Fuel flow restriction

ACCC delays decision on BP-Woolies petrol deal

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THE consumer watchdog has delayed its final decision on BP's $1.8 billion deal to buy Woolworths' 527 petrol stations.

A verdict was due October 26, but the Australian Competition and Consumer Commission now says it is deferring a decision until November 30.

Announcing the delay yesterday, the ACCC said it needed more time for analysis of data and to consider information provided by the businesses and other interested parties.

Under the proposed deal, BP service stations would accept fuel discount vouchers issued by the supermarket chain and participate in its loyalty program.

In August, the ACCC proposed to approve the deal in a draft decision released for public comment.

The decision was welcomed by independent supermarkets and fuel retailers.

At the time, a BP Australia spokeswoman said the fuel retailer was "pleased" with the ACCC's views about the merits of the deal.

She said BP welcomed findings that the deal "will generate public benefits in the form of the additional ... docket redemption sites, greater uptake of docket discounts, and increased opportunities to earn and redeem benefits under the Woolworths Rewards loyalty program".

But in its statement of issues, the ACCC said it was concerned the deal might lessen competition in fuel retailing. Woolworths "actively leads price discounting or quickly reacts to price discounting by other retailers" in the petrol market, the commission said.

It said it was concerned BP "would not follow Woolworths' pricing strategy".

The deal would also enable remaining fuel retailers to coordinate price increases more effectively, the ACCC said.

The regulator has had long-standing concerns that fuel discount vouchers provided by the major grocers when customers spend at least $30 in their stores drive anti-competitive behaviour.

In 2013, it banned Coles and Woolworths from providing discount vouchers in excess of 4c a litre.

Shares in Woolworths closed down 1.8 per cent yesterday at $24.54.

THE AUSTRALIAN

MARKET WRAP

THE share market has fallen for a second straight session as offshore investors sell shares on concerns about a weaker outlook for the Australian dollar.

The benchmark ASX 200 index dropped 0.9 per cent to 5652.1 points — its lowest level since February 8. The broader All Ordinaries index dropped 44.6 points, or 0.8 per cent, to 5719.6 points.

CMC Markets chief market strategist Michael McCarthy said the recent selling in the share market, amid low volumes, looked to be currency related.

"The shift in the outlook for the Australian dollar is, I believe, weighing on the local market," Mr McCarthy said. "With so many strategists shifting their view on the Aussie from up to somewhere between 80 and 84 (US) cents to now down to somewhere between 76 and 72 (US) cents, we've got a lot of reasons for international investors to bale out or even short." The Aussie dollar was buying US78.67c late yesterday.

The major banks fell, with **ANZ** the weakest performer, dropping 2.1 per cent to $29.24.

BHP Billiton lost 0.6 per cent to $26.00, **Rio Tinto** dropped 1.5 per cent to $67.43 and **Fortescue Metals** surrendered 2.1 per cent to $5.15. Weaker oil prices hit the energy companies, with **Woodside Petroleum** dropping 1.1 per cent to $28.70 and **Santos** 1 per cent weaker at $3.97.

MotorCycle Holdings surged 14.7 per cent to $4.85 after it announced a buyout of counterpart Cassons.

DOLLARS & SENSE by MACCA

Ford to streamline its designs

TRANSPORT

FORD Motor Company's new chief executive plans to cut almost $18 billion in costs and drop some car models as part of a renewed effort to win over sceptical investors.

The US car-making heavyweight will focus on a narrower range of vehicles under the shake-up, including trucks, sports utility vehicles and electric cars.

Jim Hackett, who became Ford chief in May, met with about 100 investors in New York overnight Tuesday to lay out his plans for the future. It comes at a pivotal time for Ford in Australia after the group last year ceased making cars here, ahead of Toyota's production shutdown this week and Holden's later this month.

Getting Ford lean and flexible would help it handle the changes the auto industry was facing, from car-sharing to self-driving vehicles, to the shift to electric cars, Mr Hackett said.

"I feel a real sense of urgency for what we're doing here," he said.

Ford said it expected to reduce material costs by $US10 billion ($12.7 billion) through new deals with suppliers and simpler designs.

It also expects to cut $US4 billion in engineering costs by 2022.

Ford's share price has languished for the past two years as shares in rival General Motors rose to their highest level in seven years.

Services sector feels pinch

THE ECONOMY

THE Australian services sector is still expanding but at a slower pace, with business conditions variable across sectors and states, research suggests.

Retail and the hospitality trades are finding conditions particularly tough as higher household electricity costs and slow wages growth curb consumer spending, according to polling by the Australian Industry Group.

It found retailers were also feeling the pinch of growing competition from online operators and offshore sellers.

Ai Group yesterday said all businesses were being affected by rising energy costs, which was putting pressure on margins and proving difficult to pass on to customers already reluctant to spend.

Its performance of services index fell 0.9 points to 52.1 in September, but stayed above the 50-point level, signifying an expansion.

The overall services sector has now expanded for seven months in a row.

Ai Group chief Innes Willox said that while the big services sub-sectors were doing reasonably well, growth was not broadbased.

The highs and lows of an exchange-traded fund gamble

THE SHORT CUT
with ANDREW MACKEN

A TOPIC of considerable interest in investing circles today is the current boom in indexation and low-fee passive investing.

It is certainly worth thinking about, given that the global exchange-traded fund space has grown to more than $US4 trillion ($5.1 trillion), according to data provider ETFGI.

A lot of thought-provoking work on the space is currently being conducted by the likes of Steven Bregman and others.

For value investors who believe that assets should only ever be acquired for less than they are worth, the primary flaw of indexation is that no concern for the price being paid for the underlying assets is given by the investor.

Without any concern for the price being paid for an asset, the probability that one is consistently underpaying for assets must surely be close to zero.

Yet $US4 trillion has already accrued to this style of investing, so there must be some attractive features.

And surely the most popular of these is the low management fee that is typically associated with index funds and other passive ETFs.

All else being equal, lower fees are naturally a good thing for any investor.

But all else is sometimes not equal.

At least in the world of active investing there is an interesting argument as to why low fees are potentially sub-optimal for investors (believe it or not).

The one-sentence summary of the argument goes like this: lower fees, means higher required funds under management, which means a smaller opportunity set and finally, a lower probability that outperformance will be generated for the end investor.

The link between fee, fund size and opportunity set is not entirely obvious but one well worth considering.

Here is the rough maths behind it. Imagine an actively managed global equity fund that invested only in businesses with market capitalisations of at least $1 billion and daily liquidity of at least $5 million.

These constraints result in about 5000 businesses listed on the major global stock exchanges from which to choose.

Such a strategy could be maintained all the way up to a fund size in the single-digit billion dollars.

Imagine, now, that particular fund manager were to pursue an alternative strategy under which he or she cut the management fee significantly (to compete with passive ETFs).

Let's say the fee was cut by a factor of five or 10.

Then, naturally, it would take five to 10 times the assets to generate an equivalent amount of revenue for the manager.

But here is the rub: the fund's opportunity set would shrink materially.

For instance, if tomorrow the fund manager woke up to $50 billion of capital in the fund, the opportunity set would be down to about 300-400 global businesses.

Add another $50 billion, and the manager would have only about 150 global businesses from which to choose.

With significantly fewer businesses from which to choose, the probability that this fund manager can compound returns at rates as high as yesterday has surely diminished significantly.

Food for thought: very low fees means very large scale; and very large scale — at least in the world of active equity funds management — means a very small opportunity set.

And a smaller opportunity set must lower the probability of very high compounded returns.

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