The Allen Consulting Group

Senate Select Committee Inquiry into the Australian Food Processing Sector

Submission by Coles

October 2011

Report by the Allen Consulting Group

The Allen Consulting Group

Allen Consulting Group Pty Ltd

ACN 007 061 930, ABN 52 007 061 930

Melbourne

Level 9, 60 Collins St

Melbourne VIC 3000

Telephone: (61-3) 8650 6000

Facsimile: (61-3) 9654 6363

Sydney

Level 1, 50 Pitt St

Sydney NSW 2000

Telephone: (61-2) 8272 5100

Facsimile: (61-2) 9247 2455

Canberra

Empire Chambers, Level 2, 1-13 University Ave

Canberra ACT 2600

GPO Box 418, Canberra ACT 2601

Telephone: (61-2) 6204 6500

Facsimile: (61-2) 6230 0149

Online

Email: info@allenconsult.com.au

Website: www.allenconsult.com.au

Contents

Executive summary

The purpose of this report is to assist the Senate in reaching an informed view on the current state of food processing in Australia.

Coles' core business is not food processing. Coles is a retailer. This report therefore begins by describing the commercial environment in which Coles operates. Coles operates in the food retail sector. We describe some important aspects of the food retail sector, such as which are the major players, market structure, and the preferred choice of business organisation in the sector. (Chapter 2)

The vertical supply chain in food processing and food supply is another important aspect of the commercial environment in which Coles operates. We describe the vertical supply chain in food supply, and show that Coles operates 'downstream' from food processors in the vertical supply chain. We show that this 'downstream' food retail sector is highly competitive. (Chapter 3)

We explain the purpose of competition law as applied to vertical supply chains. This is to protect the long-run welfare of Australian consumers. Firm behaviour **is irrelevant for competition law purposes** unless it also harms the long-run welfare of end-customers in the vertical supply chain. (Chapter 3)

Coles negotiates vigorously with upstream suppliers to ensure that customers receive lower prices. This so-called 'buyer power' leads to lower prices faced by end-customers and so increases the welfare of Australian consumers. It is **pro-competitive** rather than anti-competitive, regardless of whatever effect this has on the margins or location decisions of food processors. (Chapter 3)

We describe the concepts of 'exclusion', 'predation' and 'foreclosure' and explain the mechanism by which those types of practice can harm the welfare of end-customers (and hence are anti-competitive). The circumstances in which such practices might harm end-customers however are rare, and the *Competition and Consumer Act* 2010 already adequately provides for protection against these practices. (Chapter 3)

Turning to food processing (rather than food retail), we describe some long-run trends for manufacturing in Australia. We show that, while some metrics appear to indicate a long-run 'decline' in manufacturing, in fact, over the long-run, manufacturing has continued to grow, has continued for the main to see higher productivity, stable employment levels, as well as higher wages for workers who remain in manufacturing. (Chapter 4)

The food-processing sector in Australia is very successful. Output, profits, productivity, exports and wages have all been increasing. The basis of this superior performance is due to increased innovation that aids firms in the sector gradually to move up the value-ladder. (Chapter 5)

We describe some of the challenges facing the food-processing sector in the near future. Current and future challenges facing food-processing firms are:

- Rising labour costs

- Rising (non-labour) input costs
- Rising penetration of private label brands
- Rising Australian dollar
- Rising import competition (Chapter 5)

Firms in food processing have the opportunity to be pro-active in the face of future challenges by investing in their export capacity, investing in innovation in terms of new products, and investing in improved quality of existing products. These types of investment allow firms to be pro-active on their revenue side. Firms can also be pro-active on their cost side by investing in more efficient supply processes. Firms incapable of either type of investment have the ultimate opportunity of relocating offshore. (Chapter 5)

The future of successful food processing in Australia involves continued innovation and investment in quality across all dimensions of business. We describe two case studies of food processing sectors which provides a contrast view of how different sectors are evolving and adapting to the pressures the sector faces: processed fruit and vegetables and biscuits. (Chapter 6)

We describe the processed fruit and vegetable sector, which has recently been facing negative revenue growth. We show that the sector is focussed on exports and innovation, and that those firms in the sector that cannot do either have the option of locating offshore as a means of restoring their margins. (Chapter 6)

We also describe the biscuit sector. This sector faces moderate positive revenue growth. Past innovation means that it is further along the quality-ladder than the processed fruit and vegetable sector. We show that in this sector, firms higher up the quality-ladder need to continue to invest in innovation, while those lower on the ladder have the option of re-locating off-shore to exploit the cost advantages of being part of the global supply chain. (Chapter 6)

Finally, we suggest some non-trade-distorting ways that government can assist the food-processing sector to continue to thrive. These are:

- Accelerating Australian innovation capability
- Ongoing improvements to food and biosecurity regulation
- Improving offshore market access (Chapter 7)

Chapter 1

Introduction

Chapter 1 outlines the contents and structure of the report.

1.1 Background

Coles has commissioned the Allen Consulting Group to prepare a submission on its behalf to the Senate Select Committee inquiring into the Food Processing Sector.

The purpose of the report is to assist the Senate in reaching an informed view on the current state of food processing in Australia.

1.2 Content of this report

In this report we review the main economic drivers impacting the current and future performance of food processing in Australia.

Coles is not a food processor. Coles is a retailer. We first describe the food-retailing sector that Coles competes in. That sector is competitive. We show that the issue of food retail competition is largely irrelevant to any analysis of the current performance of the food-processing sector. The exception is that retail competition helps drive down prices of processed foods for the Australian shopper. This outcome is good for Australians and of no concern to government or the competition regulator.

Analysis of the food-processing sector in Australia should focus on the major current and long run drivers of performance in that sector.

Food processing is part of the manufacturing industry. The long-run share of manufacturing to GDP in all Western countries has been declining for decades. The same is true of the long-run share of employment in manufacturing to total employment in the economy. These long run changes are a sign of economic strength. The driver of this gradual macro-change involves firms transitioning up the value-added ladder to the benefit both of their own bottom line and the Australian economy as a whole.

Evidence shows that food processing in Australia is currently very successful. It is performing better than manufacturing more generally. Indicators of solid performance can be seen in growth in output, productivity, profit and wages. The basis of this superior performance is due to increased innovation that aids firms in the sector gradually to move up the value-ladder.

The future of successful food processing in Australia involves continued innovation and investment in quality across all dimensions of business. Those firms or product lines that cannot adapt, have the option of moving offshore where production costs are lower. We describe two case studies of food processing sectors that offer contrasting examples of adaptation to the pressures facing the sector.

Some suggestions for productive, non-economically costly government policy interventions to assist the food processing sector continue with its current success are provided in the last chapter.

1.3 Structure of this report

The remainder of this report is structured into six parts as follows.

- Chapter 2 provides general background on the food retail sector in Australia.
- Chapter 3 details the relationship of food retailing to food processing from the perspective of Australian competition law and shows that there is no anti-competitiveness in Australian food retailing.
- Chapter 4 describes the longer-run trends for manufacturing in Australia.
- Chapter 5 outlines the recent successful performance of food processing in Australia, and describes some of the challenges and opportunities for food processing in the near future.
- Chapter 6 details case studies of two major food processing sectors and the challenges they face seizing future opportunities in the industry.
- Chapter 7 concludes by detailing three policy options which the government might like to consider in order to support the food processing sector as it continues to outperform manufacturing trends in this country.

In the next chapter we introduce Coles and describe the food retail sector in which it operates and competes.

Chapter 2
The Australian Food Retail Sector

Chapter 2 describes the Australian food retail sector, the players, market structure and the preferred choice of business organisation in the sector.

2.1 Introduction

The Australian food retail sector plays a fundamental role in ensuring that Australian families enjoy the full benefits of the world's and Australia's food supply on their daily dinner table.

In this chapter we describe the basic features of the Australian supermarkets, detailing who the main players are in food retailing in Australia, and their relationship both to each other and to the Australian food processing industry.

2.2 Australian supermarkets

The largest supermarket stores classify as 'one-stop-shopping' stores. They are where Australians go to conduct their 'weekly shop'. Smaller food retailing stores are where Australians go for 'top up' or 'convenience' shopping.

In Australia, satisfaction of most Australians' 'one-stop-shopping' needs is met by the following companies: Woolworths, Coles, Aldi, Franklins, Costco, Spar and Metcash/IGA. There are also a number of smaller players at the supermarket retail level who operate either individually or under a joint branding 'umbrella' (such as Foodworks). In public market share analysis, these retailers are usually grouped under the rubric 'specialty retailers' or 'other'.

Table 2.1 gives some key summary statistics of these large supermarkets.[1]

[1] These statistics are based on 2008 information made available by the ACCC in its *Grocery Inquiry Report* 2008 (the GI Report). That information has been supplemented where possible by current information obtainable from company websites or the 2011 IbisWorld Report.

Table 2.1

SUMMARY STATISTICS FOR THE GROCERY MARKET

Retails Brand	Number of Stores	Number of Supermarkets	Geographic Scope	Average Supermarket Size	Product Range
Woolworths	2000	823	National	2000m^2	25,000
Coles	1350	741	National	2000m^2	25,000
Aldi	230	230	NSW, Qld and Vic	850m^2	900
Franklins	82	82	NSW	1500m^2	
Metcash/IGA		2500	National	1000m^2	20,000
Spar	300		North-East		14,000
Specialty retailers	22,000				

Sources: ACCC (2008), pp. 42-44, p. 97, p. 139; Company websites; IBISWorld, (2011) pp. 35-37, Coles.

Woolworths

In the food retailing sector Woolworths has the largest number of supermarket stores across Australia with 823 supermarkets.[2]

Coles

Since the Wesfarmers acquisition, Coles has developed a five year turnaround plan which seeks to take Coles' retail supermarket business from continual decline and build it back to a position of strength and in so doing establish a platform that allows the company to prosper in the future. A central element of this turnaround plan is a desire to restore customer belief that the Coles supermarket is a shop you can trust to deliver quality, service and value.

ALDI

The German-owned supermarket retailer ALDI entered the Australian market in 2001 and has gradually increased its market share. The company operates 230 stores across New South Wales, Queensland and Victoria, with approximately 95% of their products belonging to their private label or exclusive store brands[3].

Metcash/IGA/Foodworks

Metcash is a dedicated wholesaler that distributes products to downstream independently-owned retailers across the grocery, food service, convenience and route channels of the food retail sector in Australia. Most of the grocery retailers supplied by Metcash are under the IGA banner, but Foodworks is also a grocery supermarket chain supplied by the Metcash group.

[2] WoolWorth's *2010 Annual Report.*

[3] IBISWorld (2011a), p. 35

Franklins

Prior to 2001, Franklins had a greater presence in the food retail sector in Australia. At the time of sale by its former owners, many stores were bought by independent supermarket operators and the remainder, including the Franklins brand, were purchased by the South African retailers Pick n Pay. All the remaining stores that continue to hold the Franklins brand are located in NSW. Since 2001 Franklins' national share of supermarket sales has appeared steady at about 1-2 per cent, although it has now fallen to be less than 1 per cent.

Metcash is proposing to acquire the Franklins banner stores from Pick n Pay. The ACCC opposed this sale and is appealing a recent ruling by Justice Emmett that the proposed transaction would not substantially lessen competition.[4]

Costco

Costco opened a large format supermarket in Victoria in 2003 and operates under a wholesale club membership model. Costco currently has stores in Melbourne and Sydney (where head office is now located), and received approval for a third store in Canberra in January 2011[5].

2.3 Company shares in the food retailing sector

The food retail sector in Australia in 2010-11 was valued at approximately $97 billion (by sales), including supermarket and non-supermarket grocery retailers.

Supermarket retailers comprise approximately 80 per cent of the total sales of the sector ($78.3 billion[6]), with smaller grocery good retailers (such as department stores, convenience stores, specialised food stores and take away food stores) making up the balance of sales in the sector.

The ACCC Grocery Inquiry Report, released in 2008, estimated national share of sales for supermarket retail outlets of all sizes. An updated estimate of national share of sales is provided in Figure 2.1.

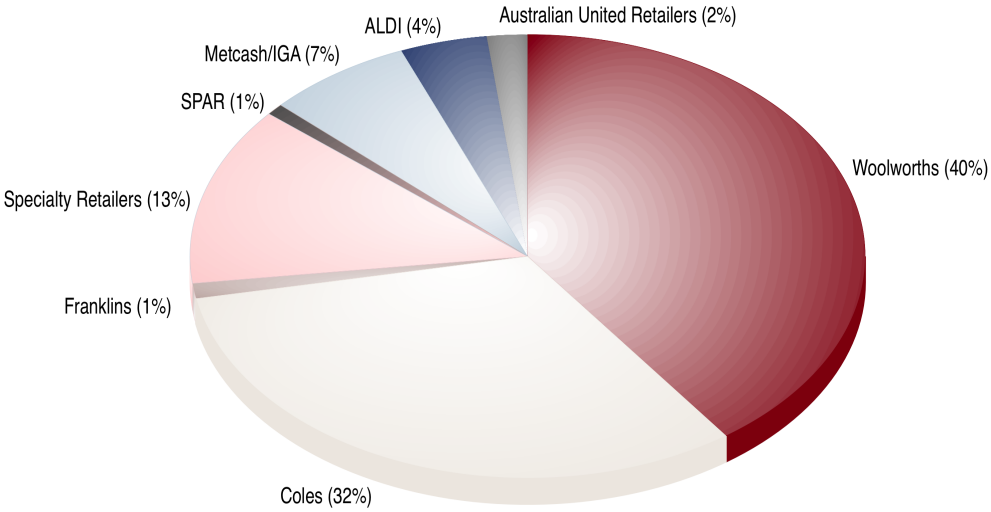
[4] ACCC v Metcash and others (August 2011), available at: http://www.austlii.edu.au/au/cases/cth/FCA/2011/967.html.

[5] Costco Wholesale Australia Pty. Ltd, Ibis World, 2010; pp.2

[6] IBISWorld (2011a),.

Figure 2.1

SUPERMARKET RETAILER MARKET SHARES 2011



Source: IBISWorld (2011) pp. 32-37

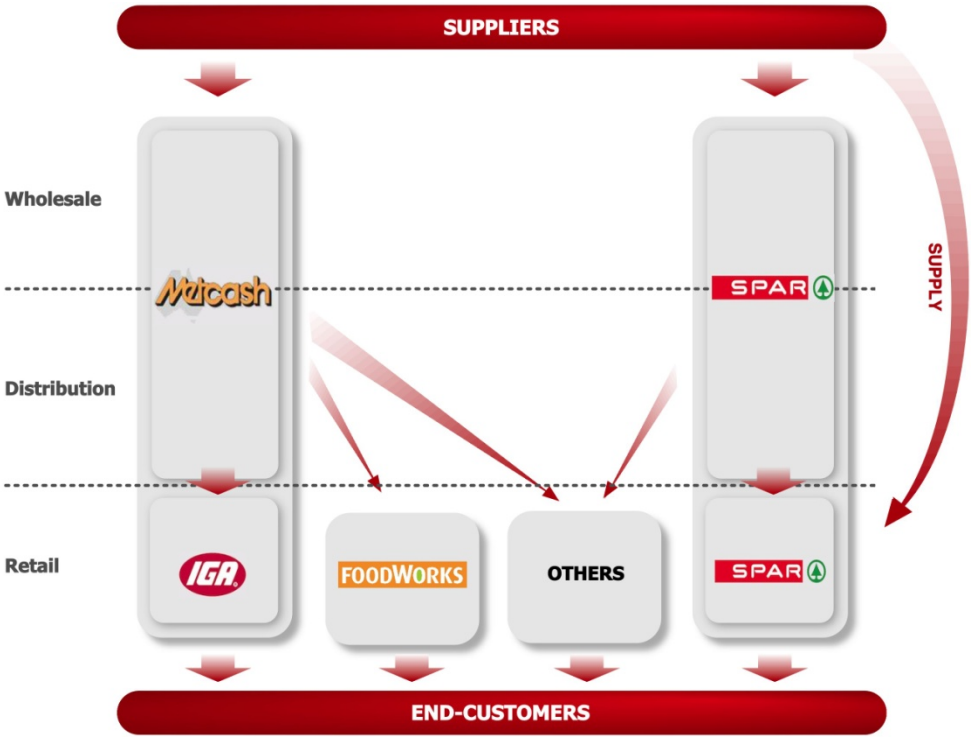
2.4 Choice of business organization in Australian food retail

Vertical integration is the dominant business organization. All the national supermarket chains except Metcash/IGA are vertically integrated in the full economic and legal sense. Vertical integration is across the wholesale and retail levels. The rise of supermarket 'private brands' shows that supermarket firms are now partly integrated even further backwards into pre-wholesale product supply.

That part of the market containing firms which are not vertically integrated across wholesale and retail is called the 'independent' market by the ACCC, and is schematically depicted in Figure 2.2 below. This description is based on a legal perspective, because retailers are owners of their stores who deal via contract with upstream suppliers, rather than employees of a company who take their upstream supply orders from company management.

