

**SUBMISSION NO. 10**  
**Horticultural Code and**  
**Farm Gate to Plate**



14 December 2011

The Hon Dick Adams, MP  
Chairman  
House of Representatives Standing Committee on  
Agriculture, Resources, Fisheries and Forestry  
PO Box 6021  
Parliament House  
CANBERRA ACT 2600

Dear Mr Adams

Coles is pleased to make a submission to the House Standing Committee on Agriculture, Resources, Fisheries and Forestry on the Constitutional Corporations (Farm Gate to Plate) Bill 2011 and the Competition and Consumer Amendment (Horticultural Code of Conduct) Bill 2011.

Coles takes great pride in the work we do to promote Australian grown and made food and we are working closely with our farmers, food suppliers and food manufacturers to promote long term sustainable relationships with participants in the agri-food supply chain.

As a member of the Wesfarmers group of companies, which started as an agricultural cooperative in Western Australia in 1914, and now has many farmer shareholders, Coles is well aware of the need to build sustainable relationships with farmers.

Coles sources 100 per cent of its fresh beef, pork, chicken and poultry and over 96 per cent of fresh fruit and vegetables from Australian farmers either direct or through wholesalers, packers or agents and increasingly works to support leading producers with volume commitments and capital support to encourage long-term investments in quality, innovation and import replacement.

***A copy of case studies that highlight the positive relationship that Coles has with fresh fruit and vegetables suppliers across the country is attached. These are the unsung heroes of Australian agriculture that get on with the job of producing quality fresh food every day.***

Coles also sources as much of its processed food products from Australian-based manufacturers where possible. Indeed, Coles is the only Australian supermarket to have an **Australian First** sourcing policy that actively works with farmers to promote import replacement and ensure long term food security. For example, Coles is the only national supermarket that sources locally grown fresh vegetables from Tasmania for its frozen vegetables range of Coles brand products in our national store network that feeds 13 million customers every week of the year.

***A copy of Coles Australia First policy is attached. A copy of a recent Coles' announcement to replace New Zealand sourced cheese with locally made Bega Cheese for all Coles brand cheese products is also attached.***

## Selling more Australian grown fresh produce

Coles has worked hard over the last three years to promote Australian grown fresh food with its customers through its advertising and marketing campaigns over the last three years.

The highly successful 'Feed your Family for under \$10' campaign, led by Curtis Stone, our 'Super Specials' fresh produce campaign and our 'Masterchef' sponsorship has encouraged Australian families back to the kitchen and rekindled a long lost passion for healthy home cooking.



Coles has recorded an incremental 2 million customer transactions per week in response to the work that we have been doing to improve our quality, service and value to Australian customers.

As a result, our customers have spent an additional \$600 million in the last three years on fresh fruit and vegetables at Coles.

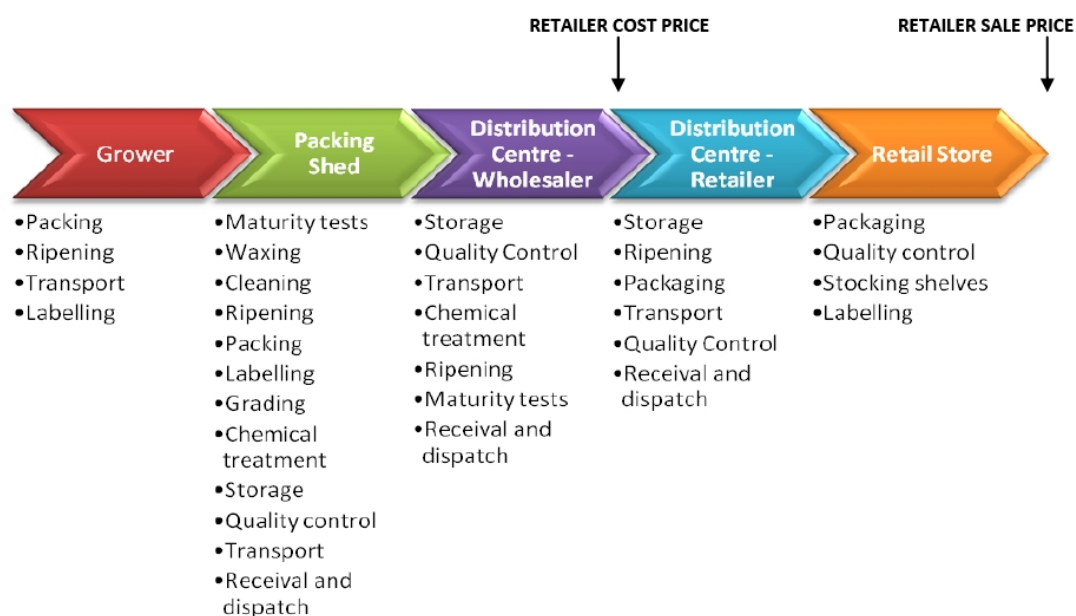
This is a clear and direct benefit for our farmer suppliers.

