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AMALGAMATED MILK VENDORS ASSOCIATION INC.

(Incorporated under the Associations Incorporated Act, 1984)

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
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Dear Mr Hawkins,

Inquiry into Competition and Pricing in the Australian Dairy Industry

The Amalgamated Milk Vendors Association Inc (AMVA) welcomes the opportunity to submit the following comments to the Senate Standing Committee on Economics to assist with its inquiry into competition and pricing in the Australian Dairy Industry.

1. Background

1.1 AMVA

The AMVA has been in existence since 1930. It is the body recognised by all sectors of the Dairy Industry and Government in New South Wales (includes Australian Capital Territory) as the peak representative body for Milk Vendors and Dairy Distributors. It is a non-profit association run by an honorary Council of active vendors and distributors.

About three years ago representations from various interstate milk vending and dairy distributor groups has seen the activities of the AMVA expand into Queensland, Victoria, Tasmania and South Australia. Dairy Distributors from Western Australia are not officially part of the AMVA at this stage although a loose affiliation does exist. The AMVA has had no contact with distributors from the Northern Territory.

The distribution sector of the NSW dairy industry was deregulated 1 July 1998 and at various other times in other States.

1.2 The Australian Dairy Industry Overview

According to Dairy Australia the dairy industry is the third largest rural industry in Australia. In 2007/2008 it was valued at \$4.6 billion at the farm gate and is a major value-added food industry with a value of \$11.5 billion at the wholesale level. In

addition, the industry employs a workforce of approximately 40,000. The Australian Bureau of Agriculture and Resource Economics (ABARE) estimate a regional economic multiplier of 2.5 from the dairy industry.

Further dairy industry information and statistics are available from the Dairy Australia website at <http://www.dairyaustralia.com.au>.

The dairy industry comprises:

- Producers (dairy farmers) – around 7,950 dairy farms and 1.7 million dairy cows producing 9,223 million litres of milk annually.
- Processing companies – processes raw milk and includes:
 - Murray Goulburn Co-op is Australia's largest manufacturer of dairy products and accounts for approximately 37% of Australian milk production. Main production products are butter, cheese, milk powders, UHT milk, whey products, infant formula and bioactive products.
 - Fonterra is Australia's second largest manufacturer of dairy products and takes around 20% of the Australian milk production. Fonterra's fresh milk distribution is less than 5% of the Australia market – they are mainly concerned with the manufacture of milk powder, cheese, butter, whey products, yoghurt and dairy desserts.
 - National Foods is the third largest dairy manufacturer accounting for 15% of Australian milk production. Main production products are drinking milk, cream, yoghurt, fresh dairy foods, cheese and fruit juices. National Foods is the major supplier to Australian fresh milk market.
 - Warrnambool Cheese and Butter Factory Co accounts for 8% of Australia's milk production and mainly produces cheese, butter, whey products and fresh milk. Fresh milk production is a minor part of their operation.
 - Parmalat Australia only accounts for about 6% of Australia's milk production and mainly produces market milk and cream for the Australian fresh milk market.
 - Other processors such as Bega Cheese, Bulla Foods, and Tatura Milk Industries are mainly involved in manufacture of cheese, milk powders, ice cream and yoghurt.
- Distributors – these are milk vendors who are either contracted or franchised to the processing companies to distribute drinking milk and dairy products to major supermarkets, independent supermarkets, petrol and convenience chains, route trade, schools, factory outlets and homes.

2. The economic effect on the dairy industry of announced reductions in prices to be paid to producers by milk processors

The economic effect on the dairy industry of reductions in prices to be paid to producers will be devastating to the industry and may see further farmer numbers being reduced as farmers are unable to receive a reasonable return (cost plus margin) to survive. Generally speaking farmers are being forced to supply the total Australian market at a price that relates to the conditions relative to commodity markets around

the world. Some farmers are currently receiving fair returns as they are either under contract with their processor and or are in a favourable locality such as those farmers in Queensland where their milk supply is mainly needed for the fresh milk market.

The Australian milk market comprises two distinct sections:

- Fresh drinking milk for the domestic market comprising regular milk, reduced fat and no fat milk, flavoured milk and UHT milk.
- Manufactured milk products for the Australian and overseas market such as cream, custard, yoghurt, dairy desserts, cheese, milk powders, butter, whey products, infant formula and bioactive products.