Figure 2.2

THE 'INDEPENDENT' SECTOR



Source: ACG

Because vertical supply via contract can constitute de facto or economic vertical integration, economists talk about competing 'vertical groups' in the food retail sector. A 'vertical group' includes the actually vertically integrated supermarket companies (Woolworths, Coles, Aldi and Franklins) and also the economically vertically integrated supermarket companies like Metcash/IGA and Spar.

A feature of the food retail sector which we did not discuss in this chapter is the vertical supply chain in which retailing is situated. In the next chapter we discuss this aspect of retailing, and use it to explain why the competitive behaviour of retailers does not relevantly affect the performance of the upstream food processing sector.

Chapter 3

Retail supermarket competition and food processing

Chapter 3 describes the competitive state of play in the Australian food retail sector. It explains the 'vertical supply chain' in grocery supply in Australia, and explains that, from a competition law point of view, behaviour by 'downstream' supermarkets is largely irrelevant to the analysis of the performance of 'upstream' food processing.

3.1 Introduction

The Senate Select Committee inquiring into the Australian Food Production Sector has been asked to consider the following term of reference:

> (c) [T]he impact of Australia's competition regime and the food retail sector, on the food processing sector, including the effectiveness of the *Competition and Consumer Act* 2010.[7]

The purpose of this chapter is to 1) explain the nature of vertical supply in the food supply sector, and 2) explain the way competition law applies to vertical supply chains.

The fundamental point is that it is very difficult for 'downstream' supermarkets to harm, in any sense relevant to competition law, 'upstream' food processors.

3.2 The vertical structure of grocery supply

In this section we describe the 'upstream' versus 'downstream' relationship between the food retail and the food processing sectors.

3.2.1 Vertical supply chains

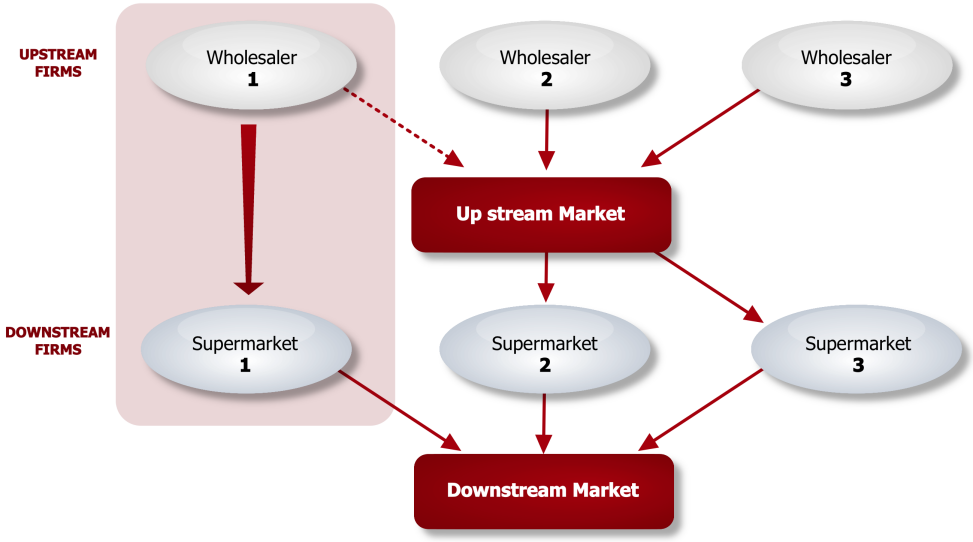
Vertical contractual relationships exist between 'upstream' (wholesale) and 'downstream' (retail) firms in most markets. Markets are generally characterised by at least two levels of supply, and in some sophisticated-good industries, more than two levels.

Figure 3.1 shows a schematic depiction of a two-level market with wholesalers, retailers, and a 'vertically integrated' firm whose business operations are integrated across the wholesale and retail levels. The wholesalers supply goods and services (inputs) to the retailers by means of an 'upstream' market, and retailers use those inputs in turn to provide goods and services to the final customer by means of a 'downstream' market.

[7] See http://www.aph.gov.au/senate/committee/foodprocessing_ctte/foodprocessing/tor.htm.

Figure 3.1

TWO-LEVEL INDUSTRY



Source: ACG

The vertical supply chain in grocery supply is usually considered to have four levels. Justice Emmett, in the recent Metcash judgment, described the following four levels in grocery supply:

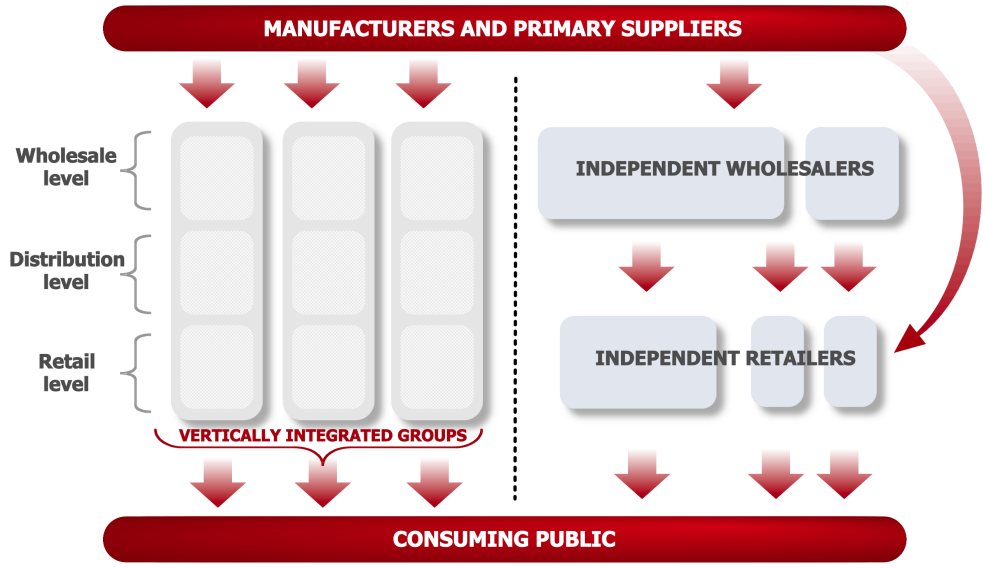
> There are four main categories of participants in the grocery industry in Australia. First, there is the **consuming public**, members of which are the ultimate acquirers of grocery products that are supplied by retailers. Secondly, there are **retailers** of grocery products, who fall into two different groups. The first group of retailers consists of self-supplying supermarket chains, such as Woolworths, Coles, Aldi and Franklins, while the second group of retailers consists of independent retailers. The third category of participants in the grocery industry consists of **wholesalers**, such as Metcash, and numerous other specialist wholesalers. The wholesalers supply grocery products to independent retailers. Finally, there are **manufacturers and primary suppliers**, who supply grocery products to the self-supplying supermarket chains, to wholesalers and directly to independent retailers. There are two different groups of manufacturers and primary suppliers. One group consists of large national manufacturers and primary suppliers of numerous types of fast-moving consumer goods, such as Coca Cola Amatil, Nestlé, Unilever and Procter & Gamble. There are also smaller, state-based manufacturers and primary suppliers, such as Saxbys Soft Drinks, McDonnell's Fruit Supply and fresh produce farms.[8]

A schematic representation of this vertical supply chain is depicted in Figure 3.2.

[8] *Metcash* case at para [4].

Figure 3.2

VERTICAL SUPPLY CHAIN IN AUSTRALIAN SUPERMARKET RETAILING



Source: ACG

3.3 The food retail sector is competitive

This section describes the nature of competition in the food retail sector and shows that courts and inquiries have consistently found that the sector is highly competitive.

3.3.1 What is the 'product' that supermarkets offer the end-customer?

In vertical supply chains, what ultimately matters from an economic and commercial point of view when assessing competitiveness is the final product/service purchased by end-customers, and the money they hand over when making such a purchase.

In the case of large supermarket retailing, the final service provided by supermarkets is the 'one-stop-shop' or the 'weekly shop'. It is important to note that this is from the perspective of the end-customer. Customers go to large supermarkets in order to get most of their weekly shopping done in one fell swoop.

Supermarkets offer a number of advantages to suppliers and consumers. First, their economies of scale and scope enable them to obtain inputs more cheaply and thus sell final goods more cheaply to end-customers. A second advantage is that supermarkets generally are able to reduce consumer search costs. The third advantage is that supermarkets resolve the coordination problem for shoppers and distributors by placing both competing and non-competing goods within the same vicinity. For example, in supermarkets, breakfast cereals on a shelf compete with each other, and yet complementary (non-competing) products (like milk, sugar and so on) can also be found nearby. These are all important benefits offered by supermarkets to consumers.

3.3.2 How do supermarkets compete?

Product dimension

Large supermarkets are primarily in the business of selling products. But what distinguishes them from other retail grocery stores that also sell products is that they are in the business of providing the 'service' of convenient, 'one-stop-shop' shopping. This service is a bundle of price and non-price characteristics. Non-price characteristics are:

- Range of product lines and brands
- Travel time to supermarket
- Food quality
- Store characteristics, such as aisle width, lighting, cleanliness, decor, and so on
- Parking facilities
- Opening hours
- Attached liquor store
- Fuel discounts and loyalty programs

It is known that supermarkets at the retail level compete both on price and on non-price factors.

When the ACCC surveyed Australians as part of its 2008 Grocery Inquiry, it found that customers regarded a range of store characteristics as just as important as price. These include food quality (the single most important factor in supermarket choice, outside price), store characteristics such as cleanliness and layout, availability of favourite brands and the range of products and brands available (the GI report, p72).

These survey results support the fact that large supermarkets are really offering a service (the 'weekly shop') rather than individual products per se. The quality of this 'one-stop-shop' experience informs each supermarket company's respective brand. Supermarket brands are distinct from the brands of individual products shelved within them (which belong to the suppliers of the products).

Supermarkets compete to make that single service superior to the one offered by competitors by adjusting dimensions of the service bundle other than the price dimension. In the language of economics, supermarkets are competing in 'product space' as well as 'price space'.[9]

[9] See any introductory book on Industrial Organisation. Competition in product space is often an investment race, and is modelled in game-theoretic economics as a 'Cournot' 'game' or else a product-differentiated price ('Bertrand') 'game'.

Geographic dimension

Local competition

In order to provide the end-customer with the service of the 'one-stop-shop', firms build large supermarkets able to carry thousands of product lines. As an example, a large Coles supermarket might carry up to 25,000 products. One of the primary economic functions of supermarkets is to offer the complementarities involved in locating competing products/services within the same vicinity, thereby sparing customers the search and travel costs that would be involved if they had to buy their preferred basket of products from multiple stores.

From the retail customers' point of view, competition for their one-stop-shopping dollar is local. Customers do their weekly shopping at a large supermarket located near the residential home, and, in the face of price rises (or any other change in the shopping experience which might displease them), will only consider switching to alternative supermarkets within the same vicinity.

For the purpose of competition analysis, the ACCC usually defines the region of local supermarket competition as being a 3-5km radius around each supermarket in high density areas (it can be much wider in rural areas). This radius is based on population density, and the radii for supermarkets located in rural regions where populations are thin can be much larger than in urban areas.

State and national competition

From a customer's point of view, competition may be local, but from the point of view of the competing supermarket groups like Coles, Woolworths and Aldi, competition can also be regional or even national in the sense that supermarkets are building a trusted national customer brand.

Competition between supermarket groups depends not just on the actions of existing stores, but also on the development of new stores over time. That is, sales growth is generated either by:

- more people passing through existing stores and/or spending more when they are in those stores, or
- growth in store numbers.

From a financial perspective, supermarket groups experience competition for the weekly-shopping dollar in a national sense. The supermarket groups advertise nationally, and the smaller chains also advertise nationally or at least regionally (as opposed to each store advertising individually). This reflects the importance of brand-recognition. Some people will stay loyal to a particular supermarket brand even if it is not the closest supermarket available because of the perceived value of the supermarket brand to them.

3.3.3 The food retail sector is extremely competitive

It is well accepted that the food retail sector in Australia is competitive. A number of cases and inquiries have all come to the same conclusion that the sector is very competitive. Here are some examples.

ACCC grocery inquiry

In 2008 the ACCC conducted a wide-ranging inquiry into supermarkets in Australia. In its 2008 Grocery Inquiry Report, the ACCC concluded as follows regarding the nature and extent of competition among supermarkets:

> Competition in retailing groceries in Australia is **workably competitive**.[10]

When a sector is 'workably competitive', it means that there is no concern under competition law, and no need for intervention by the ACCC.[11]

While the ACCC may have found in the past that barriers to entry can be high, they are not so high as to prevent experienced, well-funded foreign companies from setting up in this country. In the last few years Aldi and (very recently) Costco have entered the market and continue to grow in market share. As the ACCC noted in its 2008 Grocery Inquiry Report:

> The evidence suggests ALDI's impact has disrupted [Coles' and Woolworths'] price behaviour over the smaller range of items typically stocked in its stores.[12]

The 2008 Grocery Inquiry Report also expressed hope that Wesfarmer's takeover of Coles would lead Coles to offer greater competition to Woolworths:

> A possible trigger for more vigorous price competition between [Coles and Woolworths] is the expected improvement in Coles' cost of doing business. The ACCC believes any increased competition is more likely to occur on non-price elements of the retail offer, such as store refurbishments and an improved fresh product offering.[13]

And that is exactly what has been happening since the release of the report in 2008, with Coles competing to offer better value for Australian customers.

Metcash judgment

In August 2011 Justice Emmett decided the Metcash merger case and concluded:[14]

> **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.[15] [emphasis added]

He further concluded that:

> 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. [emphasis added]

---

10 ACCC (2008), p/ 212. [Emphasis added.]

11 See Shogren 2004, *Dynamic Efficiencies and Workable/Effective Competition*, available at: http://www.accc.gov.au/content/item.phtml?itemId=506371&nodeId=0315944b1f91978facbd438e405a2bc2&fn=Session%202:Dynamic%20Efficiencies%20-%20Rod%20Shogren%20paper.pdf

12 ACCC (2008), p. 87

13 ACCC (2008), p. 87

14 Although the ACCC has appealed this decision, the conclusions in relation to market competitiveness remain valid.

15 Metcash case at para [12].

3.4 The goal of competition law in vertical supply chains

The goal of competition law in vertical supply chains is to protect or enhance the welfare of end-customers. It is emphatically not to protect the profits or existence of 'upstream' firms in a supply chain.

3.4.1 The fundamental competition policy goal for vertical supply chains

A basic lesson of competition law as applied to vertical supply chains, when considering the lawfulness of behaviour of firms located 'upstream' in the vertical supply chain, is that competition law need only be concerned with the welfare of the final consumer. The final (or end) consumer only cares about the quality, quantity, and price of the final product. What transpires 'upstream' in the process of producing the final product is irrelevant to the consumer of the final good.

To give rise to concern under the CCA, competitive behaviour by firms must be genuinely anti-competitive. 'Anti-competitive' means that the effect of the behaviour is detrimental to *efficiency* (economic welfare) from a societal point of view. If the effect enhances rather than detracts from efficiency, then the effect is pro-competitive.

That behaviour by 'upstream' firms is only anti-competitive when it detracts from what economists call efficiency follows from the overall object of the CCA (contained in CCA Section 2). This states that the object of the CCA is to 'enhance the welfare of Australians through the promotion of competition'.[16]

Competition is not an end in itself, but is to be preferred only when it increases efficiency (or 'enhances the welfare of Australians'). A common way of expressing this is that the CCA is concerned to assist competition, not competitors, i.e. to enhance the competitive process, not to support individual competitors.[17]

For example, in the *Boral* case, Gaudron, Gummow and Hayne JJ observed:

> [T]hese laws are concerned with 'the protection of competition, not competitors'.[18]

In *Universal Music Australia v ACCC*, the Full Federal Court stated:

> Competition is a process and the effect upon competition is not be equated with the effect upon competitors, although the latter may be relevant to the former. Competition is a means to the end of protecting the interests of consumers rather than competitors in the market.[19]

In the context of vertical supply chains, anti-competitive effects are those which harm the end-customer and pro-competitive effects are those which benefit the end-customer.[20]

---

16 As well as through the promotion of fair trading and provision for consumer protection. See also CCA section 44AA.

17 The *Melway* case (2001) 205 CLR 1 and the *Boral* case (2003) 215 CLR 374.

18 (2003) 195 ALR 609 at [160].

19 (2003) 131 FCR 529 at 585.

20 *Re Qantas Airways Ltd* [2005] ATPR 42-065, and Metcash case at para [160].

3.4.2 Who are end-customers?

In the case of the food retail sector, end-customers are ordinary Australians who conduct their weekly shop in supermarkets across the country and those customers are assumed to prefer lower - rather than higher - prices for quality products in supermarket aisles.

3.5 Buyer power

A common concern directed at the behaviour of large supermarket groups like Coles and Woolworths is that they drive a hard bargain in their negotiations with suppliers. It is alleged that this is what enables them to obtain lower prices for the products they stock on their shelves. This provides a benefit to customers in the form of lower prices, but some critics see it as a problem for food processors.