## Farm gate pricing

Coles understands the motives of agri-food representative bodies in supporting the principle of the Constitutional Corporations (Farm Gate to Plate) Bill 2011 to improve transparency of agri-food supply chain arrangements and increase customer understanding of how much farmers get at the farm gate. Greater supply chain transparency is certainly a worthy objective.

The reality is that the agri-food supply chain is complex and that there are a range of parties including growers, packing shed operators, transport operators, distribution centre operators and wholesalers and retailers who all influence the final retail price of fresh produce. However, Coles is increasingly dealing direct with farmers to source locally made produce.

## The agri-food supply chain



However, Coles' believes that the objectives of the Constitutional Corporations (Farm Gate to Plate) 2011 Bill as stated by its political sponsors are misguided, that the Bill is poorly drafted and it will not achieve the desired intent.

Indeed, the Bill may have unintended consequences including creating confusion amongst consumers and placing costly compliance burdens on farmers and others through the agri-food supply chain.

Coles' notes that many of the submissions by Federal and State agri-industry association to the Senate inquiry into the Bill recommended against the Bill on these grounds, including the **National Farmers Federation**: "The NFF does not believe that the Bill will improve farm gate prices and will instead create a confusing layer of information for consumers."

The **NSW Farmers Association** was also critical of the Bill: "The supply chain is complex and highly variable operation on which costs change significantly on a geographical and seasonal basis. Without further information, there is a general concern amongst members that displaying only the farm gate price may misrepresent the costs associated with the supply of fresh produce such as freight, storage, labour, etc."

Coles has therefore commissioned a report by leading agri-food consulting firm, Freshlogic, to try and estimate at a very high level in selected categories where data is reasonably available what the farm gate share of the final retail price is.

***A copy of the Freshlogic report is attached including a graphic of the full agri-food supply chain within selected fresh produce categories that reinforces the complexity and costs involved in the paddock to plate arrangements in Australia.***

Freshlogic took months to complete the report because of the lack of industry data across all categories of fresh produce and lack of data on above farm gate costs amongst all participants. This means it is highly qualified and partial data.

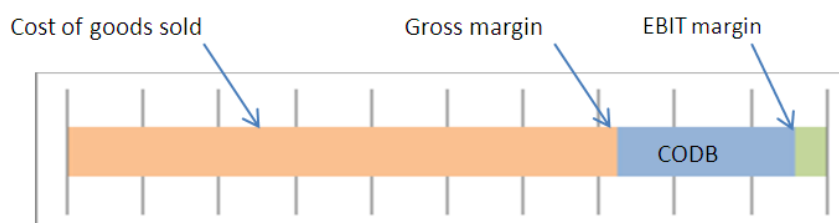
However, the Freshlogic report shows that in most fresh produce categories that can be measured at an industry level, farmers receive between half and two-thirds of the final retail price in supermarkets. This suggests that farmers receive a fair share of the retail price for fresh produce given the other costs and players in the agri-food supply chain.

### Farm Gate Pricing & Beyond

Farmgate	Beyond farm
<p><i>Farm Gate prices vary by produce &amp; across growing seasons and regions. Prices are largely determined by supply and demand, usually on a daily basis, but also impacted by climatic events &amp; conditions as well as export markets</i></p>	<p><i>Beyond Farm prices include the cost of aggregation, distribution, packaging and changing hands between market agents, wholesalers, distribution to retail and the CODB at retail level</i></p>

The Freshlogic report also shows that above farm gate component of the retail price includes a range of costs including packing, transport, storage and distribution, as well as marketing, storage and waste in stores that directly contribute to the cost of doing business in a national supermarket network and final retail price to customers.