Current prices paid to farmers are based around world commodity markets, exchange rates and world demand. The recent global financial crises caused a huge fall in commodity prices and as such the processors claim to be justified in reducing farm-gate prices irrespective of the type of milk product or market they are producing for.

In addition, weather conditions from time to time, Government policies such as the Carbon Pollution Reduction Scheme (CPRS) and the much talked about Water reforms all impact on farm viability as well as their local communities.

Food security is becoming an important issue throughout the world as food producers are being encouraged to increase production to meet the needs of a growing population. However, unless appropriate returns are available to the farmers our food production may suffer a huge shortfall as many farmers are forced out of agriculture.

3. The impact of the concentration of ownership of milk processing facilities on milk market conditions in the dairy industry

In their publication *Australian Dairy Industry in Focus 2008*, Dairy Australia indicated that the utilisation of Australian milk in 2007/08 listed drinking milk as 24%. At that time the major manufacturers and suppliers to the market milk sector of the Australian market were Australian Co-op Foods (Dairy Farmers), National Foods, Parmalat and Fonterra. Parmalat's share is estimated at 12-15%, Fonterra's share is about 5% while other small interests would amount to a further 2% leaving the combined market share of National Foods and Australian Co-op Foods at around 78-81% of the drinking milk market.

In 2008 the ACCC gave approval to National Foods to purchase the Australian Co-op Foods business. Subsequently certain parts of the National Foods business have been sold to Parmalat as part of undertakings given by National Foods to the ACCC in the deal to purchase Australian Co-op Foods. However, the sale to Parmalat did not include any milk volume, apart from trade serviced by distributors as part of the divestment, and therefore the National Foods share of the current market would be around 75-81%.

The rationalisation in processor numbers following the purchase of Australian Co-op Foods had the effect of reducing competition for raw milk in some areas. One would have to question the logic in the ACCC decision to allow such a dominant position to be held by one processor, particularly as the ACCC were opposed to a rival bid for Australian Co-op Foods from a much smaller processor.

4. The impact of the consolidation of the ownership of the market or drinking milk sector with the manufacturing milk sector on milk market conditions in the dairy industry

As stated above one processor has a very dominant position in the fresh milk sector in the Australian dairy industry. As a result it is difficult to see how a long term competitive environment can exist for farmers, distributors and consumers alike.

Over the years processors have been closing regional production plants to cut costs and improve efficiencies especially when equipment replacement was due. The regional factories took up the production shortfall, provided local employment and were vital in the overall scheme when production problems arose.

As a result of these policies by processors to close regional processing plants route trade customers, consumers and distributors (contractors, vendors, franchise owners) are severely disadvantaged in the market place because of never ending stock shortages. This has the obvious impact curtailing profit for small business operators such as route trade customers, restaurant trade, coffee shops and distributors. Some of these small business owners are forced to purchase interim stock from supermarket outlets at these times so that they can continue to operate their business.

5. The impact of the concentration of supermarket supply contracts on milk market conditions

One would consider that there is a very competitive environment in the Australian market place in relation to the major retailers and some of their competitors such as the convenience chains. However, the problem in this area is the fact that the major supermarket chains are selling generic product at such low prices compared to most other retail outlets that they are cornering the market to eliminate competition. Branded product in the supermarket chains and elsewhere in the market is subsidising the price that the supermarket chains are able to secure from the processor.

Over recent years the major supermarket chains (Coles, Woolworths and Aldi) have increased their market share to around 57% of drinking milk sales. A large portion of this share relates to generic or private label product. As a result of the dealings between supermarket chains and processors the farmer is paid less for his product than would otherwise be the case.

Retail prices in NSW as at November 2009 in the major chains are:

| Outlet | Product | Retail Price |
|-----------------------|-----------------------|---------------------|
| Woolworths Bateau Bay | 2 Lt Home Brand | \$2.17 |
| | 2 Lt Woolworths Brand | \$2.47 |
| Coles Bateau Bay | 2 Lt Smart Buy | \$2.17 |
| | 2 Lt You Love Coles | \$2.47 |
| Aldi Stores | 2 Lt Milk | \$2.17 |

It is interesting to note that the recommended supermarket retail price in June 1997 (12 years ago) for home brand milk in 2 Lt containers for the Sydney Metropolitan, Blue Mountains, Central Coast and Newcastle areas was \$2.23. At that time the

supermarket chains paid \$1.9332 for each 2 Lt container of home brand milk and \$1.96 for 2 Lt branded milk that had a maximum retail price of \$2.32. At the same time (June 1997) farmers in NSW were paid \$0.5335 cents per litre for their market milk (drinking milk) supply and a much lesser value for surplus milk or milk that was used for manufacturing purposes such as making cheese, butter, etc. In June 1997 distributors (milk vendors) paid \$1.7742 for 2 Lt branded milk and pay around \$2.77 at the present time.