> For my part, I find it novel to be fielding complaints that prices of certain staples are too low rather than too high. This is novel given the widespread concern across the community about the cost of living and the pressures being placed on household budgets.[21]

Buyer power is in fact pro-competitive rather than anti-competitive.

3.5.1 What is buyer power?

Buyer power refers to strong bargaining power on the part of a buyer when negotiating with sellers.

> [T]he ability of a buyer to influence the terms and conditions on which it purchases goods.[22]

Buyer power has become a talking point over time because of the rise of large supermarket groups through merger and organic growth. The OECD has shown that the rise of the 'big box' retailer is a phenomenon across the Western world.[23] Several economic factors are responsible for this rise:

> [E]conomies of scale, ability to buy in bulk, reduction in distribution costs, savings in internal organisation and logistics, and implementation of efficiency-enhancing technological innovations (like bar-code technology).[24]

But all these developments would be commercially worthless if end-customers did not evince an evolving preference for the convenience of shopping in single locations (the 'one stop shop').

3.5.2 Why buyer power is not a problem for competition regulators

Sellers and buyers are not in competition

An important point about vertical supply chains, from a competition law point of view, is that competition only occurs among firms at the same functional level. That is, upstream firms at the wholesale level compete against other upstream firms at the wholesale level, and downstream firms at the retail level compete against other downstream firms at the retail level.

---

21 Speech by the Parliamentary Secretary to the Treasurer, the Hon David Bradbury MP. Bradbury (2011) on *Developments in Competition Policy*.

22 OECD Directorate for Financial, Fiscal and Enterprise Affairs Committee on Competition Law and Policy, *Buying Power of Multiproduct Retailers* (1999).

23 Ibid. See also OECD *Roundtable on Buying Power of Multiproduct Retailers*.

24 Scheelings and Wright (2006).

Importantly, upstream firms are not in competition with downstream firms (and vice versa). Rather, the relationship between upstream firms and downstream firms is one of complementarity.[25] In any sale contract, sellers need buyers to execute a trade – both sides of the bargain are needed to close the bargain. Sellers compete with sellers to contract with buyers, and buyers compete with buyers to contract with sellers, but, sellers and buyers are not, with respect to each other, in a relationship of competition, but rather are in a relationship of complementarity.

Bargaining power is not market power

Competition law is concerned with the regulation of abuse of market power, anti-competitive arrangements and consumer protection. Bargaining power is not the same as market power, and competition law does not concern itself with the regulation of bargaining power.[26]

In markets involving a few buyers facing a few sellers, the relevant variable of consideration is bargaining power rather than market power. Market power relates to positioning at the retail level whereas bargaining power relates to negotiating position in a vertical supply arrangement. The major supermarket retailers bargain with upstream suppliers (major and minor) for the supply of their supermarkets for on-sale to end-customers. That bargaining is robust. Supermarket retailers try to drive their suppliers down in price, because they know that is what their customers want. Competition among the supermarket retailers is driving them to compete in giving their customers what they want, namely, lower prices for quality products.

Sellers and buyers may not be competition with each other, but once they are ready to close a deal, they do 'compete' on the final price. Once a deal is ready to be closed, there is only one pie to be sliced, and the zero-sum nature of price negotiations in any transaction means that, the bigger the slice for the seller, the smaller the slice for the buyer, and vice-versa.

Negotiations between sellers and buyers in Australia's grocery supply chain

The recent Metcash decision described the major players in the grocery supply chain as follows:

- **Major retailers:** Woolworths, Coles, Aldi, and Metcash/IGA.
- **Examples of food processors:**
  - *National* - Coca Cola Amatil, Nestle, Unilever, and Procter & Gamble.
  - *State or regional* - Saxbys Soft Drinks, McDonnell's Fruit Supply and fresh produce farms.[27]

The retail supermarket chains enter into supply contracts with upstream food processors. There are more upstream food processor companies than there are downstream supermarket groups, giving the downstream supermarket groups a *seeming* bargaining advantage in their dealings with suppliers.

---

[25] See the recent *Metcash* case at paras [158] ff.

[26] This of course refers only to Part IV of the CCA 2010. Part V of the CCA 2010 deals with consumer protection. Relevantly, it contains unconscionable conduct provisions to protect smaller businesses and requires bargaining power to be used in a fair and reasonable manner.

[27] *Matcash* case at [4].

But even from the perspective of bargaining power, matters are more complicated than what a simple tallying up of the relative size or number of players on each side of the negotiating table would suggest. What matters is the indispensability (from the end-customers' perspective) of each supplier's brand(s). Large national (and international) brands, which are very popular with consumers, give the owners of those brands great bargaining power and therefore a larger slice of the pie shared between supplier and retailer.

Some of the large national companies with whom Coles negotiates for supply (Kraft, Heinz, Unilever, and so on), including some of those mentioned by Justice Emmett in his recent Metcash judgment (above), are in fact Australian subsidiaries of huge global companies, some of them among the biggest companies in the world. Within their categories they can have Australian market share larger than what Coles has in retail. To give just one example, Mars has nearly 95 per cent share in the 'gum' food category; while Campbells (Arnotts) has about 68 per cent share in the biscuits category.[28]

Even small suppliers, if possessed of a relatively unique product or brand (like, for example, organic goats cheese fetta) popular with a higher-income demographic (and so capable of attracting a high margin), can also gain a disproportionately large share of the margin which their product achieves.

Private label brands were created precisely to play a role in strengthening the bargaining position of retailers vis-a-vis popular brands.

> [B]y increasing retailers' negotiating leverage against major suppliers, it reduces retailers' dependence on any individual branded product, gives the retailer greater flexibility to reduce branded products' shelf space or stock a more limited range, and increases the credibility of retailers' threats to delist branded products. In other words, private label products are a form of investment in bargaining position.[29]

The success of Australian retailers over the last 10 years in leveraging their bargaining power to obtain lower prices for their customers (and lower margins for the suppliers) is documented by the increasing complaints of even large international food processors like Heinz.[30]

It should be noted that is a well-accepted principle of competition policy (as embodied in Part IV of the CCA 2010) that it is not the role of competition law to interpose the state into the bargaining dynamics of independent firms in the marketplace.

3.5.3 Buyer power is pro-competitive

Whether the benefit of lowered input prices achieved through robust but fair bargaining with 'upstream' suppliers is passed on to end-customers depends on how competitive the 'downstream' retail sector is.

[28] Euromonitor; AFGC; Senate Economics References Committee transcript (10/03/11).

[29] Scheelings and Wright (2006).

[30] http://www.smh.com.au/business/heinz-blasts-supermarket-power-20110829-1jie4.html.

In the case of the food retail sector, as we saw above, inquiries and cases have shown that the food retail sector is highly competitive. It follows that price reductions obtained from wholesalers as a result of buyer power are highly likely to flow through to end-customers, thereby increasing their welfare by lowering the cost of their weekly shopping bill and increasing the quality of product and service at their local supermarket.

Lower prices for end-customers increases both the short-run and long-run welfare of end-customers, and so is pro-competitive, even if this can have the effect of reducing the margins of 'upstream' suppliers.

3.6 Exclusion, predation and foreclosure in vertical supply chains

Economic analysis of competitive markets accepts that there can be occasions when firms situated in a vertical supply chain and holding a position of power might be capable of acting anti-competitively.

3.6.1 What are the categories of unilateral anti-competitive conduct?

Exclusion is where a dominant incumbent firm located somewhere in a vertical supply chain attempts to damage actual competitors, or to prevent the possible entry of potential competitors, by entering into long-term exclusive contracts either with 'upstream' suppliers or 'downstream' buyers or both. An exclusive contract binds an 'upstream' supplier to only supply the dominant firm and no other firm, or else binds a 'downstream' buyer to only buy from the dominant firm and no other firm. The longer is the term of the contract, the more powerful is the exclusionary effect. Refusal to supply (or to buy) is also a form of exclusionary market behaviour.

Predation is where a dominant firm located somewhere in a vertical supply chain attempts to damage or drive out actual competitors, or to prevent the possible entry of potential or new competitors, by lowering its price below its costs for a period sufficient to drive out actual competitors or to deter new competitors. The losses sustained during the period of below-cost pricing are recouped one the actual competitor has been driven out or the new entrant has been deterred.

Foreclosure is where a firm located somewhere in a vertical supply chain attempts to 'leverage' its dominant position in a first market to obtain a dominant position in a second market where it is not currently dominant. In the second market in which the firm seeks to 'leverage' its dominance, foreclosure acts similarly to predation in its effect, but involves instead non-pricing behaviour on the part of the dominant firm. That is, the 'leveraging' practice either drives out actual competitors, or deters potential or new competitors, in the hitherto competitive second market. Examples of non-price practices used to achieve 'leverage' include strategic investments and the bundling and tying of monopolised goods with competitive goods.

3.6.2 Why are these types of behaviour anti-competitive?

These types of behaviour are anti-competitive - in the rare cases when they can be successfully carried out - because they lower the long-run welfare of end-customers. They lower the long-run welfare of Australians because they alter the market structure of formerly competitive markets, making them less competitive. Driving current competitors out of a market, or deterring potentially new competitors from entering a market, ensure that in the long-run the market is less competitive and so price remains higher than it would be in a competitive market. In the case of predation, the mechanism to achieve long-run price increases involves short-run price decreases, which is good for end-customers in the short-run. But predation – in the rare cases when it can be successfully carried out – still harms end-customers in the long-run regardless of its short-run benefits, and anti-competitive behaviour is judged by the long-run harm to end-customer welfare.

3.6.3 These types of behaviour are rare and difficult to pull off

A number of points need to be made about the likely anti-competitive effects of these types of behaviour.

The **first** point to make about these types of possible anti-competitive conduct is that it is not confined to retail-level supermarkets: *any* firm with substantial market power, located *anywhere* in *any* supply chain, *might* be capable of such behaviour if the (rare) conditions for the anti-competitive success of such behaviour exists. Specifically, this applies as much to large food processors as to supermarket chains.[31]

The **second** point to make is that the conditions for these types of behaviour to be successfully anti-competitive are extremely rare. The intellectual history of the analysis of these types of behaviour is that they were once (in the 50s and 60s) thought to be automatically anti-competitive (the 'Warren Court era' in the US), but were then (in the 70s and 80s) thought to be automatically pro-competitive (the 'Chicago School' era), and are now thought to be more often pro-competitive than not, but that they can - very occasionally - be anti-competitive under a narrow set of possible market conditions (the 'post-Chicago School' era).

[31] Recall that it was mentioned above that some of the large upstream suppliers with which Coles negotiates for supply have market shares in their category much larger than is Coles' market share within retailing.

The **third** point to make is that the *Competition and Consumer Act* 2010 already contains prohibitions of these types of behaviour. These prohibitions are correctly general rather than industry-specific, and so apply to all firms located in all industries, regardless of where they reside in the supply chain. The relevant provisions are sections 45, 46, 47 and 48 of the *Competition and Consumer Act* 2010. These provisions have analogues in other jurisdictions around the world and indeed in terms of substance adequately express the global policy consensus regarding how such behaviour should be regulated under a general competition law. Though in need of textual simplification, in recent inquiries into Australian competition law there has not been any suggestion that there exists a substantive 'gap' in the efficacy of these provisions.[32] It is occasionally mentioned that litigation is perhaps sparser than it should be in this area (especially in relation to section 46), but given the accepted rarity of the conditions under which such types of behaviour can be said to be anti-competitive, rarity of litigation is to be expected.

In this chapter we have detailed the high competitiveness of the food retail sector in Australia and the adequacy of the competition law regime under which that competition takes place. It should be obvious that if the Senate is interested in understanding what is really going on in food processing in Australia, its focus should be on that sector. In the following chapters we do precisely that, beginning with a consideration of the performance of Australian manufacturing generally.

[32] See the *Dawson Report* 2005.

Chapter 4

Long-run economic trends in Australian manufacturing

Chapter 4 describes some long-run trends for manufacturing in Australia. It shows that, while some metrics appear to indicate a long-run 'decline' in manufacturing, in fact, over the long-run, manufacturing has continued to grow, has continued for the main to see higher productivity, as well as higher wages for workers who remain in manufacturing.

4.1 Introduction

Food processing is part of the manufacturing sector. It is a well-known fact about manufacturing in advanced economies like Australia's that its relative importance 'declines' with time. This is a long-run phenomenon. Relative importance is measured in terms of share of GDP and share of total employment.

But a long-run 'decline' in those metrics is consistent with rising profits, rising productivity, and rising wages for those still working in manufacturing. This is because, over time, manufacturing changes character. It becomes more about quality and exports and innovation and less about commoditised products requiring low-wage, routinized labour.

In other words, over time, manufacturing climbs the value-added or quality ladder, leaving low-quality products to be produced in countries with lower wages and less-skilled workers.

4.2 Is there a 'decline' in manufacturing in Australia?

Absolute data

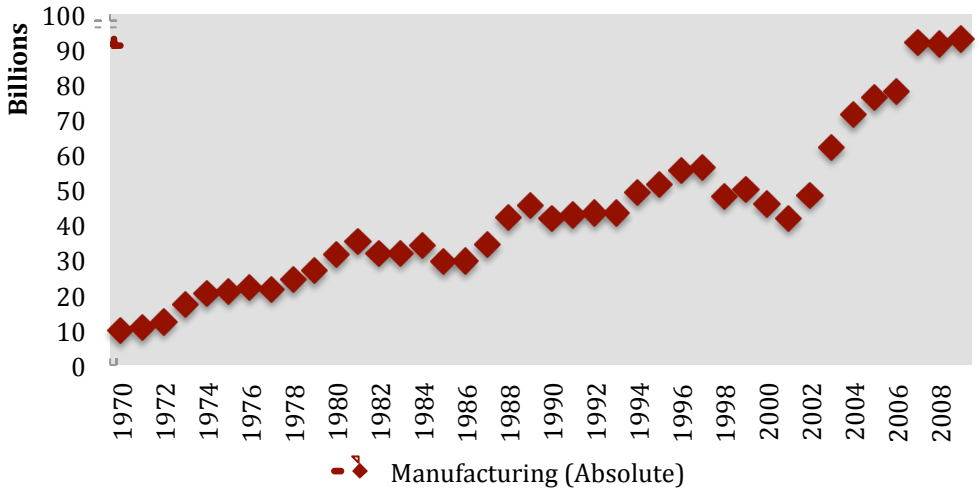
Two common metrics used to measure the macroeconomic importance of a sector like manufacturing are 'industry value added' (or output) and 'employment'. When these two metrics are examined in their absolute sense, there is no 'decline' in output and only a slight 'decline' in employment. In fact, there has been significant growth in manufacturing output over time.

Figure 4.1 shows the growth in Australian manufacturing since 1970. Two facts are obvious from this figure.

The first fact is that Australian manufacturing has grown significantly over the last forty years. Australian manufacturing grew from an industry valued at approximately $US10 billion in 1970 to an industry valued at approximately $US92 billion in 2009 (all in 2009 US dollars). No economist believes that Australian manufacturing will not continue to grow as significantly over the next forty years.

Figure 4.1

THE LONG RUN GROWTH OF AUSTRALIAN MANUFACTURING



Source: UN data and ACG[33]

The second fact is that manufacturing is highly cyclical –when the economy turns sour, manufacturing is hit hard. It should be noted how strong was the growth in manufacturing during the 2000s, and how relatively minor was the impact of the GFC on manufacturing in Australia. Very recently, manufacturing growth has levelled out, but this is off a very high decade-long growth rate.

Table 4.1 shows that the size of the workforce in Australian manufacturing has been steady over the long run in absolute terms. Of course, since output has been increasing over that time, this means that there has been a large long-run increase in manufacturing productivity and, consequently, wages (see below).

Table 4.1

FOOD INDUSTRY VALUE ADDED ($M)

	1978	1984	1990	1993	1996	2000
Employment level ('000)	1278.1	1196.5	1235.1	1130.7	1171.8	1141.1
Share of total	21.2	18.4	15.7	14.1	12.6	12.6

Source: RBA[34]

Relative data

The manufacturing sector has been experiencing a 'decline' when considered by the two metrics of contribution to GDP and of employment share in the economy.

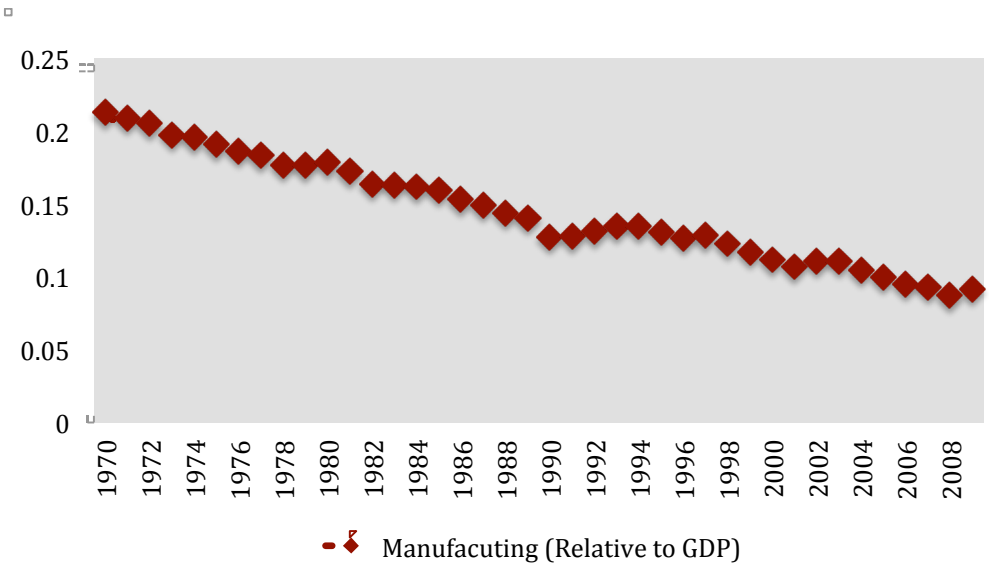
[33] Available at: http://unstats.un.org/unsd/snaama/dnltransfer.asp?fID=2.