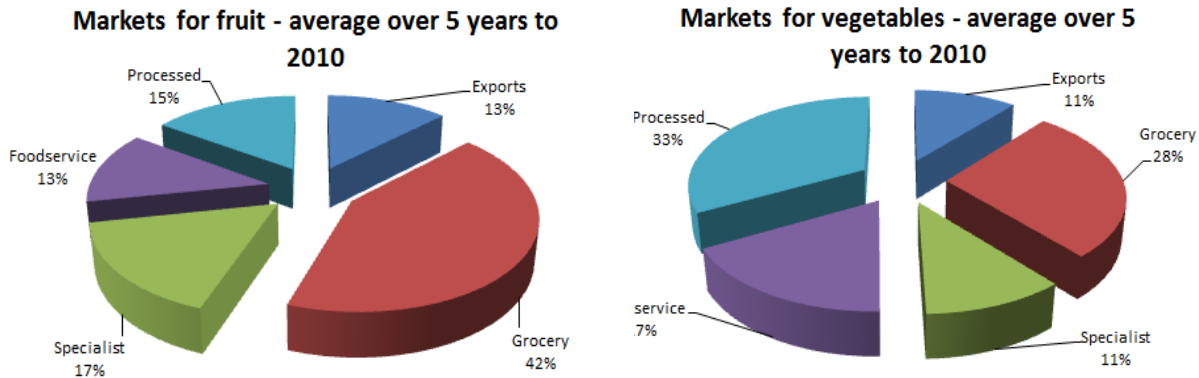
### Coles EBIT margin after COGS and CODB



*Retail margins in each category vary, as they reflect individual product gross margins, cool chain and wastage costs as well as direct product and store costs related to the Cost Of Doing Business*

Indeed, as the Freshlogic report confirms, the final net profit margin for supermarket retailers is very low. In the case of Coles, this is less than 5 cents in the dollar across the entire business. While the annual profit number looks big to the farmer or the consumer, this represents a relatively low rate of return on assets employed to deliver fresh produce across a national network of 740 supermarkets in every State.

The Freshlogic work also highlights that the major supermarkets source less than half of the fresh fruit and less than one third of the fresh vegetables sold in Australia. This confirms that other players, including food processing, food service such as restaurants, specialist fruit and vegetables retailers and export markets, have a big impact on the final farm gate price. It also highlights the choice available to farmers in selling their produce.



What the proposed Bill does not deal with at all, is high and rising input costs and falling farmer margins. As farmers are largely price takers in commodity markets, despite the sale options open to them, their ability to minimise input costs and generate on farm efficiencies are key drivers of their long term sustainability.

If there is a case for Federal and State Government action to assist farmers it lays in helping them mitigating rising input costs, especially where State and federal Government taxes and utility charges contribute to the problem, and in fostering innovation and efficiencies in managing on farm costs and improved productivity.

## **Retail food pricing**

The customer rationale for Coles' food pricing campaigns is clear: we are trying to help our customers to combat rising living costs and encourage them to spend more on Australian grown fresh food.

Between 2000 and 2007, Australian food price inflation increased by more than four percent per annum. Over the past 12-18 months, rising utility bills, interest rates and other expenses have taken an estimated \$150 out of the average Australian household's monthly disposable income.

Against this backdrop, Coles has reduced food and grocery prices and delivered real food price deflation in its stores of about two percent – putting an estimated \$800 million to \$1 billion back into customers' pockets.

Retail competition led by Coles has driven food price deflation and provide economy wide benefits through lower cost of living for Australian families.

Coles recognizes the concerns expressed by some farmers and their representative bodies that food price discounting in our stores as part of our "Down Down" campaign may squeeze margins through the supply chain but we believe these concerns have been misplaced and we have worked hard to explain what we have done to minimise any direct flow through to the farm gate from our actions.

To be clear for members of the Standing Committee, Coles has fully funded retail food price cuts from its own profit margin, and in many instances, paid food processors more for their produce to ensure that farm gate prices are not affected. Coles has funded these price cuts through internal cost savings, NOT by pushing cost savings initiatives down the agri-food supply chain to farmers.

