



25 February, 2011

## **The Impacts of Supermarket Price Decisions on the Dairy Industry**

### **Summary**

As the Chief Executive Officer for Norco Co-operative, I work very closely with our farmers and know intimately their precarious financial positions. The discounting of home brand milk to the extent that has taken place will in all likelihood drive downward pressure on the overall farmgate milk price for our farmers. Our farmers are already running basically on cost in terms of production with a slim margin of profit.

Taking into account the current challenges re the weather, this is a further commercial challenge to their livelihood with far greater implications. We believe action needs to be taken immediately to protect the long term dairying industry because if the prices are further reduced at farmgate there will be a mass exodus of the industry compounding our already previous losses. This will have severe repercussions across all sectors of the Australian community.

We must as a nation look to our food resource for our future generations and the well being of our country. This is predominantly our farm base and farmers must be able to survive and have viable businesses that the younger generation will want to be involved in. Please consider this very carefully in your enquiry.

### **Who is Norco?**

Norco Co-operative Limited (**Norco**) is a diverse agricultural co-operative wholly owned by its dairy farmer suppliers. Norco currently has 260 active members operating 165 dairy farms in northern New South Wales and southern Queensland.

Norco currently purchases all of its milk from its own members, other than some organic milk that is purchased from two organic dairy farmers. In 2009/2010 Norco's dairy farmers produced 143 million litres of milk, representing about 17% of milk production in Northern New South Wales and Southern Queensland<sup>1</sup>.

Norco also retails a range of Nimbin Natural cheese, operates an ice cream production facility, operates a Rural Retail business with 24 rural stores in northern New South Wales and south east Queensland, operates a wholesale business and an Agribusiness division incorporating Goldmix Stockfeeds, Crest Seeds and SuperVites that manufactures and sells quality stockfeed, bird seed products and pet food respectively.

### **Farm Gate, Wholesale & Retail Milk Prices**

Norco's average farm gate milk price for the financial year 2009/10 was 54.11 cents per litre. This price is the actual price paid to producers and it is before any costs are added on for the collection, processing and final distribution of the finished product. The 54.11 cents per litre paid to Norco's farmers is approximately 3 to 4 cents per litre above our

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<sup>1</sup> According to Dairy Australia, the 2009/2010 milk production for Northern New South Wales was 325 million litres, and for Queensland was 530.5 million litres.

farmers break even position, which was documented in the Northern Dairy Industry Cost Model.

The retailers have reduced their price from \$2.47 for 2 litres of unbranded milk to \$2.00 which is a 23.5 cent per litre reduction. If this reduction were to be passed back down the supply chain, it would result in a farm gate milk price of 30.61 cents per litre which is well below the break even milk price of 50 cents per litre and the industry would come to a halt.

Norco is concerned about the retailers' milk pricing strategy. Since the introduction of the lower price in January, Norco has seen a 2% uplift in generic milk products sold and we are expecting to see a larger change over an extended time. The retailers have stated that they will bear the cost of the milk price reduction but for how long will this last? Selling milk for a loss is not a sustainable pricing model. Norco already sells milk that ends up in retailers outlets at a reduced price in order to ensure that all of Norco's milk is placed and any further pressure on this price cannot be borne by our farmers.

Historically the processing sector has endeavoured to supply smaller independent retailers with a price competitive product to the major retailers. The current price driven promotions undertaken by the major retailers is a position the processing sector cannot support further along the supply chain without adversely impacting profitability and farm gate price. Processors rely on a mix of business between branded products and generic products to make their total profit. The price differential and the processor's margins are such that they depend on a reasonable proportion of branded product sales to balance the lesser, and sometimes negative, margins available on generic products. If consumers abandon branded products in favour of generic products some processors may also be forced to leave the industry.

Norco would like to note that the cost of producing milk in the northern part of Australia is higher than southern Australia due to the cost of land and the fact that farmers need to supply a certain volume of milk 365 days a year to satisfy the marketplace. While it is a fact that the majority of milk (64%) is produced in Victoria, northern Australia needs to maintain a Dairy Industry in order to reduce food miles and also in order to ensure food security across Australia.

Norco is concerned about the impact on our brand and on other processors' brands of the retailers' pricing strategy. As the generic volume increases, as a result of the recent pricing strategy, the retailers will more than likely apply pressure to the processors to reduce their price to keep their brands on shelf. Applying pricing pressure to the processors means that any price reduction must be passed onto the suppliers, which will push the suppliers below the break even position and will see farmers exiting the industry.

### **Decrease in Australian Production of Milk**

The Australian production of milk has decreased from 11 billion litres in 2004 to 9 billion litres in 2011, of which 25% is drinking milk. (Coles state that they represent 5% of the total milk volume. Their 5% though represents 20% of the national drinking milk category). In the northern area of Australia where Norco is situated, 90% of our milk is produced for drinking milk and 10% goes into other products such as ice cream. Pricing pressure on our farmers will result in farm closures and will mean that drinking milk will need to be distributed from Victoria to meet consumers needs, adding cost to the milk via freight.

A potential reduction of milk production in the northern part of Australia will also mean that milk production in Australia will be confined to Victoria. This would mean that Australia's food source area would be dramatically reduced and food security consequently put at risk. Dairy Australia's recent Situation Outlook report states that for every dollar spent on farm, three dollars are created in the downstream economy. Consequently if farms exit the industry due to a lower milk price, employment and retail activity will be adversely affected in local communities.

Any reduction in Norco's milk production will also impact the quality of the milk sold in the community. Milk is a staple food in any diet and Norco's brand of milk does not contain permeate. Norco's milk is 100% milk. Some of the other brands use permeate and retentate in their products and although permeate is a legal food, it is not 100% milk. Norco is proud that our product is 100% milk and that we provide a high quality food product to the community. The government should address food labelling laws so that consumers know when additives such as permeate and retentates are included in their food products.

Norco recommends that the senate committee investigate strategies to support the Dairy Industry in NSW and Qld to ensure staple foods such as milk and fresh dairy products are available to consumers at all times.

Our recent exposure to flooding in Qld and the Co-operative's ability to deliver fresh milk to residents in Qld when other milk processors were unable, demonstrates that food security should be considered when climatic or unforeseen catastrophic events are imposed upon the people of Australia.

### **Is the Retailers' Pricing Anti Competitive?**

The retailers have stated that they will wear the profit impact of their milk price reduction, but for how long? As the generic volume increases, as does their facings on the retail space, at the expense of the branded options, the processors will be placed under pressure to reduce the price of their branded products or face the real threat of losing shelf space and/or ranging. This is anti-competitive behaviour as it means that the processors will be forced to reduce their price, or lose the opportunity to have their brands sold through the retailers' outlets.

The retailers should be made to keep their promise of not putting price pressure on the processors in order to keep the fresh milk market alive in northern Australia.

Norco achieved a \$2.3m net profit in 2009/10. A 1 cent per litre price reduction, if borne by Norco, would cost the Co-operative and its members \$1.4m, so we can absorb a very small price reduction before we have to pass the price decrease onto our farmers. Our farmers only have a very small profit margin so any price reduction passed onto them could put their businesses into a loss situation and result in the closure of their farms and the reduction of fresh milk production in Australia. Does the Australian consumer want to drink fresh milk or UHT? We believe they want a fresh milk option.

Recommendations have been put forward by the Senate Economic References Committee to address the very issue that is now occurring. It seeks to explore the effect of market dominance by two major retail chains and its effect on the farm gate price for milk. What progress has been made with these recommendations?

**Brett Kelly**  
Chief Executive Officer