[34] RBA, *The Manufacturing Sector: Adapting to Structural Change* (March 2001)

Figure 4.2 shows the long-run 'decline' in the *share* of Australian manufacturing as a proportion of Australia's GDP. The relative size of the manufacturing sector decreased from about 22 per cent in 1970 to about 10 per cent in 2009.

Figure 4.2

MANUFACTURING 'DECLINE' IN AUSTRALIA



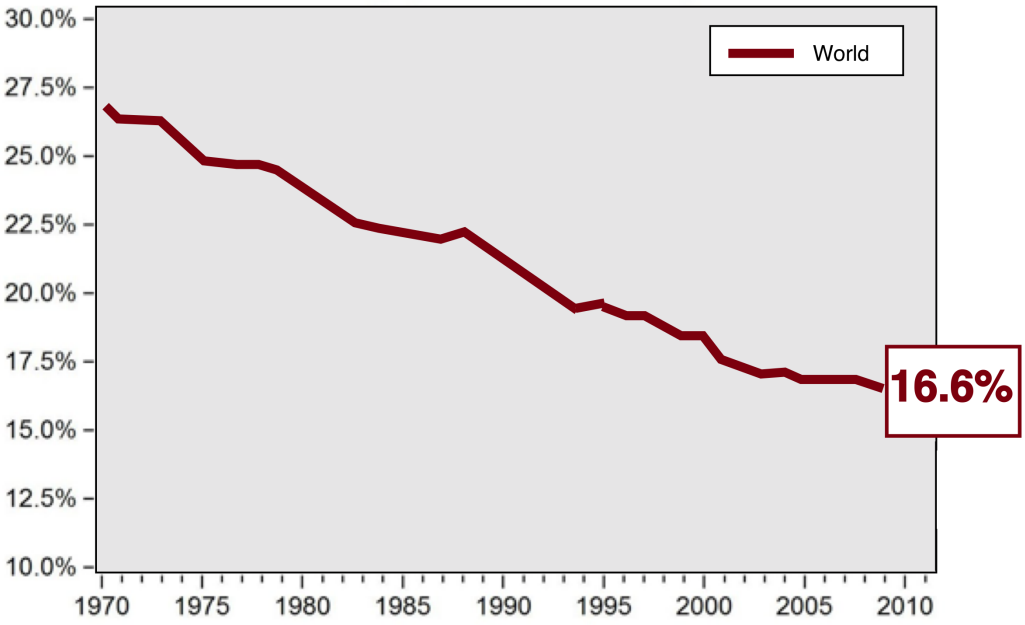
Source: UN and ACG[35]

This decrease is not unique to Australia. Figure 4.3 shows the same result for the world economy.

[35] Available at: http://unstats.un.org/unsd/snaama/dnltransfer.asp?fID=2.

Figure 4.3

MANUFACTURING 'DECLINE' IN ALL ECONOMIES



Source: UN and ACG[36]

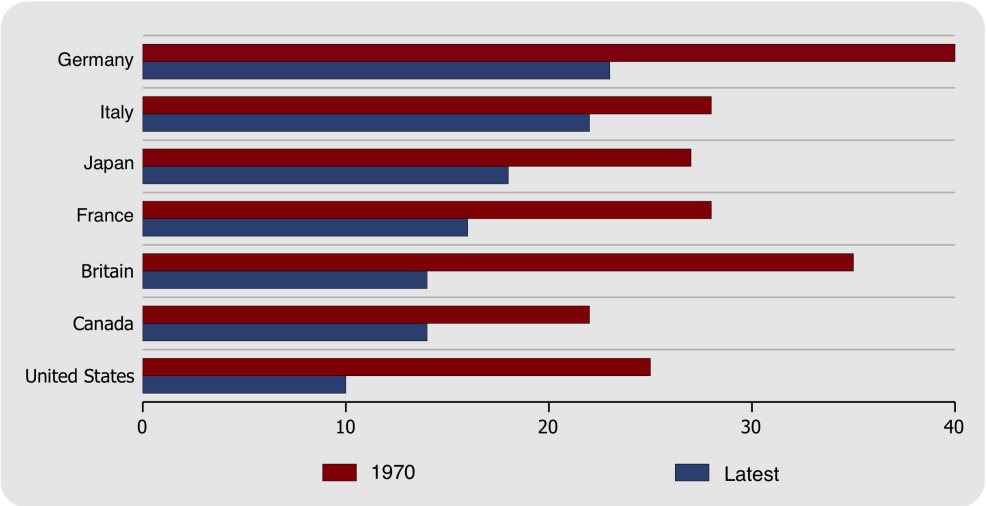
Figure 4.4 shows the relative 'decline' for a small sample of advanced economies. In some countries the decrease since 1970 has been more pronounced than in others, but it has occurred in all countries in the sample. In fact, it is a common phenomenon of all 'mature' (OECD) economies. Economic theory suggests that, as an economy matures, there will be a move in relative importance away from the manufacturing sector towards the service sector, and voluminous cross-country evidence confirms that theory.[37]

[36] Available at: http://unstats.un.org/unsd/snaama/dnltransfer.asp?fID=2.

[37] See for example, Feinstein, "Structural Change in Developed Countries During the Twentieth Century", *Oxford Review of Economic Policy* (1999) 15 (4): 35-55, and Cheol-Sung Lee, "International Migration, Deindustrialization and Union Decline in 16 Affluent OECD Countries", 1962-1997, *Social Forces,* Vol. 84, No. 1 (Sep., 2005), pp. 71-88.

Figure 4.4

MANUFACTURING EMPLOYMENT 'DECLINE' IN DEVELOPED ECONOMIES



Source: The Economist, Manufacturing employment – Industrial metamorphosis – Factory jobs are becoming scarce. It's nothing to worry about, accessed 25 August 2011. (http://www.economist.com/node/4462685)

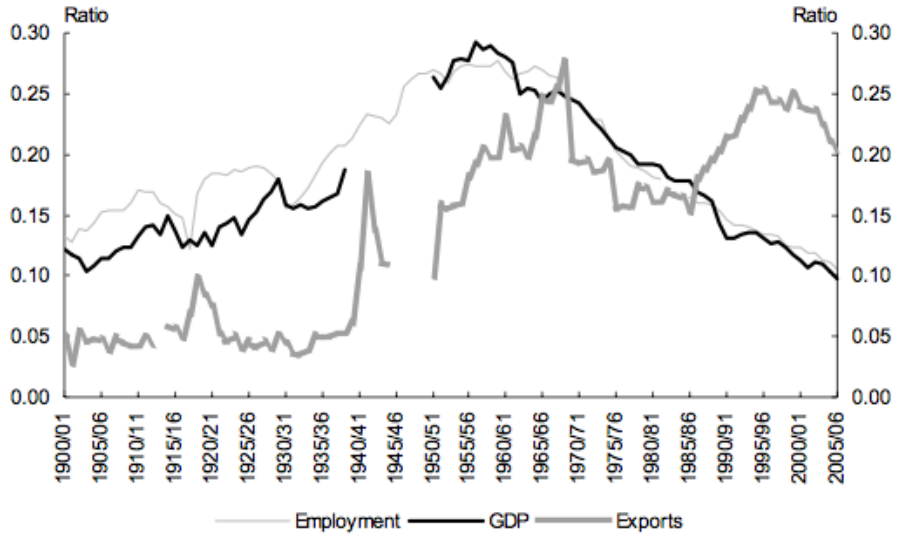
> This 'rise and fall' in manufacturing's share of the economy is not unusual. The typical pattern of economic development across most advanced economies has been that the manufacturing sector initially increases its share of the economy at the expense of the agricultural sector and then is later itself displaced by the growth of the services sector.[38]

Figure 4.5 summarises the long-run historical trend for output-share, employment-share, and exports-share. It can be seen that the result is the same for manufacturing's share of total employment as a proportion to all employment in the economy since 1970. Manufacturing's share of exports however has increased since the mid-1980s, though it has been decreasing again recently.

[38] HoR page 10 chapter 2

Figure 4.5

MANUFACTURING EMPLOYMENT 'DECLINE' IN DEVELOPED ECONOMIES



Source: ABS, RBA, Bulletin 1962[39]

Gary Banks, chairman of the Productivity Commission, recently summarised the long-run historical trend of labour in Australian manufacturing as follows:

> Employment in Australia's manufacturing sector expanded considerably in the first half of the twentieth century and continued to grow into the 1970s, fostered by expanding domestic market opportunities and high import protection. Although the number of people employed in manufacturing peaked in the early 1970s, the share of total employment accounted for by manufacturing was already beginning to decline. The decline in manufacturing's employment share has thus been happening for around 40 years. Similarly, agriculture's share of employment has also steadily declined.[40]

4.3 Periodic concern about the 'decline' of manufacturing in Australia

Periodically, concern emerges in the public sphere about the 'decline' of manufacturing in Australia. In the last fifteen years, Australia has seen multiple inquiries by the Productivity Commission and the Australian parliament on this issue. The following is just a sample:

- Gretton and Fisher (1997) report on *Productivity Growth and Australian Manufacturing Industry*;
- Productivity Commission (2003) report on *Trends in Australian Manufacturing*;
- House of Representatives (2007) report on *Australian manufacturing: today and tomorrow*; and
- Barnes (2011) report on *Multifactor Productivity Growth Cycles at the Industry Level*.

[39] Reproduced from House of Representatives Standing Committee on Economics (2007).

[40] Banks (2011), p. 4

Dutch disease?

Since the rise of the resources boom in the early 2000s, this concern has dove-tailed with an added concern of the impact of the boom on Australian manufacturing (the 'Dutch disease').

> The phenomenon [. . .] known as the 'Dutch disease' [. . .] was first raised in the context of the effect the development of natural gas in the 1960s and early 1970s had on manufacturing in the Netherlands.[41] With the development of North Sea oil, and the decline of the UK manufacturing industry, in the 1970s and 1980s, the term was much used in Britain. In Australia it is often referred to as the 'Gregory thesis' as it was described by the ANU economist Bob Gregory in a 1976 paper.[42]

The 'Dutch disease' is the theory that a booming resources sector sucks labour and capital out of the manufacturing sector, raises the wages of workers in the manufacturing sector (without any corresponding increase in productivity) and leads to an appreciating exchange rate, making it harder for manufacturers to export (although cheaper imports should lower unit costs for many manufacturers).

> This adjustment process has been variously referred to as 'de-industrialisation', the 'Dutch Disease' and, most recently, the 'two-speed economy'. These labels suggest a policy problem, requiring government intervention to reverse or dampen the structural adjustments required by the resource boom. But it is important not to lose sight of the fact that these economy-wide impacts unambiguously raise our national wealth.[43]

Historically, Australia's 'real' exchange rate (a trade-weighted, inflation-adjusted exchange rate) has tended to move with changes in the terms of trade (the relative price of imports to exports). In the first decade of the twenty-first century that relationship has broken down.[44] It is therefore not even clear that the dynamics of the 'Dutch disease' are currently in play in Australia.

In any event, as was observed about the 'Dutch Disease' literature nearly three decades ago, at the time the academic articles were being written:

> Although virtually ignored in much of the discussion, consumption of all goods would increase, as would national expenditure and aggregate welfare; indeed, terms such as 'Dutch Disease' seem to imply that it is a morbid condition rather than the sign of a lucky country.[45]

A problem?

Figure 4.6 shows the gradual rise over time of the share of services compared to manufacturing of output in the total economy.

---

[41] The expression was apparently coined by *The Economist* in its 26 November 1977 issue. More academic versions, by Australian international trade specialist Max Corden, were published in 'Booming sector and de-industrialisation in a small open economy' (co-authored with J Neary), Economic Journal, volume 92, 1982 and 'Booming sector and Dutch disease economics: survey and consolidation', *Oxford Economic Papers*, volume 36, 1984

[42] R Gregory, 'Some implications of the growth of the mineral sector', *Australian Journal of Agricultural Economics*, vol 20, no 2, August 1976, pp. 71–95.

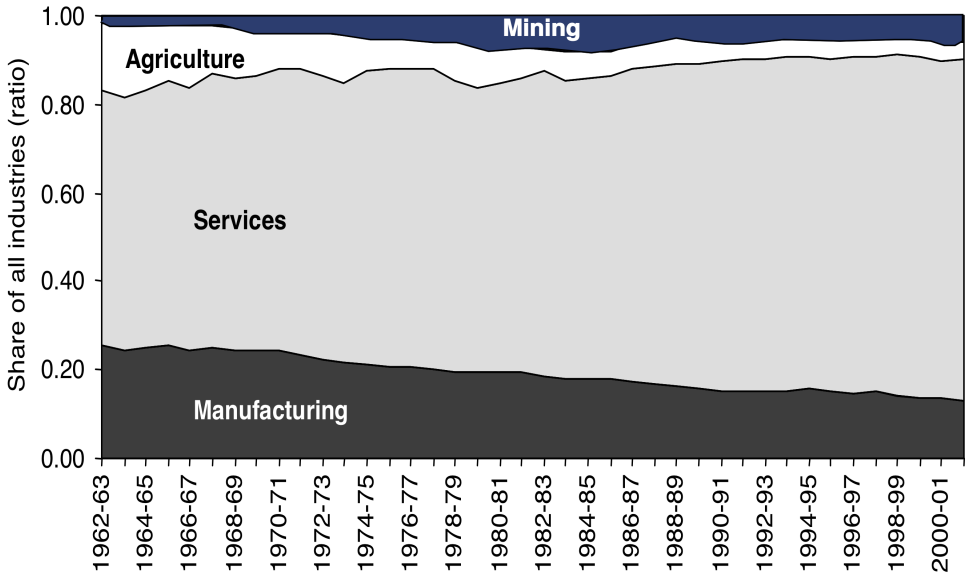
[43] Banks 2011 speech, page 2.

[44] D Gruen, 'A tale of two terms-of-trade booms', Economic Roundup, Summer 2006, p. 25. See also the Figure 2.4 of page 18 of the HoR 2007 report, chapter 2.

[45] Porter, M.G. 1984, 'Mining and the Economy — Some Key Issues' in Cook, L.H. and Porter, M.G. (eds.), *The Minerals Sector and the Australian Economy*, George Allen & Unwin, Sydney, pp. 1–35, at page 16.

Figure 4.6

CHANGE IN THE COMPOSITION OF THE AUSTRALIAN ECONOMY 1962-63 TO 2001-02 (CURRENT PRICES)



Source: Productivity Commission (2003), Figure 3.3, p. 10.

This long-run structural shift in the economy has multiple causes, the prime one being shifting tastes and expenditure by Australians as they become wealthier.

> [T]hat shifting consumer preferences are likely to be the most important determinant of the relative decline of manufacturing output and the growing ascendancy of services.17 This is not an adverse phenomenon — meeting people's preferences makes Australia better off. This underlines why the diminishing share of manufacturing in the economy is largely a positive for Australia, rather than a problem.[46]

As a country gets richer, a smaller proportion of workers will be needed in manufacturing as households can only consume a finite number of cars, fridges or microwaves. As disposable income rises, households tend to spend a bigger chunk of their income on services, such as holidays, health and education.

The Productivity Commission examined the issue of whether there was a 'problem' here in a large and complete 2003 report. The Productivity Commission concluded:

> [Manufacturing's] *relative* decline has largely reflected rising incomes and changing preferences that have stimulated the relative demand for services. As a result, the economy-wide 'cake' has outgrown the 'slice' represented by manufacturing. High relative productivity growth rates in manufacturing have accentuated these effects for manufacturing employment. Since this structural shift is predominantly the realisation of consumers' choices, it is a process that has made Australians better off.[47]

[46] Productivity Commission (2003), p. 33.

[47] Productivity Commission (2003), p. 40.

