents are in denial despite growing evidence they are losing market share to new players who can run promotions online and no longer have large media advertising costs as high points of entry.

Motor and home and contents insurance market share is difficult to monitor because of the lack of solid industry data. But UBS analyst James Coghill has been using APRA statistics and estimates share from the bottom up to try and get a clearer picture of where the market is heading.

UBS' latest sector update in April says Suncorp and IAG's share of the personal insurance market has reduced from 63.1 per cent to 58 per since 2010. Suncorp has shed 3.6 per cent in motor and 2.3 per cent in home and contents during that time. Meanwhile, IAG lost 1.7 per cent in motor and 1.4 per cent in home and contents. This results in a total $800 million windfall to new entrants.

It also found new challengers' share of the motor market was 13.5 per cent in the December half compared with 12.4 per cent six months earlier and their motor books were up 24.8 per cent in the period while home and contents rose 36.6 per cent. It estimates $175 million moved to challengers in the period.

While insurers claim they have maintained their share, this implies a significant shift structurally over a long period of time.

There has also been a creeping shift in the grocery landscape which has traditionally been dominated by Woolworths and Wesfarmers-owned Coles. German discounter Aldi, Costco and SPAR are starting to make an impact on the incumbents' market share. A grocery price war could shake up the market in the same way it did in the United Kingdom where it hurt Tesco, Asda and Sainsbury's.

The four major banks, which are the focus on a Senate committee inquiry this week into financial advice, are the notable exception, retaining their grip on the commercial banking market.

CRYING FOUL

There is an accidental irony in Rio Tinto's latest production numbers which show the global miner's iron exports fell at a time when Fortescue Metals is crying foul over a low-cost rival flooding the market.

The surprise fall in the amount of iron ore shipped in the March quarter (versus the December quarter of 2014) briefly gives Rio Tinto the high moral ground in the political debate raging around iron ore, even though the real reason for the decline was because of bad weather and a train derailment.

The latest data also weakens the argument that Rio Tinto and BHP Billiton are trashing the market by flooding it with new supply and driving down prices.

Analysts say the March numbers suggest demand from China is weaker and this means the low iron ore price is not necessarily Rio Tinto or BHP Billiton's fault.

Rio Tinto shipped 72.5 million tonnes of iron ore in the quarter, which was 9 per cent higher than the corresponding quarter a year ago, but 12 per cent less than the December quarter.

It was also lower than the 74.7 million tonnes produced in the quarter, a reversal of the miner's position last year when it dipped into stockpiles to shore up its balance sheet.

This surprised the market which had been tipping stronger numbers. While it is an interesting twist in the political storm surrounding iron ore pricing, it will have little real impact on the debate.

Sure, it makes the miner look good given rival Fortescue Metals upped its full-year guidance and posted a solid increase for the quarter last week at the same time it was accusing Rio Tinto and BHP Billiton of flooding the market.

But the real reason for the decrease really has nothing to do with that. Wet weather, a tropical cyclone and a train derailment which temporarily blocked an inload train circuit at Dampier, were the factors behind the weak numbers. Bad luck for Rio Tinto but bad timing for Fortescue as well.

The politics surrounding iron ore are affecting the way Rio Tinto manages its stockpiles in the slightest and the miner has reaffirmed its 2015 shipping guidance of 350 million tonnes this year.

Rio Tinto is not blinking despite Fortescue's increasingly noisy campaign for government intervention and will continue to sweat its assets now that is got 90 per cent of the infrastructure it needs in place for the Pilbara operations.

Analysts had expected the miner to ship as much as it produced in the quarter and the numbers were slightly below analyst forecasts. But margins remained solid and there is nothing in the numbers that will alarm the market.

Matthew Stevens is on leave

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