

Senator Chris Ketter
Chair
Senate Economics Reference Committee
PO Box 6100
Parliament House
CANBERRA
ACT 26000



February 7, 2017

Dear Senator

During our discussion with the Committee at Shepparton we felt there was quite a focus on the impact of the sale of \$1 litre milk on the Victorian dairy industry. I feel it is important that we provide some written context to that discussion, including the role of the UDV.

We were also asked to review and comment on a submission '*Market Failure in the Western Australian Dairy Industry*' from Mr Andrew Weinert, a dairy industry consultant. It had been apparently been discussed at the Perth session the day prior.

Because we are not familiar with the detail of the operations of the Western Australian milk market, it is difficult for us to comment other than observe that he makes a strong case arguing market failure in that market.

However, because the milk processing sector in Victoria is very different we don't believe it is correct to extrapolate the Western Australian position across southern Australia. The challenges here are different, but no less significant.

Fresh milk context

Victorian dairy farmers produce approximately 2/3rds of all milk produced across Australia. That is about 6 billion litres. Of that milk, about 7% is required for the Victorian drinking milk market. Of that milk, about half is sold under the supermarket labels, the balance under branded labels. That is, in total about 3.5-4.0 per cent of all Victorian milk is sold as fresh milk under the supermarket private label brands.

In economic terms that is why Victoria is less concerned about the financial impact of \$1 litre milk than Queensland and Western Australia who rely heavily on returns from fresh milk sales (for example, almost 100% of milk production in Queensland is used for fresh milk products).

That is not to say the impact of supermarket discounting is not adversely diminishing returns to Victorian farmers because it is. As we mentioned during our discussion, we believe the impact of supermarket discounting of the 'dairy cabinet' of cheeses, butter, yogurts and other products (including fresh milk) is financially detrimental to Victorian dairy farmers.

The committee may recall our attempt to highlight the impact of discounting reaches across the entire dairy cabinet where branded products offered by our processors are forced to compete with comparable heavily discounted supermarket private label products for sales.

And there is the additional issue of the impact on struggling farmers who believe their efforts in producing highly nutritious and safe food are devalued by supermarkets, especially with their 'loss leader' advertising campaigns.

Where the UDV fits in

The UDV is an advocacy body. We are not directly involved in marketing milk products. Dairy farmers have traditionally relied on their milk processor to do that.

After Murray Goulburn and Fonterra acted as they did, the UDV immediately wrote to, and met with the companies calling for them to reverse their decisions. We also looked for available legal options to unwind the decisions.

When it became clear that the decisions would not be reversed by the companies, and could not be immediately reversed by the legal system, our members requested we set about ensuring that this situation would never be allowed to happen again.

We also worked hard with the Victorian and federal governments on a package of personal and business measures designed to support farming families during this particularly stressful time.

Our members asked us to work for a future where farmers would have milk supply agreements and milk pricing structures that were fair, transparent and equitable.

That is why we have strongly supported the work of the ACCC and ASIC regulator investigations, and it is why we have been active in supporting the ADF led Code of Conduct development. The Code will ensure that no price changes are made retrospectively, that farmers receive all payments owing to them that have accrued over the term of a contract (including loyalty payments), and that a price formula or a price setting mechanism is clearly defined, and agreed, within a contract.

Milk Prices to Farmers

There are a couple of additional points worth making that are sometimes lost in discussions.

Not every company retrospectively altered the price paid to farmers. A number of companies, including Bega (Tatura) and the Saputo owned Warrnambool Cheese & Butter Co, did not retrospectively lower the price they paid to farmers. At a cost to their balance sheets they held their price at \$5.60.

Secondly, both Murray Goulburn and Fonterra entered the discounted milk market to supply Coles and Woolworths sometime after the supermarkets introduced \$1 a litre milk.

Farmers trust their processor to maximise the returns to farmers. Milk processors have adopted different strategies to achieve that objective. For example, Burra Foods relies heavily on export sales.

The committee heard directly from Barry Irvin on the Bega strategy, "I would quite frankly say that part of my job is to create options for my product. It is to be able to send it internationally; it is to be able to make it into infant formula, or to do something else. The power that we should be continuing to develop is to have an option for the very valuable product that we produce which means that, if you like, there is competition for the retailers to want to convince you to deliver it to them rather than to someplace else."

Warrnambool Cheese & Butter (WCB) in its comments to the ACCC Dairy Inquiry Issues paper say, 'In our experience however the margin that can be gained through the retailers' private label business are very tight and in general WCB has not participated in that market for that reason.'

Lion also affirm that view in their comments to the ACCC dairy Industry Issues paper "It is precisely because Lion is a branded milk player focused on sustainable margins and profitability that it can offer the sort price premiums, contract security and choice to farmers outlined above. Any further erosion in branded milk and dairy volumes will only compound margin compression in the processing sector, which is already struggling to generate sustainable commercial returns."

The UDV has been told by other processor representatives that in the past six years they have 'lost' valuable dairy cabinet margin through supermarket sales. The only outcome from reduced returns is lower farmgate prices for dairy farmers.

The ACCC inquiry into the Australian dairy industry is very important for a number of reasons, but none more important than having a key regulator with considerable powers to access documents and witness testimony looking at the entire dairy supply chain, especially at the retail point.

The Victorian dairy industry is under severe duress and must change to have any chance to grow. Both farm and milk processing businesses are stressed by a combination of circumstances and for some there is uncertainty about how they will operate in the future.

The introduction of the Unfair Contracts legislation last year was important in setting changes in farmers' relationships with the processors. The Effects Test may be similarly important in rebalancing the relationship between processors and retailers with the hope that the 'lost' dairy cabinet margin may one day find its way back to our farming families.

We thank the Committee for their involvement in the future of the dairy industry.

Yours sincerely

Adam Jenkins
President
United Dairyfarmers of Victoria