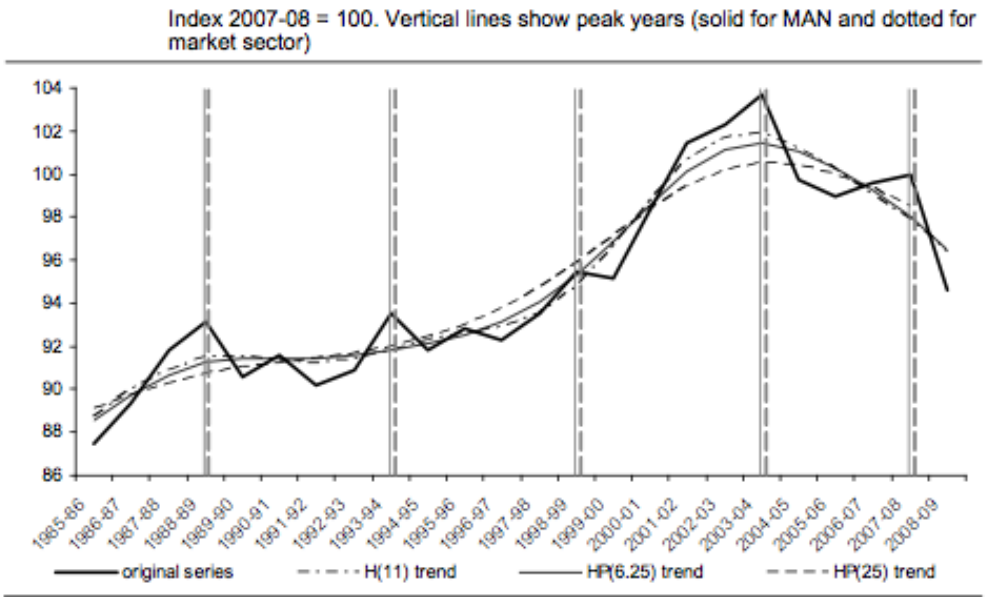
4.4 Why the long-run 'decline' in manufacturing is a good news story

Productivity

Productivity in manufacturing consistently rose over the last forty years (although it did begin to decrease around 2004/2005). Between 1968/69 and 1994/95 it was about 0.8 per cent.[48] Figure 4.7 shows the long-run rise in productivity as well as the recent decrease beginning around 2005.

Figure 4.7

MANUFACTURING MULTIFACTOR PRODUCTIVITY (MFP) INDEX, INDEX 2007-08 = 100



Source: Barnes (2011), Figure 3.10, p. 42.

It is also much easier to automate manufacturing than services, replacing men by machines. Faster productivity growth in manufacturing than in services means that manufacturing needs fewer workers than the services sector. In turn, as workers move into more productive areas, this gives a boost to overall productivity and hence living standards.[49]

The recent decrease in productivity in manufacturing is due entirely to the voracious capital and investment needs of the mineral sector during that time, as the mining sector invests in increased capacity in order to meet the world's demand for Australia's resources.

[48] Gretton and Fisher (1997), p. 27.

[49] The Economist, Manufacturing employment – Industrial metamorphosis – Factory jobs are becoming scarce. It's nothing to worry about, accessed 25 August 2011. (http://www.economist.com/node/4462685)

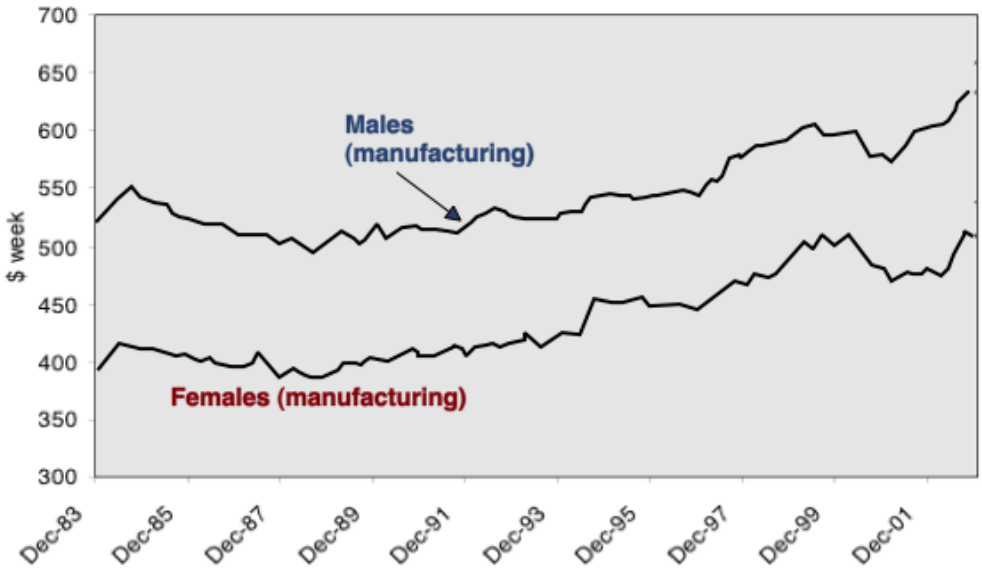
> One casualty of the demand-side boom has been reduced supply-side performance, as measured by productivity indicators. While there are other ingredients, a key influence on Australia's recent productivity slump has been the massive injection of labour and capital, together with more costly production and resource depletion effects, directed at satisfying minerals demand. However, this can hardly be described as a 'problem', given its flipside of higher prices, profits and national income growth.[50]

Wages

If productivity within an industry is rising, then wages within that industry must rise. Figure 4.8 shows that, as expected, manufacturing wages have been rising steadily over the last fifteen years. Workers who remain in manufacturing (instead of moving to an even higher wage sector like services or – currently – mining) see their wages steadily increasing.

Figure 4.8

AUSTRALIAN MANUFACTURING INDUSTRY TOTAL HOURLY RATE OF PAY (EXCLUDING BONUSES) INDEXB



Note:

a Ordinary time full time adult wages exclude overtime payments and relate only to full time work (or work over 35 hours per week) for adults or those receiving full adult pay rates. 'All industries' refer to all private sector industries.

b Constant price estimates were produced by deflating nominal weekly earnings by the weighted average capital city CPI.

Source: Productivity Commission (2003), Figure 5.4, p. 91.

4.5 Ascending the quality ladder and off-shoring

While the dividing line can be seemingly arbitrary, the manufacturing industry tends to be classified as 'elaborately transformed' and 'simply transformed' sectors. The classification is made according to the relative complexity of the product produced. Elaborately transformed sector has grown much faster than the simply transformed sector.

[50] Banks 2011 speech at page 6

> The more basic forms of manufacturing tend to make more intensive use of low-skilled labour and are therefore much more vulnerable to competition from economies such as China with plentiful cheap labour (and lighter regulation) and economies of scale.[51]

Firms located in the simply transformed sector of manufacturing are most at risk of their business needing to be relocated overseas. Indeed, there are three main strategies for such firms:[52]

- Increase productivity
- Increase sophistication of product (invest in quality and innovation) and so move up the 'value chain'
- Move the business off-shore

Firms moving up the value chain into niche markets earn higher margins and require a more highly skilled and specialised workforce. Exporting final output also becomes more important.

> Australian manufacturers are moving up the value chain. For example, clothing production now only accounts for less than three per cent of manufacturing and what remains is increasingly high-end fashion or specialist wear such as fire-resistant clothing.[53]

Supply chains are increasingly global. Large global companies make global strategic decisions about the location of subsidiaries every day. Australian firms or subsidiaries which cannot increase productivity or innovate have the option of locating production to a developing country with cheaper input costs.

As the politicians who sat on the House Standing Committee on Economics, Finance and Public Administration in 2006/07 concluded:

> The future composition of the [manufacturing] sector will be different from what it is now. Based on evidence received by the inquiry, with limited government intervention, the sector will select its own winners and ultimately cull its losers. The industries that will survive are likely to be those at the technological frontier; those manufacturing industries that embrace these new technologies; and some naturally protected by high transport costs for their type of good.[54]

In this chapter we have described the economic drivers of manufacturing and shown how manufacturing changes with time. It becomes more high-end, more productive, producing higher wages for those that remain in manufacturing. In the next chapter we show that food processing, which is an important part of manufacturing, shares in these attributes and in this dynamic change.

[51] House of Representatives (2007), p. 57
[52] House of Representatives (2007), p. 61
[53] House of Representatives (2007), p. 9
[54] House of Representatives (2007), p. 6

Chapter 5

The performance of the Australian food processing sector

Chapter 5 describes how the Australian food processing sector is very successful. Output, profits, productivity, exports and wages have all been increasing. The chapter describes some of the challenges/opportunities facing the sector in the near future.

5.1 Introduction

The Australian food processing sector is part of manufacturing in Australia. It is a sector which has been performing well. Output in food processing has been increasing, productivity has been increasing, wages have been increasing, profits have been increasing, exports have been increasing, and innovation is on the rise.

There are some challenges ahead for the Australian food processing sector, but each challenge provides an opportunity for the sector to continue to grow and innovate.

5.2 The Australian food processing sector is very successful

Absolute data

Australian food processing is a significant component of the Australian manufacturing sector.[55] Australian food processing's share of total manufacturing output in Australia averaged about 18 per cent between 1968/69 and 1994/95.[56] It currently makes up 17.4 per cent of the manufacturing sector in 2009-10.[57] This means that almost one-fifth of all manufacturing in Australia involves food processing of one sort or another.

There is no current crisis in food processing in Australia. The sector has been growing for decades. Average annual output growth in the food processing sector between 1968/69 to 1994/95 was about 1.8 per cent. This was the same as growth for all manufacturing during that period.

Most recently, from 2006-2010, industry value-added growth in the food processing industry was approximately 13.5%, as can be seen in Table 5.1.

Table 5.1

FOOD INDUSTRY VALUE ADDED ($M)

	2006–07	2007–08	2008–09	2009–10
Manufacturing	101,898	107,413	103,925	96,809
Food product manufacturing	14,833	15,988	16,441	16,832

Source: ABS, Australian Industry 2009-10, Cat. No. 8155.0

[55] Note that the category of 'food processing' in ABS statistical tables includes also beverages and tobacco.
[56] Gretton and Fisher (1997), Table 2.1, p. 20
[57] Calculated based on industry value added data from ABS, Australian Industry 2009-10, Cat. No. 8155.0.

Australian food processing has also been consistently productive. Between 1968/69 and 1994/95 productivity (TFP) for that sub-sector averaged about 0.2 per cent.[58]

Employment within the food-processing sector has recently been held steady since 2006-07, as Table 5.2 shows.

Table 5.2

FOOD INDUSTRY EMPLOYMENT ('000)

	2006–07	2007–08	2008–09	2009–10
Manufacturing	1,005	1,005	974	955
Food product manufacturing	206	220	217	210

Source: ABS, Australian Industry 2009-10, Cat. No. 8155.0

Finally, Table 5.3 shows that the Australian food-processing sector increased its profit (earnings before interest, tax, depreciation and amortisation (EBITDA)) for the period 2006-07 to 2009-10. This was despite the impact of the global financial crisis during that time. The food processing sector's profit increased by 30.3 per cent over that period. Profit increased from about $4.3 billion to about $5.7 billion over that period. This is an annual growth in operational cash-flow of about 7-8 per cent over the period.

Table 5.3

FOOD PRODUCTION EBITDA ($M)

	2006–07	2007–08	2008–09	2009–10
Food product manufacturing	4,345	5,291	5,432	5,660

Source: ABS, Australian Industry 2009-10, Cat. No. 8155.0

Relative data

In terms of relativities rather than absolutes, Australian food processing does not show nearly the same 'decline' for output (as a share of GDP) and for employment (as a share of total employment) as for manufacturing as a whole.

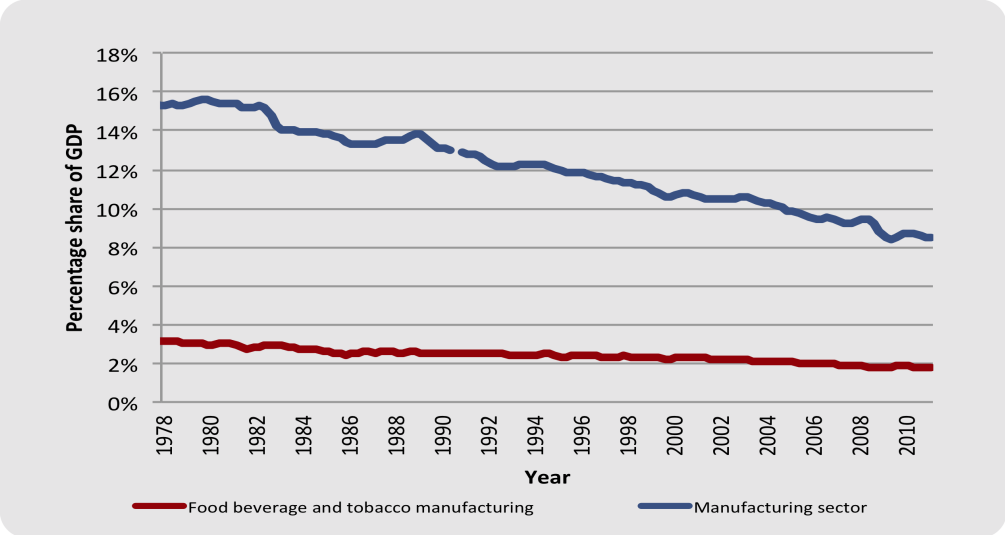
Figure 5.1 shows that the decrease over time of the share of food processing's output to GDP is extremely mild compared to that of manufacturing as a whole.[59]

[58] Figure 2.9 on Page 25, 1997 PC Gretton and Fisher

[59] Figure 5.1 also shows that the share of retailing output increased in that time, as we would expect since retailing is part of the services sector rather than the manufacturing sector.

Figure 5.1

INDUSTRY VALUE ADDED AS A PERCENTAGE OF GDP (%)

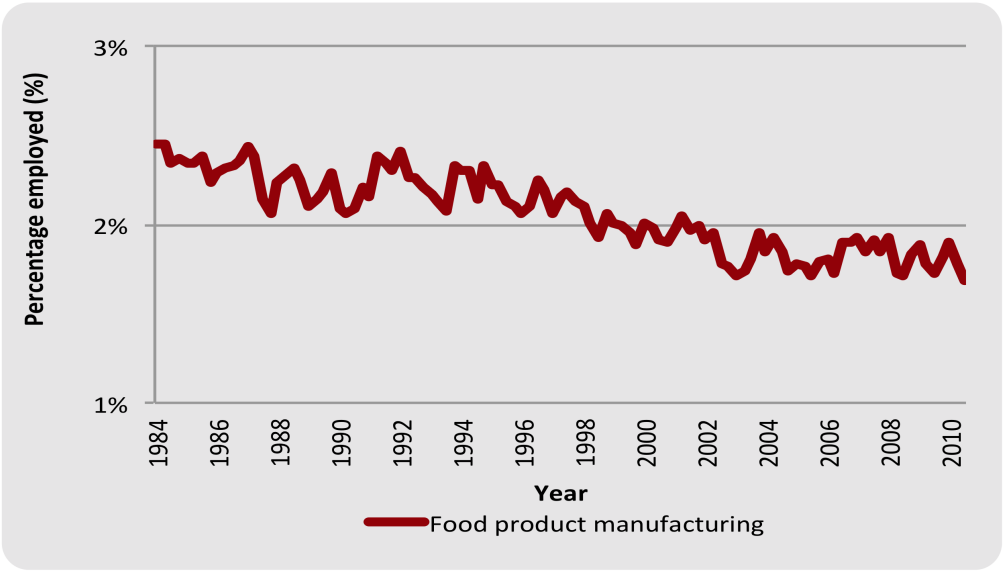


Source: ABS, Australian National Accounts: National Income, Expenditure and Product, Cat. No. 5206.0

Figure 5.2 shows that the food processing sector's share of employment has decreased slightly. The proportion of people employed in the food manufacturing sector decreased from 2.45 per cent in 1984 to 1.68 per cent in 2010, as shown in Figure 5.2.

Figure 5.2

PERCENTAGE EMPLOYED (%)



Source: ABS, Labour Force, Australia, Detailed, Quarterly, Cat. No. 6291.0.55.003

5.3 Future challenges for the Australian food processing sector

During the last few years, in the aftermath of the GFC, most Australian food manufacturing sectors experienced challenging commercial conditions arising from common issues such as:

- Variable *successful* product innovation
- Raw material supply variability and cost volatility
- Domestic market limitations to growth and geographic isolation from larger offshore markets
- The increasing appreciation of the Australian dollar dampening export demand

In this section we list some of the future challenges facing food processing in Australia.