We are unaware of the price that the supermarket chains pay for their milk purchases in the current market place but it seems incredible that retail price for a large part of the milk in supermarkets remains lower today than was sold in June 1997.

6. Whether aspects of the Trade Practices Act 1974 are in need of review having regard to market conditions and industry sector concentration in this industry

Many consumers do not consider that the ACCC is concerned with the protection of the consumer and the spirit of competition. The major retailers continue to eliminate competition through a process called mergers and acquisitions as did National Foods when they purchased Australian Co-op Foods. The community sees many activities of major retailers and others as engaging in conduct that they see as unconscionable and bullying through abuse of market power.

Issues surrounding competition or the conditions under which competition can flourish need to be examined. These issues need to be brought into line with community expectations of exactly what competition means. In addition, the market strength of those organizations that deal with primary producers needs special attention so that cost plus margin is paramount to secure our agricultural communities and protect our National interest for the future.

This is not to say that inefficient operations are to be bailed out but rather a fair reward should be provided to farmers to maintain our world-class dairy industry. The dairy industry in Australia has a value estimated by Dairy Australia at \$11.5 billion at the wholesale level and as food security has become an important worldwide issue we need to put appropriate measures in place to support the Australian dairy industry.

Prior to deregulation a two-tiered pricing system or quota system operated for payments to farmers. This system had a regulated price for drinking milk and a separate price for manufactured milk that was set by the processors at a rate that was substantially lower than the regulated price. The benefit of this system was that the farmers had certainty about part of their production and therefore they were prepared to invest in the future. This type of system needs to be re-established to make certain that farming communities remain viable so that we secure Australia's future food supply.

7. Any other related matters.

The introduction of any type of regulated system or subsidy is contrary to those who support the free trade scenario and the global economy. However, it is interesting to note that a large number of countries introduced assistance to farmers as a result of the global financial crises to assist their domestic industries. This included the USA and a

large number of countries in the European Union including Germany and France. This situation had an obvious impact on Australian exports and is a contributing factor to some of the current pricing policies of Australian based processors.

In a recent study tour to the World Dairy Summit in Berlin, sponsored by the NSW Dairy Industry Conference, it was noted that some dairy farmers in Germany are considered to be part of the tourist industry and that subsidies paid to those dairy farmers are for tourist purposes. The other interesting observation was that the low farm gate prices paid to farmers in the United Kingdom were as a result of retailers such as Tesco controlling the market and determining the price.

One would think that for competition to be effective the market would at least demand a large number of buyers and sellers rather than the situation that we see in Australia where we have a small number of buyers controlling the market by some means or other. This situation certainly exists with regards to the major chains in the retail market as the quest to supply private label products at the cheapest price often to the detriment of suppliers, communities and ultimately consumers. Processors in the dairy industry, through various means, are now in a similar position where we have a small number of buyers and a large number of sellers. In both these circumstances the price being paid to some farmers and suppliers is being manipulated by the market strength or power of the buyer. Governments need to rectify this imbalance to protect the long-term future of Australia's food supply.

Processor and Distribution sectors of the dairy industry are coming under increasing pressure from the supermarket and convenience chains to source product through some type of warehousing system. Short-term economic benefits to the retailers of such a system cannot be denied but a warehousing system recently introduced by one convenience chain is having a negative impact on the dairy industry as overall sales and product lines have been reduced.

Briefly, the warehousing system introduced above was agreed to by the processors to be able to maintain their product supply to the chain. The chain involved wanted to secure a high volume product (milk) to supplement other low volume products into a central warehouse to enable all products to be delivered in one delivery to the individual stores of the chain rather than the store receiving deliveries from numerous suppliers each day.

The AMVA is currently working on an industry based distribution model that will provide substantial cost savings to the industry.

We confirm that Col Lawson will be available to discuss any of these issues with the members of the Senate Inquiry.

Yours sincerely,

Bob Paton
Secretary
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