Indeed, Coles has invested hundreds of millions of dollars over the last three years to make our supply chain more efficient so we can shift fresh produce from paddock to plate more quickly and in better condition, and we have dramatically improved how we store and present our fresh produce in our supermarkets so it lasts longer when customers take it home.

The Australian Competition and Consumer Commission (ACCC) fully reviewed the Coles milk price discounts and reported on 22 July 2011, and in subsequent appearances before the Senate, that Coles had not engaged in predatory pricing and that the January 2011 Coles brand milk price cuts were pro-competitive.

Coles also notes the key findings of the final Senate Inquiry into milk discounting, which reported on 3 November 2011, that concluded:

- In general, price discounting is likely to be pro-competitive and of benefit to consumers. Provided it does not constitute predatory pricing, a retail price cut should not be discouraged
- The January 2011 price cuts in a staple product is undoubtedly good news for consumers in the short term. Attempting to predict with any certainty any longer term impact on consumer welfare is difficult, if not impossible;
- It is apparent that when looking at the dairy industry at a national level, most dairy farmers will not be significantly worse off because of the price cuts;

- Although (milk) processors are undoubtedly in a challenging position, the management of their branded products and the terms on which they supply private label milk to the supermarkets is a matter for them; and
- The Committee is not of the view that the specific price discounts by Coles which were the subject of this inquiry warrant legislative amendments. It is not clear that the amendments proposed during the inquiry would actually provide a 'remedy' to the milk pricing issue.

Coles has not undertaken price reduction initiatives for purely altruistic purposes. We are a business and we work within the law to maximise our sales and profits and returns to our shareholders.

However, we have a clear self-interest in making sure that our suppliers share in the benefits of increasing sales. Our customers want Australian grown food and we want to ensure long term sustainable food security.

We have seen strong sales growth as a result of the campaigns that we have run in the last three years, and our farmers and agri-food chain suppliers have directly benefited from that sales growth.

Most of the concerns about Coles pricing policies or supply chain initiatives aired in the media or at Parliamentary Committees do not come from Coles' suppliers but from others in the agri-food supply chain or professional lobby groups who have a stated competition policy and political agenda and want to use legislation or regulatory change to intervene in competitive markets and protect and promote the economic welfare of their members.

### **Agri-food supply chain relationships**

It needs to be understood that day-to-day negotiations in the business sector are often robust. Indeed, farmers are not shy in making their views known to Coles if they do not think they are given a fair go, and they know their legal rights well.

Farmers have effectively used existing legislative and regulatory avenues to air grievances where disputes occur, including the existing Produce and Grocery Industry Code of Conduct and the Australian Competition and Consumer Commission.

Coles works cooperatively with the PAGIC Ombudsman to resolve any issues that arise in the produce and grocery supply chain. Coles has responded to all complaints received by PAGIC and the ACCC and no matters are unresolved.

Coles and all other major retail groups, including Aldi and Woolworths, have been part of the PAGIC and its predecessor for ten years. The PAGIC applies to the entire supply chain of the retail grocery industry.

We believe the existing framework in PAGIC is sufficient to ensure the necessary transparency in dealings with suppliers and provides sufficient dispute resolution procedures. In fact, the Horticulture Code mirrors many of the transparent trading terms and dispute resolution procedures set out in the PAGIC.

Coles set out its position in its response to the 2008 ACCC Inquiry into the competitiveness of retail prices for standard groceries. In general, supply contracts that Coles enters into with its suppliers incorporate Coles' standard terms and conditions, which include provisions specifying the process to be used to resolve any disputes that arise between the supplier and Coles.

Given that Coles negotiates milk supply terms with large multinational dairy processors, we submit that it is not necessary or appropriate for there to be a similar form of horticulture code applying to those arrangements.

We do however support increased ability for farmers to collectively negotiate with processors and also submit that to increase in some circumstances their ability to negotiate and achieve efficiencies in their businesses, that those collective bargaining arrangements include some form of additional consultation with appropriate accountants or such advisors to assist their organisations.

The ACCC and Law Council of Australia submissions support the view that there is sufficient regulatory oversight of the grocery industry and that there is no need for any additional legislative amendments or new regulatory structures.

Coles notes that the submission to the Senate Milk Inquiry by the Australian Food and Grocery Council (AFGC), which represents the multinational milk processors, does not support the extension of the Horticultural Code of Conduct to the dairy industry.