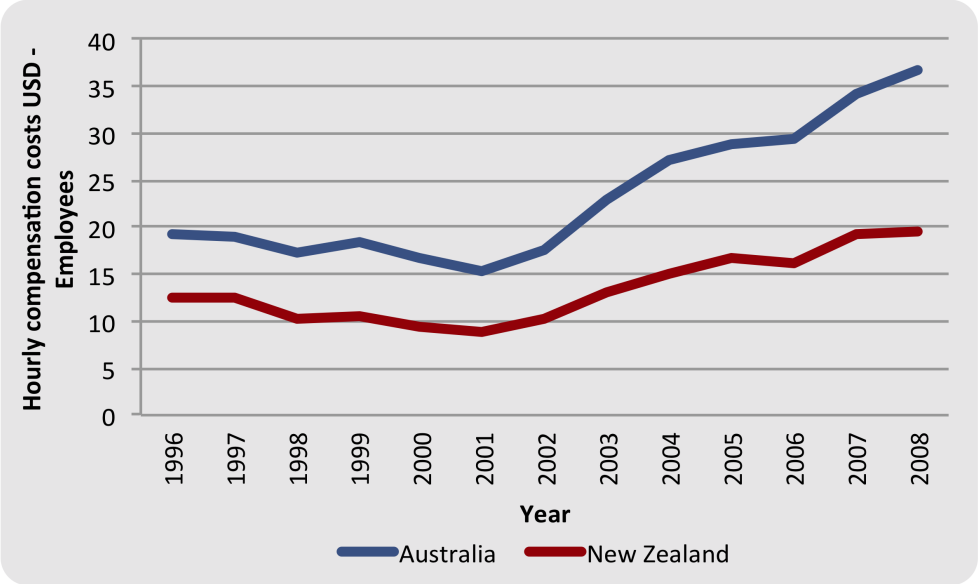
Increasing labour costs

Manufacturing labour cost in Australia has been increasing since 1998 as shown in Figure 5.3. Rising costs affects all firms within the food processing sector. But for firms stuck with commoditised products, it is also the difference in wage costs between Australia and neighbouring countries that is important, especially in the context of possible re-location decisions by firms.

There has been some recent re-location activity to New Zealand from Australia. New Zealand is a comparably developed country in the same region. Compared to New Zealand, labour cost in Australia is higher for employees in the manufacturing industry. In addition, the gap between the cost of hiring manufacturing workers in New Zealand versus Australia has been widening since 2002, as Figure 5.3 also shows. Combined with the current currency advantage which New Zealand enjoys, due to Australia's resources boom, the decision of a number of Australian food processing companies recently to off-shore to New Zealand makes great sense.

Figure 5.3

MANUFACTURING INDUSTRY EMPLOYEES HOURLY COMPENSATION COSTS IN US DOLLARS



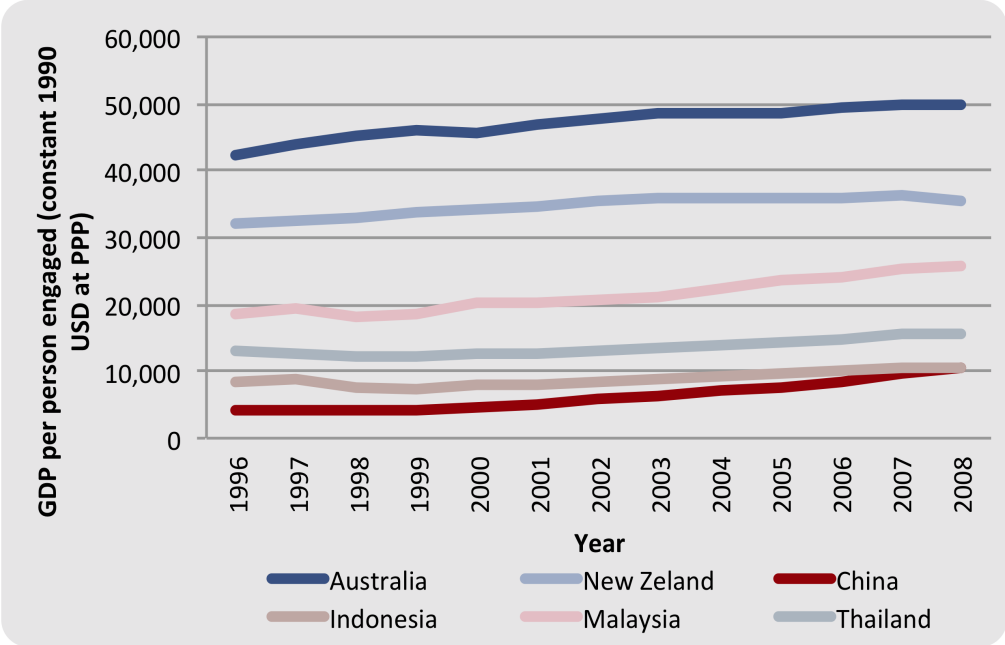
Source: International Labour Organisation, Key Indicators of the Labour Market Database (http://kilm.ilo.org/KILMnetBeta/default2.asp)

The difference in labour productivity between Australia and New Zealand increased by 37.5 per cent, while, during the same period, the difference in labour cost increased by 151 per cent. This indicates the difference in labour productivity between the countries cannot explain the widening gap in the difference in labour costs clearly shown in Figure 5.3. This implies labour cost is growing more rapidly in Australia compared to New Zealand. The impact of the resources boom in Australia explains this disparity.

Figure 5.4 shows that Australian manufacturing labour productivity has been increasing. It also shows for comparison similar increases for neighbouring counties, as well as the fact that Australia is more productive than its neighbouring countries. In short, Australian workers are paid more because they are better workers. Commoditised products which would waste the talents of Australia's superior manufacturing workforce are best produced in those countries with less talented (and, hence, cheaper) workers.

Figure 5.4

COMPARISON OF MANUFACTURING INDUSTRY LABOUR PRODUCTIVITY IN SOME NEIGHBOURING COUNTRIES



Source: International Labour Organisation, Key Indicators of the Labour Market Database (http://kilm.ilo.org/KILMnetBeta/default2.asp)

The increase in Australia's labour cost cannot be fully explained by the increase in Australia's labour productivity. While Australian manufacturing productivity increased by 17.4 per cent between 1996 and 2008, labour cost increased by 90.5 per cent. Something more is going on in Australia.

That something more is Australia's current resources boom, which is driving up labour costs in all parts of the Australian economy (not just in the resources sector).

> The structural adjustment being forced upon the economy by these changes [resulting from the resources boom] will be dislocating for many firms, workers and regions. The challenge for policy makers is to facilitate as smooth an adjustment as possible for all affected. [60]

This fact can be dramatically shown by comparing Australia's labour costs, not to neighbouring developing countries as was done above, but to comparably advanced economies such as the US, UK and Canada.

> Non-miners not only find they have to pay more to prevent skilled labour being bid away, those that are exporters or compete with imports also see their competitiveness eroded by movements in the exchange rate in response to the higher terms of trade.[61]

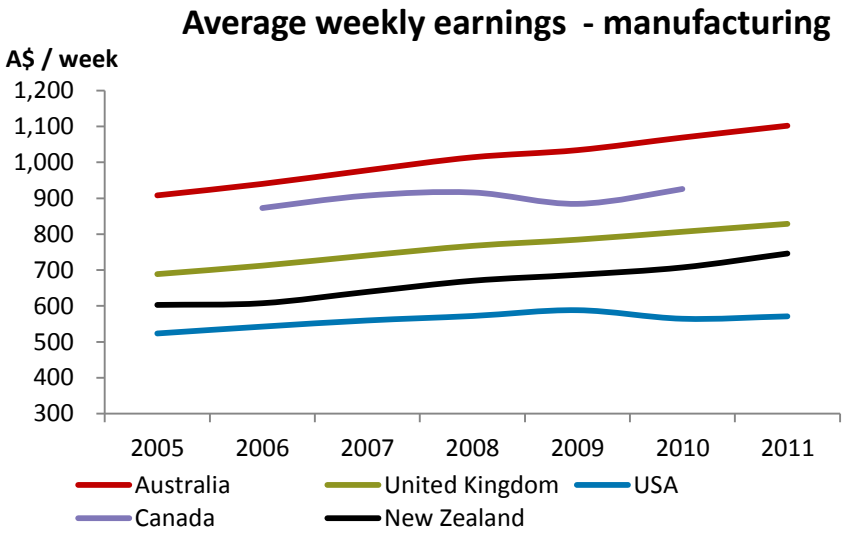
Figure 5.5 shows how Australia's labour costs compare to those of these other Western countries. It can be seen that, since the mid-2000s, Australia has been top of the pile.

[60] Martin Parkinson, 2011, available at: http://www.treasury.gov.au/documents/2077/PDF/Sustaining_growth_in_living_standards.pdf.

[61] Martin Parkinson, 2011.

Figure 5.5

COMPARISON OF MANUFACTURING INDUSTRY COSTS ACROSS SOME DEVELOPED COUNTRIES



Source: Coles

Increasing input costs

The food processing industry is likely to face volatile input prices over the next ten year as suggested in a report by the OECD.[62] The report is cautiously optimistic that agricultural commodity prices will fall from their 2010-11 levels, but in real terms are likely to remain on a higher plateau during the next ten years compared to the previous decade. Higher commodity prices will be passed through the food chain resulting in food price inflation.

There are also signs that agricultural production costs are rising and productivity growth is slowing resulting in global agricultural production projected to grow at 1.7 per cent annually compared to 2.6 per cent in the previous decade.

In addition, per capita food consumption will expand most rapidly in Eastern Europe, Asia and Latin America where incomes are rising and population growth is slowing. Vegetable oils, sugar, meat and dairy products should experience the highest increases in demand.

The combination of uncertain weather conditions, increasing energy prices, growing consumption demand, resource pressures imply that producers, traders, consumers and governments will face increased uncertainty and price volatility when competing for agricultural commodities.

[62] OECD – FAO, Agricultural Outlook 2011-2020.

Increasing private label penetration

Private label products have increasing penetration in Australia.[63] Australia lagged behind other western countries in the size of penetration of private labels but is now catching up.[64] Private label products now constitute about one in four products in our major supermarkets.[65]

The effect of a greater penetration of private label products is to increase supply-chain efficiency and lower costs over time for commoditised products. Commoditised products are the ones where private labels have been most successful.[66] In that product space, private labels help firms to become more efficient in their production processes and to achieve greater scale (which is important for commoditised products, which are generally high volume and low margin).[67]

Greater penetration of private labels helps food processing firms achieve the scale needed to remain viable as domestic producers of commoditised products. The greater penetration also aids retailers to achieve lower prices in their bargaining dynamics with food processors. At the very least it aids in enabling retailers to ascertain whether proposed price increases from suppliers are the result of genuine upstream cost increases (as we saw in the previous section above) or are an attempt to pad out supplier margin. This kind of information is better known to food processors than to retailers, thereby creating a dynamic of asymmetric information bargaining. Private labels helps to create 'screen' in which such differing information can be separated out.[68] This development has been needed in Australia given that the top Australian food producers on average have been earning much higher margins/profits (EBIT) than the top global producers.[69]

Increasing import competition

Figure 5.6 shows that Australia imported more food and beverage compared to grocery. Specifically, between 2004-2005 and 2009-2010:

- food and beverage imports increased from $6.3 billion to $9.9 billion, growing by 57 per cent; and
- grocery imports increased from $10.7 billion to $12.9 billion, growing by 21 per cent.

[63] The recent rise of Aldi in Australia, with its business model dedicated to private label products, has played a role in this catch-up in Australia.

[64] For the European numbers (already 35 per cent in the UK in 2000), see Competition Commission (2000), *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom,* Cm 4842, The Stationery Office, London.

[65] Coles.

[66] Burt, S. (2000), 'The Strategic Role of Retail Brands in British Grocery Retailing', *European Journal of Marketing* 34:875-90. If private labels cannibalise the branded labels of upstream food processors, then its greater penetration can over time lead to lowered revenue for food processors. However, good brands are hard to replace by private brands, especially on non-commoditised products.

[67] Lincoln and Thomassen, *Private label: turning the retail brand threat into your biggest opportunity* (2008), chapter 5.

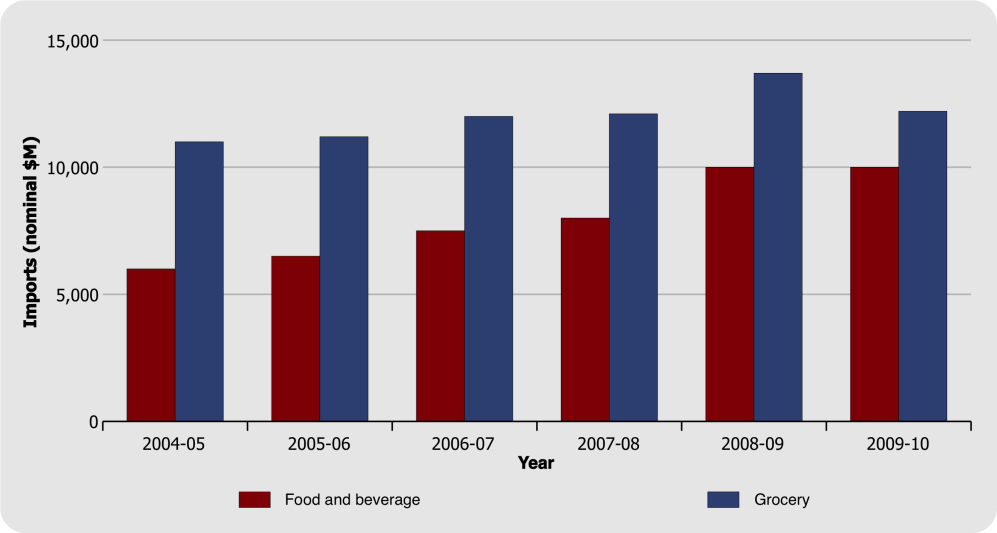
[68] Samuelson, 1982.

[69] Coles. See also Department of Agriculture, Fisheries and Forestry, *Price Determination in the Australian Food Industry* (2004), Figure 121 at page 111.

Australia has recently acquired a trade deficit in the food processing sector. Comparing export and import revenue, it can be shown that the level of imports has exceeded exports since 2008-09. In 2004-05, Australia exported $1.21 for every $1 of imports. By 2009-10, this was reduced to $0.92 of exports for every $1 of imports. In other words, in 2004-05, exports exceeded imports by $3,788 million but by 2009-10, imports exceeded exports by $1,748 million.

Figure 5.6

AUSTRALIAN IMPORTS (NOMINAL $M)



Source: Australia Food and Grocery Council, State of the Industry Report 2010, p. 77

Growing strength of the Australian dollar

The Australian dollar has grown from strength to strength since 2000-2001, as shown in Figure 5.7. The strengthening dollar makes Australian exports more expensive relative to other countries and makes imports more attractive alternatives to domestic products.

The rising dollar is a longer-term phenomenon due to Australia's sustained resources boom.

The strengthening dollar explains a significant part of the worsening terms of trade experienced in the food product manufacturing industry as Australian food products become increasingly expensive and less attractive overseas. Those parts of the food processing sector which both face sizable imports and also have a significant export profile are being squeezed between the tightening pincers of the falling Australian prices of their import-competition on the one hand and the rising overseas prices of their exports on the other.

It should also be pointed out that the trade deficit in food manufacturing combined with the rising Australian dollar (which makes imports cheaper for Australians) has a combined effect of making the average Australian's weekly shop cheaper. Indeed, as Treasury secretary Martin Parkinson recently stated, a higher dollar, leading to lower prices in the economy, is one of the ways in which the Australian economy spreads the benefit of the resources boom to all Australians, making everyone better off over time.

> But this higher exchange rate is also one of the ways in which the benefits of the mining boom are spread to consumers – witness the dramatic falls in the prices of imported consumer goods.[70]

Figure 5.7

EXCHANGE RATE – TRADE WEIGHTED INDEX (MAY 1970=100)

Source: Reserve Bank of Australia, Exchange rate data, accessed 23 August 2011. (http://www.rba.gov.au/statistics/hist-exchange-rates/index.html)

5.4 Future opportunities for the Australian food processing sector

Exogenous drivers of higher costs place firms in a reactive frame. But challenges are also the driver of pro-active seizing of opportunities. Seizing opportunities means acting pro-actively to control costs and influence future revenue flow. Costs can be controlled through off-shoring, and future revenue flow can be influenced by exporting and innovation.

[70] Martin Parkinson, 2011, Sustaining growth in living standards in the Asian century, available at: http://www.treasury.gov.au/documents/2077/PDF/Sustaining_growth_in_living_standards.pdf.

Off-shoring

Off-shoring is a legitimate response to rising costs and import competition for those firms located on the commoditised end of the product spectrum. It is a global phenomenon, ever-present, though globally has been exacerbated by the GFC (as manufacturing is especially pro-cyclical).[71]

Supply chains are increasingly global, operated by global multi-nationals. There is a strong case that Australia should be connected to these global supply chains better than we currently are.[72] Integration into global supply chains occurs not only by Australian firms re-locating overseas, but by Australian firms buying overseas companies, and also – as was frequent during the 2000s - by Australian firms being bought by foreign companies.

> Over the last few decades, there has been considerable integration of production by manufacturing enterprises across national boundaries. Cross border ownership of productive resources has risen significantly. The increasing role of cross border ownership provides additional evidence of an open manufacturing sector. Today, large transnational corporations compete for customers around the world with components of their production chain strewn across nation states.[73]

As the Economic Committee of the House of Representatives reported in 2007, off-shoring is not obviously detracting of the welfare of Australians, largely because it is focused on firms stuck with commoditised products requiring routinized, low-wage labour for which Australian workers are rightly too expensive:

> Many Australian manufacturers have moved their production offshore, to remain competitive in international markets. These manufactures [. . .] still contribute to the well-being of Australians as the profits from the manufactures accrue to Australian shareholders. These profits appear in the income account of the balance of payments and add to gross national income in the national accounts. Furthermore, often it is the basic manufacturing process that is now conducted offshore and the more high-value design and management functions remain in Australia.[74]

Increased export profile

Figure 5.8 shows that Australia exported more food and beverage compared to grocery. While exports in the food and beverage industry have been relatively stable, grocery export has been increasing from 2003-04 to 2009-10. It has increased from $1.3 billion to $4.9 billion, representing a 268 per cent increase over that time.

[71] Economist, *How important is it to make things?* 30 August 2011, at: http://www.economist.com/blogs/freeexchange/2011/08/manufacturing.

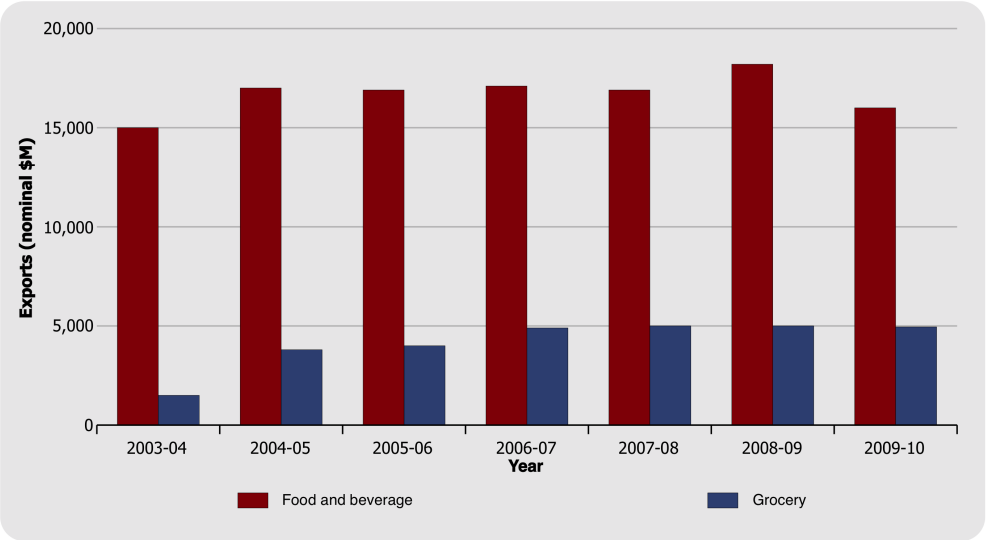
[72] House of Representatives Standing Committee on Economics (2007), chapter 4.

[73] PC trends 03 Report.

[74] House of Representatives Standing Committee on Economics (2007), p. 12

Figure 5.8

AUSTRALIAN EXPORTS (NOMINAL $M)



Source: Australia Food and Grocery Council, State of the Industry Report 2010, p. 74

Innovation

Innovation is the preferred solution to the long term competitiveness of the food manufacturing industry.

The Australian food processing sector has a proud and successful history of innovation. Rather than develop resources to compete as a low cost producer, the sector is better placed to concentrate on developing areas of their value chain aimed at occupying higher value, innovative and quality driven niche products.

A commitment to innovation implies a higher, sustained commitment in the short to longer term to research and development to improve profitability, either through the development and production of higher value added products or processes aimed at reducing manufacturing costs. Longer term this may stimulate a re-examination of Australia's place in the food industry value chain shifting predominantly toward an onshore focus of IP generation and development, rather than IP generation, development and manufacturing all happening onshore.

In this chapter we showed that the Australian food processing sector is very successful. Continued success in the future will depend on firms within the sector continuing to adapt, innovate, and manage costs efficiently. In the next chapter we focus on two sectors of Australian food processing, and tell the story of how they are changing to reap the rewards of future opportunity.

Chapter 6

Market Forces and Competitive Responses: Case Studies from Australian Food Processors

Chapter 6 explores case studies of two sectors in the food processing sector (fruit and vegetable processors and biscuit manufacturers), showing how they have had to respond to long-run trends in manufacturing in order to remain viable or thrive. The two sectors provide contrasting examples of responses to the pressures facing the sector as a whole. The two main responses have been innovation and off shoring.

6.1 Introduction

We have seen that the long term economic performance of the food processing sector over recent years has equalled the performance of the total manufacturing sector. There is no 'crisis' in food manufacturing in Australia. This successful performance is based on continued improvement in managing costs, on making supply processes more efficient, and on innovation in product design and product improvement. In the long run, innovation is the most important. Innovation will need to continue to grow as a key success factor to maintain the long term competitiveness of Australian food processing.

There is an inherent limitation to understanding the performance of a sector through the analysis of broad economic data alone. Interpreting the performance of the broader food processing sector to be favourable when compared to the broader manufacturing sector performance does not imply that the performance of individual food processing industries within it have been uniformly positive. Different food processing industries are performing differently in growth terms, and responding to current market drivers in different competitive ways.

In order to understand how food processors are performing at an operational level, we drill down and analyse two food processing industries. They are:

- **Fruit and Vegetable processors**
- **Biscuit manufacturers**

For each sector, we examine industry performance, and the key factors driving commercial competitiveness.

In selecting these industries, we have considered how differences in manufacturing intensity, position in the value chain, and category maturity can affect commercial performance.

6.2 Revenue performance of the two sectors

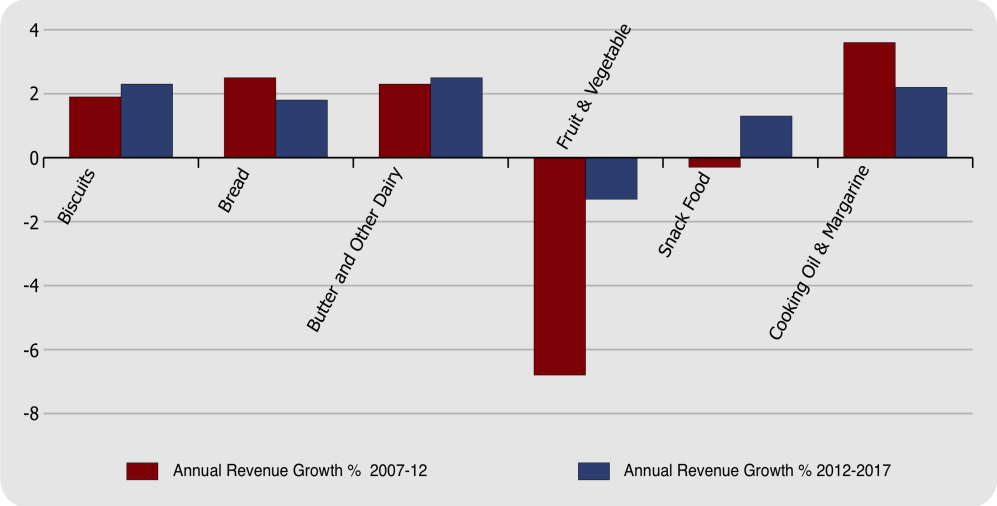
Figure 6.1 shows recent and projected revenue performance for a number of sectors within food processing in Australia.

Of the two sectors chosen for examination in this chapter, it can be seen that processors of fruit and vegetables have recently been doing it very tough, while producers of biscuits have been moderately successful.

As we will show, the key strategic responses to improve the competitive performance of firms in these two sectors has been either broadly 'innovation oriented' (either via product innovation to grow revenue or process innovation to improve profitability) or 'cost containment oriented' in nature (which includes off-shoring).

Figure 6.1

ANNUAL REVENUE GROWTH IN AUSTRALIAN FOOD PROCESSING INDUSTRIES



Source: IbisWorld (various reports) and ACG

Fruit and vegetable processing

This involves firms which manufacture products like tinned fruit and tinned tomatoes. It can be seen from Figure 6.1 that their average revenue over the last few years has been declining rather than growing. From 2007 to now it has averaged minus 7 per cent per annum. Figure 6.1 shows that such decline is expected to continue, though in the immediate future it is projected to be much less than it currently is.

Speaking generally, the processed fruit and vegetables sector is a 'commoditised' product sector. In the language of the House of Representatives report into Australian manufacturing, its products for the most part belong in the category of 'simply transformed' rather than 'elaborately transformed'.[75] It follows from what we know of the macro-drivers of long-run performance, as detailed in chapter 4, that firms in such a commoditised sector, in order to maintain margins, must try to either export, or move up the quality-ladder, or re-locate their production off-shore (see section 4.5 above). Unsurprisingly, much of the recent news involving off-shoring has involved firms situated in this sector.[76]

Biscuits

This involves firms which manufacture products like sweet or dry biscuits. It can be seen from Figure 6.1 that their average revenue over the last few years has been growing. From 2007 to now it has averaged almost 2 per cent per annum. Figure 6.1 shows that this solid though hardly spectacular revenue growth is expected to improve slightly in the immediate future.

Speaking generally, the biscuit sector is further advanced up the quality-ladder than the processed fruit and vegetable sector. This was the result of major mergers and take-overs during the 2000s, which incorporated Australian firms into the global supply chain. This was important because much biscuit manufacturing is high-volume/low-margin, which places a premium on firms achieving scale. In a number of cases it also enabled those (formerly) Australian firms to become entirely re-located off-shore as part of their new parent-company's global supply chain.

Products in the biscuit sector are partly 'commoditised' and partly more elaborate. Some firms have only commoditised products in their offering, while others have only more elaborate products (for example, niche player Lavosh), and others still have a mixture of both. It follows from what we know of the macro-drivers of long-run performance, as detailed in chapter 4, that firms will attempt to export and/or off-shore the commoditised products within their offering while further investing in and developing the more elaborate products in their offering. Unsurprisingly, some of the recent news involving off-shoring has involved firms situated in the commoditised spectrum of this sector.[77]

[75] See House of Representatives Standing Committee on Economics (2007). And see section 4.5 above.

[76] See, just as a recent example, CCA's decision in relation to cutbacks at SPC in the Goulbourn Valley, as reported here: http://www.theage.com.au/victoria/dollars-rise-slices-150-spc-jobs-20110809-1ijya.html.

[77] See, just as a recent example, Campbell Soup Company's decision to retrench jobs at its Arnott's factory in Brisbane, as reported here: http://www.couriermail.com.au/business/call-to-reform-productivity-as-arnotts-tells-190-staff-their-jobs-will-go-with-67-million-upgrade/story-e6freqmx-1226084437155. Note, however, that - despite the entrenchments - this is in fact a story about a company investing in increased productivity.

6.3 Fruit and Vegetable Processors – An Industry Fighting Decline

6.3.1 Introduction

The Australian fruit and vegetable processing industry is characterised by negative growth. Since 2001-02, there has been a 12.3% decline in the number of enterprises operating in the industry,[78] and take overs of major Australian icons by multinational food processors, such as SPC Ardmona by Coca-Cola Amatil and Golden Circle by Heinz-Watties, have had a high media profile. Key competitive responses to turning around the performance of these businesses have been product innovation and stabilising the cost base through restructure, product and internal rationalisation, and the improvement of operational efficiency.

6.3.2 The industry and its players

The fruit and vegetable processing industry consists of companies that preserve via freezing, bottling and canning (excluding sun dried products). In 2011, the industry had a turnover $3.8 billion and a low/moderate gross profit of $201.2 million (5.3%).[79] The industry has exhibited negative annual growth from 2006-2011 (minus 6.8%), although this is forecast to slow to near flat annual growth in the period 2011-16. (minus 1.3%)[80].

Key companies that operate in this industry are Heinz Watties (market share 19.8%), Simplot Australia (market share 13.0%), Coca-Cola Amatil (market share 8.0%) and McCain Foods Australia (market share 6.0%)[81]. All are Australian subsidiaries of US-origin multinational food processing companies.

6.3.3 Market forces and key drivers

The Australian fruit and vegetable industry has been impacted by increasingly difficult supply and demand side conditions over the past five years[82]. A summary of these include:

Supply Side Cost Impacts:

- *The impact of natural disasters affecting the major food bowls of the Eastern seaboard, including the Murray Darling Basin Floods, Cyclone Yasi and the Queensland floods from 2006-2010;*
- *The increased cost of goods from increased farming input costs; including fertilizer.*
- *Increased labour costs compared to those in countries from which competing imports originate*

[78] IBISWorld (2011b), Fruit and Vegetable Processing in Australia, p. 36
[79] Ibid, p.20
[80] Ibid, p.2
[81] Ibid, pp.25-29
[82] Ibid, p.4

These cost impacts are upward. Upward cost impacts such as adverse growing conditions and increased grower cost of goods are forecast to continue as the effects of climate change and forecast increases in fossil fuel prices continue to be felt. Imports are forecast to continue to rise over the 2011-16 period where imports as percentage of demand will increase from 31.36 to 35.91 per cent.[83]

Demand Side Revenue Impacts:

- *The rise of cheaper imported competition*
- *Rising Australian dollar*
- *An increase in the consumption of fresh fruit and vegetables driven by greater awareness of healthy eating practices*

The tendency of Australia's major retailers to increasingly source processed fruit and vegetables from overseas due to price or to interrupted supply considerations has intensified the competitive pressures on local food processors.[84] Similarly, the strong Australian dollar is expected to have a long-term downward revenue impact on exports of Australian processed fruit and vegetables.[85] A greater preference for freshness on the part of consumers leads to them substituting away from processed fruit and vegetables towards the fresh versions. However, this downward pressure on revenue is countered with upward effects flowing from successful increased value adding in the branded product arena.

6.3.4 Industry operating conditions

Capital Exposure*:* Fruit and Vegetable processing is a highly capital intensive industry with the ration of capital per labour units being more than twice that of the general manufacturing sector, and more intensive than vegetable growing[86]. The industry is the 18th highest employer of labour in the food processing sector[87], and whilst significant increases in machinery investment over recent years have increased throughput without commensurate increases in employment[88], cost inputs from labour remain significant.

Research & Development costs are also increasing for the industry. Methods to improve manufacturing efficiency, product taste, nutritional value and shelf life are important to deliver competitive advantage to food processors, but add to the costs of goods for products. Changing consumer preferences for value added formats of fruit and vegetables, including ready-to-eat convenience salads, are an example of this. Larger multinational players are perhaps better placed to make these investments in innovation capital and labour, as they can be leveraged across a higher revenue base than smaller operators.

[83] Ibid, p.36
[84] Ibid, p.4
[85] On the cost side, a rising dollar lowers the price of imported inputs.
[86] IBISWorld (2011b), p.30
[87] Ibid, p. 36
[88] Ibid, p.30

Cost and Revenue Volatility: The volatility in supply primarily arising from changes to growing conditions and natural disasters from 2006-2010 has impacted cost volatility. With the industry operating on significant long term pricing contracts reducing revenue volatility,[89] this introduces significant profit risk to food processors. Further cost impacts are seen with the increase of imports to meet the shortfall of demand arising from adverse growing conditions. An example of this was the need to import tomatoes in 2010-11 due to heavy rainfall and flooding across Eastern Australia.

6.3.5 Key success factors

Innovation

To counter increasing cost inputs and capitalise on other consumer trends such as healthy eating in an increasingly time poor world, fruit and vegetable processors have increased their penetration via appealing to different demographics through the development of private label lines and value added convenience products, such as ready-made meal accompaniments and meals-on-the-go. This particularly pertains to the development of domestic Australian markets that are less susceptible to strong downward revenue pressures arising from the strong Australian dollar, as seen in export markets for these products. This currency effect is expected to continue to dampen demand from offshore markets for the industry.

Such innovation must continue for food processors to reverse the revenue decline of the industry. By effectively "upselling" consumers on everyday meal items within the boundaries of effectively leveraging their manufacturing capacity and increasing economies of scale through non-grocery channel diversification and private label contracts, food processors can increasingly build profit into their operations.

Product innovation also includes manufacturing improvements that improve the customer appeal and profitability of existing products, for example freshness and shelf life improvements through improved packaging.

Stabilising the Cost Base

Low margin, high volume operating manufacturers are profitable only via stringent cost control and leverage of manufacturing capacity to reduce overhead impacts of the costs of goods. Stabilising cost inputs through long term (and hedged) raw materials contracts, in addition to maximising manufacturing capacity via private label supply and acceptable consumer-led new product development, is a key success factor in the fruit and vegetable processing industry.

6.3.6 Competitive responses

SPC Ardmona and Golden Circle are examples of iconic Australian fruit and vegetable processors that have undergone significant restructuring and innovation redevelopment to remain commercially competitive.

[89] Ibid, p.33

Golden Circle was a Queensland based growers co-operative of over 700 farmers that was affected by inefficiencies and a lack of product innovation when it was acquired by US food processing giant, Heinz, in late 2008. Heinz restructured and stabilised the cost base of the operation, as well as improved product development activity to add new value added juice formats to improve consumer appeal.

SPC Ardmona – Australia's leading producer of ready-to-eat packaged fruit and vegetables - was acquired by Coca-Cola Amatil (CCA) in 2005 as part of CCA's drive to incorporate healthier eating and drinking products into their portfolio. In 2006, CCA streamlined costs in the operation by centralising and consolidating twelve of SPC Ardmona's offsite warehouses into a new $15 million national distribution centre. Focussed product development of convenience fruit and fruit bar formats under the Goulburn Valley brand followed. More recently, the CCA group has announced the closure of the Mooroopna plant in Victoria, citing the effects of the high Australian dollar and a 35 per cent drop in export sales in 2010-11[90] as key drivers underpinning further rationalisation to the cost base of the operation.