Coles notes that the AFGC is the leading industry proponents for a UK style supermarket code of conduct and ombudsman. Interestingly, many AFGC members have larger market shares in their grocery categories than Coles but do not see themselves subject to the Ombudsman.

The AFGC claims the market power of the large supermarkets, coupled with aggressive retail pricing, is squeezing the margins of their members and threatening their viability. The AFGC claims that: “food manufacturers are being forced to shut business or relocate offshore which in turn is disadvantaging their regular, long term suppliers of fresh produce.”

***Coles has attached a chart that confirms the high market shares of the global and domestic food manufacturers amongst AFGC. Coles has also attached a report commissioned by the Allen Consulting Group which we have lodged with the Senate Inquiry into food processing that reveals the real reasons for the current performance of food manufacturing in Australia – high and rising input costs and a strong Australian dollar – not supermarket food discounting or private label growth.***

The real reason the AFGC is pursuing this campaign against the major supermarkets is that it wants a return to the period between 2000 and 2007 when grocery inflation was an easy driver of profit growth for food manufacturers and allowed them to escape the hard decisions about improved competitiveness and long term investments in quality, innovation and branding.

What the AFGC really want is high food prices to fund their profit margins. They are cynically using consumers and farmers to protect and grow their profit margins and return on capital.

In August 2011, Justice Emmett of the Federal Court decided the Metcash merger case and concluded that supermarket retailing was increasing competitive and was benefitting consumers, and the Allen Consulting Group concludes that bargaining power through the agri-food supply chain is pro-competitive where it results in lower prices for consumers and it is NOT the role of Government policy to protect competitors”.

Justice Merrett concluded that:

***“The grocery industry in Australia is a highly competitive industry characterised by high volumes and low margins. The operators of self-supplying supermarket chains are extremely disciplined and endeavour to standardise their offerings at any one time. Nevertheless, those offerings are not static, but shift as the chain operators explore market opportunities and develop new strategies. On the other hand, the products offered by independent retailers exhibit greater diversity than those of the chains in areas such as, for instance, size and location. Independent retailers may choose, or be forced, to rely upon factors other than price to attract customers. ”***

***“It is reasonable to conclude that the scale and intensity of retail competition is extreme and is increasing. Volume is the key to success for the major supermarket chains, independent retailers and Metcash alike.”***

The Committee should note that UK proposals for a supermarket Ombudsman have been on hold and are subject to further review by the current Government. It would therefore be premature to adopt a proposal that has not even been accepted in another jurisdiction.

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<sup>1</sup> Metcash case at para [12].

## **Summary and recommendations**

Coles takes great pride in the work we do to promote Australian grown and made food and we are working closely with our farmers, food suppliers and food manufacturers to promote long term sustainable relationships with participants in the agri-food supply chain.

Coles has worked hard over the last three years to promote Australian grown fresh food with its customers through its advertising and marketing campaigns over the last three years.

Coles has recorded an incremental 2 million customer transactions per week in response to the work that we have been doing to improve our quality, service and value to Australian customers. As a result, our customers have spent an additional \$600 million in the last three years on fresh fruit and vegetables at Coles. This is a clear and direct benefit for our farmer suppliers.

Coles' research shows that in most fresh produce categories that can be measured at an industry level, farmers receive between half and two-thirds of the final retail price in supermarkets. This suggests that farmers receive a fair share of the retail price for fresh produce given the other costs and players in the agri-food supply chain.

The research highlights that the major supermarkets source less than half of the half of the fresh fruit and less than one third of the fresh vegetables sold in Australia. This confirms that other players, including food processing, food service such as restaurants, specialist fruit and vegetables retailers and export markets, have a big impact on the final farm gate price. It also highlights the choice available to farmers in selling their produce.

The research also shows that above farm gate component of the retail price includes a range of costs including packing, transport, storage and distribution, as well as marketing, storage and waste in stores that directly contribute to the cost of doing business in a national supermarket network and final retail price to customers.

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The Committee should note that proposals for a supermarket Ombudsman modelled on the UK system have been on hold and are subject to further review by the British Government. It would therefore be premature to adopt a proposal that has not even been accepted in another jurisdiction.

Yours sincerely

John Durkan  
Merchandise Director