6.4 Biscuit Manufacturing – A Traditional Category Grows via Niche Innovation

6.4.1 Introduction

The biscuit manufacturing industry is well established, demonstrating many of the classic signs of a sector in well established maturity. With few new entrants, an estimated 86 per cent household penetration[91] and significant brand diversification; the industry seems to hold limited new opportunities for significant domestic growth[92] The industry is a net importer, and is subject to ingredient cost volatility and revenue volatility from highly competitive trading conditions across their domestic and export markets.[93]

The industry has dealt with these challenges primarily via product innovation, consumer price increases and cost containment measures. One of the most notable cost containment measures undertaken was the transfer of manufacturing operations to China by Kraft in 2003-2006. Product innovation, particularly "new-to-category" innovation shown by Effem Foods Pty Ltd (for example, their "Pods" range of confectionery-biscuits) demonstrate that niche growth opportunities for consumer-relevant and commercially viable product extensions are still available for Australian food manufacturers.

[90] http://news.smh.com.au August 9, 2011
[91] IBISWorld (2011c), p. 12
[92] Ibid, p. 11
[93] Ibid, p. 36

6.4.2 The industry and its players

The biscuit industry is highly segmented and divided into sweet and savoury categories. Sweet biscuits form the traditional core focus of the industry, with products divided into plain, creams, chocolate and health. Savoury biscuits are more recent additions to the category, showing good growth as consumer tastes trend to healthier, low fat options.[94] In 2011, industry turnover was $1.3 billion with a low gross profit of $48.3 million (3.7%).[95] Revenue annual growth from 2006-2011 was slow at 1.9%, although this is forecast to increase to 2.3% annual growth in the period 2011-16[96].

Key companies that operate in this industry are Arnott's Biscuits Holdings Pty Ltd (market share 63.1%), Goodman Fielder Ltd (market share 13.5%; as Paradise Foods) and Kraft Foods Australia Ltd (market share 9.4%)[97]. An Australian biscuit making icon, Arnott's was acquired by US food giant, The Campbell Soup Company, in 1997. US based Kraft Foods is the world's second largest food company,[98] and Goodman Fielder is one of Australasia's largest food companies operating in the Australia-Pacific region.[99]. Notably, major Australian biscuit manufacturer and UK owned multinational food company George Weston Foods exited the industry in 2003; citing falling profits. Selling their biscuit interests to Arnott's, Paradise Foods and a Fijian company, the divestiture further consolidated a concentrated supplier market in Australia.[100]

6.4.3 Market forces and key drivers

Challenging supply and demand side conditions over the past five years has impacted the Australian biscuit industry[101]. A summary of these include:

Supply Side Cost Impacts:

- *Fluctuating commodity prices of wheat and sugar*

Input price volatility of wheat, particularly over 2007-08 (6.1%) and 2008-09 (minus 14.7%) has presented challenges to biscuit manufacturers operating on modest cost of goods margins. Wheat prices are forecast to increase in 2011-12[102]. Rises in wheat prices have been attributed to rising energy costs, adverse climatic conditions and rising biofuel production[103]

Sugar prices are also expected to continue to be higher than average, with the industry forecasting only modest increases in production following recovery from Cyclone Iasi. Sugar industry revenue is forecast to increase by 2.3 per cent in 2011-12,[104] adding to increased cost of goods pressures for biscuit manufacturers.

[94] Ibid, p. 13
[95] Ibid, p. 3
[96] Ibid, p. 3
[97] Ibid, p. 29
[98] http://www.arnotts.com.au/about-us/arnotts-heritage.aspx
[99] http://www.goodmanfielder.com.au/index.php?q=node/3
[100] IBISWorld (2011c), p.30
[101] Ibid, p. 5
[102] Ibid, p. 5
[103] Ibid, p.6
[104] Ibid, p.5

Demand Side Revenue Impacts:

- *The Rise of Health Conscious Consumers*
- *Appreciation of the Australian Dollar*
- *Rising Population*

Both upward and downward revenue impacts are operating on the industry. Upward revenue impacts include a rising population expected to reach 36 million by 2050 from the current 22.6 million[105], the opportunity for continued geographic diversification via exports and the exploitation of new market niches, particularly in the area of healthy and cafe style biscuits. Driven by emerging polarisation of consumer needs for snacking products that are healthier with lower fat and sugar; or indulgent, to address cafe style eating in- the-home, successful examples of niche innovation include the Arnott's Snackright and Arnott's Cafe Emporium brands.

Whilst geographic diversification remains an opportunity area to address lower growth opportunities in the Australian domestic market, it brings with it the risk of downward revenue impacts through the continued appreciation of the Australian dollar. Australia is a net importer of biscuits and through it's geographic isolation, exports have been limited due to distribution issues. Over 90 per cent of Australia's biscuits are exported to only three customers: New Zealand, United Kingdom and the United States, which when coupled with the strong Australian dollar, represent significant revenue risk for the biscuit industry.[106] Geographic expansion into regions with low biscuit penetration, changing consumer tastes and increasing disposable incomes and population, that is, into regions such as China, India and parts of South America are likely to grow in the near future.

6.4.4 Industry operating conditions

Capital Exposure*:* Biscuit manufacturing is rated as a medium capital intensive industry, however pressures to increase economies of scale, longer production runs and reduce labour costs are seeing manufacturers increase their level of mechanisation. Currently, the ratio of capital per labour units is marginally less than the average of the general manufacturing sector, owing to the relatively low level of labour utilisation in biscuit production.[107]

Research & Development costs are medium for the industry, with efforts concentrating on improving packaging and formulations to withstand distribution, increased shelf life, manufacturing efficiency and changing consumer tastes. Success with commercialising high value added formats of biscuits, such as functional varieties, have been limited. The limited size of the Australian domestic market, coupled concentration of research and development undertaken by a concentrated industry sector has perhaps limited high value product innovation[108]. The development of more research partnerships with public sector research organisations could be beneficial in addressing this trend.

[105] Australian Government Treasury website, The 2010 Intergeneration Report, accessed 30 August 2011. (http://www.treasury.gov.au/igr/igr2010/report/html/02_Chapter_1_Economic_and_demographic.asp)
[106] IBISWorld (2011c), p. 7
[107] Ibid, p. 31
[108] IBISWorld (2011c), p.33

Cost and Revenue Volatility: General cost and revenue volatility for the biscuit manufacturing sector is lower than for other sections of the food processing sector, such as fruit and vegetable processing; however**,** profit volatility due to adverse weather conditions, fluctuating wheat and sugar costs and the impacts on exports via an appreciating Australian dollar are realities, and have been discussed previously.

6.4.5 Key success factors

Innovation

In some ways, the Australian biscuit manufacturing sector has managed to successfully operate on relatively lower levels of category innovation perhaps due to the concentrated nature of industry ownership, high level of household penetration and highly developed segmentation for the category. However, the Australian snacking repertoire is becoming increasingly competitive and poorly defined, and a key strategy for the sector will be competing with substitutes, both healthy and not, for shopper basket share.

To this point, the effective marketing of differentiated biscuit products will be important. Not only to deter switch to other snacking substitutes, but to also compete with increasing private label competition from supermarket retailers, who have cleverly marketed their offerings quite closely to their branded counterparts to increase consumer switch.

Product innovation to meet changing domestic consumer tastes around health, to address transportation and shelf life issues, have been discussed elsewhere. The industry is forecast to stabilise industry value added as a percentage of revenue at around 36 per cent from 2011-16,[109] indicating a flattening of innovation. The industry seems to be arriving at a critical decision point with respect to innovation investment, and could be considering significant category diversification or the acquisition of takeover targets (artisan biscuit players?), as options for strong growth opportunities rather than growing via organic growth alone.

Stabilising the Cost Base

Achieving economies of scale and scope across formulations is important to the manufacturing efficiency and profitability of the biscuit manufacturing sector.[110] The winning of private label contracts that might enhance volume throughputs and reduce cost for branded biscuit manufacturers can further enhance this.

A key success factor in maintaining profitability in the biscuit manufacturing industry is also the ability to hand on cost increases to consumers (refer to Kraft Foods below).

[109] Ibid, p.36
[110] Ibid, p. 20

Geographic expansion remains one of the key strategies to stabilising cost volatility and is an opportunity area for the industry. Reducing the reliance on a small number of exporting customers, and realigning geographic focus to regions of growing consumer opportunity for the category, will be a critical growth strategy for the industry going forward. The measure does represent risk to the offshoring of production in the Australian domestic sector, as companies shift manufacturing increasingly to new offshore markets to meet growing export demand.

6.4.6 Competitive responses

While industry ownership of the biscuit industry is quite concentrated, several changes in company and brand ownership from 2003 demonstrate the competitive nature of running large scale, profitable biscuit operations in Australia. Two examples of food companies with well established Australian operations that have had different competitive responses to these market conditions are Kraft Foods and Effem Foods.

Kraft Foods owns a number of successful biscuit brands including Ritz, Oreo and Premium. Kraft has experienced difficult revenue growth particularly from 2006-2009, where a combination of higher input prices, volume declines, acquisitions and "unfavourable volume mixes" lead to a revenue decline from $675.0 million to $576.4 million (minus 14.6%). Revenue growth in the biscuits portfolio actually grew in 2008 and 2009 due to increased product pricing. Despite the difficult trading environment, Kraft managed to maintain non-tax profit growth by passing on price increases to customers and by containing promotional and administrative costs[111] The company also completely offshored their manufacturing base to China in 2006 to address high and unsustainable operational costs.

The manipulation of discretionary and variable operational costs, such as marketing and promotion, can often only be maintained in the short term before impacts on brand health and market share occur, but it nonetheless is a viable strategy when trading conditions are difficult in the face of rising production cost inputs.

Effem Foods Pty Ltd is a diversified private company that is a relatively new and small entrant into the Australian biscuits category, with a market share of less than 1 per cent in 2010-11[112] .The Effem Group portfolio includes successful household brands such as Mars, Uncle Ben, Pal and Masterfoods.

In 2004 Effem Foods successfully launched a hybrid confectionery-biscuit brand called Pods. The launch demonstrated that highly mature category could grow by the innovative leveraging of strong consumer brands into new categories in unexpected ways. This was achieved via the introduction of new and surprising biscuit formats filled by established and successful confectionery formulations, including the Twix, Snickers, Bounty and Mars brands, ostensibly bringing new buyers to the biscuit category and to these confectionery brands.

[111] Ibid, p. 28
[112] Ibid, p. 29

In this chapter we have summarised how two different sectors of food processing have been dealing with the commercial challenges they face. Innovation or off-shoring have been the main responses for firms trapped with commoditised products, and both sectors exhibit firms which have been in either response. In the next chapter we detail what government can do to assist firms further their quest to innovate up the quality-ladder

Chapter 7

Conclusion

Chapter 7 summarises the main points discussed in this report and suggests some ways that government can assist the food processing sector to continue to thrive.

7.1 Summary

The Australian food processing sector is performing well. In some key indicators - profit, employment, and output - it is performing better than the wider Australian manufacturing sector. This success is owed to firms within the sector grasping the opportunity to innovate, export, and/or re-locate off-shore.

Looking forwards, the Australian food processing sector continues to face a highly competitive and challenging commercial environment. This is because the sector is experiencing continued downward pressures on price and profitability from external drivers such as the appreciating Australian dollar, increasing raw material costs, and increasing competition from cheaper imports.

In the face of these external drivers, food processing firms at the commoditised end of the product-spectrum continue to face a threefold choice: innovating up the quality-ladder; exporting; or re-locating off-shore. These three strategic options allow firms to focus on what they can control. The first two options in particular enable future revenue growth to be influenced by decisions made now with respect to the selection of new markets and/or new products.

As the competitive landscape in the food processing sector increasingly commoditises, a predictable outcome of sector structural change in open market economies becomes the decision of food manufacturers to compete or withdraw from markets when a cost threshold is passed. Lowered profitability drives an industry to seriously consider and adjust its long term position in the value chain.

7.2 How the government can help

There are various means by which government can support an innovative food industry without interfering with current trade and fiscal policy.

Unsurprisingly, the numerous reports and inquiries in manufacturing which have been produced in recent years by the Productivity Commission and the different houses of parliament (see chapter 4) contain numerous sensible suggestions of ways in which the government can support the sector without distorting trade.

> Australia's own economic history shows the futility of attempting to stand against such transformative forces, and the importance of focusing assistance on workers, not firms; and in encouraging innovation and investment in skills.[113]

[113] Martin Parkinson, 2011.

These include export assistance, R&D assistance, education and worker-trainer assistance, reducing regulatory burden, developing nascent sectors and assisting the venture capital end of the financial sector. No one policy response fits all scenarios, and the range of firms, with products at different levels of complexity, requires a range of government response. In what follows we focus briefly on the following as being especially worth highlighting among the suite of possible government policy options.

Accelerating Australian Innovation Capability

- Measures aimed at aggregating state and federal research capability and facilities in the area of food science to focus resource deployment and accelerate innovation.
- Supporting the development of public-private research and development partnerships to leverage public sector research capability and capacity in areas of basic food science research into the private sector.
- Further developing this concept would be the promotion of co-located public-private sector research and development clusters in close proximity to manufacturing operations.

Ongoing Improvements to Food and Biosecurity Regulation

- Australian regulation in food safety and quality are amongst world's best practice. As cheaper food product imports increase into Australia, it is critical to ensure that these standards are applied universally to protect consumer safety (and not simply provide increased barriers to trade).
- Equally important is the ongoing improvement of food labelling regulation that clearly communicates country of origin status for food products, enabling consumers to continue to make informed choices around locally made versus imported food products.

Improving Offshore Market Access

- Continuing to grow offshore markets for the food industry that build economies of scale, build revenue and reduce manufacturing costs will remain important priorities for the short to medium term viability of the sector.
- With the inevitable increase in domestic competition due to market globalisation and private label penetration, gaining access to large markets with developing Western food tastes with higher value niche product offerings is critical.
- To support this, government should continue to improve access to offshore markets through the extension of Free Trade Agreements, as well as continuing to provide innovative export development assistance, both to individual companies and the industry.

As offshore markets grow and domestic market competition inevitably intensifies, some sections of the food processing sector will choose to move more labour intensive aspects of their operations offshore. The government role here in a free market economy is not to prevent this from occurring, but to provide assistance to industry in developing competitive vertically integrated value chain structures, such as offshore shared facilities, in order to reduce costs and leverage collective innovation capability for commercial competitive advantage.

References

Australian Competition & Consumer Commission (2008), *Report on the ACCC inquiry into the competitiveness of retail prices for standard groceries*, Canberra.

Banks, G. (2011), *Australia's mining boom: what's the problem?*, address to the Melbourne Institute and The Australian Economic and Social Outlook Conference, 30 June 2011.

Barnes, P. (2011), *Multifactor Productivity Growth Cycles at the Industry Level*, Productivity Commission Staff Working Paper, Canberra.

Bradbury, D. (2011), *Developments in Competition Policy*, Opening Address to Law Council of Australia Competition and Consumer Workshop, 27 August 2011.

Burt, S. (2000), 'The Strategic Role of Retail Brands in British Grocery Retailing', *European Journal of Marketing* 34:875-90.

Competition Commission (2000), *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom,* Cm 4842, The Stationery Office, London.

Department of Agriculture, Fisheries and Forestry (2004), *Price Determination in the Australian Food Industry*

Gretton, P.K. and Fisher, B. (1997), *Productivity Growth and Australian Manufacturing Industry*, Industry Commission Staff Research Paper, AGPS, Canberra.

House of Representatives Standing Committee on Economics (2007), *Australian manufacturing: today and tomorrow: Inquiry into the state of Australia's manufactured export and import competing base now and beyond the resources boom*, Canberra.

IBIS World (2010), *Costco Wholesale Australia Pty. Ltd.*

IBISWorld (2011a), *Supermarkets and Other Grocery Stores in Australia*.

IBISWorld (2011b), *Fruit and Vegetable Processing in Australia*.

IBISWorld (2011c), *Biscuit Manufacturing in Australia*.

Lincoln and Thomassen (2008), *Private label: turning the retail brand threat into your biggest opportunity*.

Martin Parkinson, 2011, *Sustaining growth in living standards in the Asian century*

OECD Directorate for Financial, Fiscal and Enterprise Affairs Committee (1999), *Competition Law and Policy, Buying Power of Multiproduct Retailers*.

Productivity Commission (2003), *Trends in Australian Manufacturing*, Commission Research Paper, AusInfo, Canberra.

RBA, *The Manufacturing Sector: Adapting to Structural Change* (March 2001)

Samuelson (1984), *Bargaining with Asymmetric Information*, Econometrica, Vol. 52(4), pg 995.

Scheelings, R. and J. D. Wright (2006), *'Sui Generis?': An Antitrust Analysis of Buyer Power in the US and EU*, Akron Law Review.

Shogren, R.(2004), *Dynamic Efficiencies and Workable/Effective Competition*, Australian Competition and Consumer Commission 2004 Regulatory Conference, Gold Coast, Australia, 29 July 2004