Queensland Dairyfarmers' Organisation

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

4th March 2011

Dear Committee Secretary,

Re: Inquiry into the impacts of supermarket price decisions on the dairy industry

The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to submit the following comments to the Senate Standing Committee on Economics to assist with its inquiry into the impacts of supermarket price decisions on the dairy industry.

The QDO is the peak industry organisation representing the interests of dairy farmers in Queensland. The QDO is a member of the Australian Dairy Farmers (ADF) and the Queensland Farmers' Federation (QFF).

The QDO is currently seeking further advice on the recommendations we wish to make to this Inquiry and as such the QDO will be seeking to provide a supplementary submission to present these recommendations. However, put simply, the use of milk as a close to or below cost 'advertising agent' by major retailers needs to stop as it has led to a situation of market failure and is undermining the sustainability of the domestic dairy industry.

The QDO would welcome the opportunity to discuss any of these issues and or information presented in our submission with the members of the Senate Inquiry.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd

Queensland Dairyfarmers' Organisation

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Submission to the

Senate Standing Committee on Economics

Inquiry into the impacts of supermarket price decisions on the dairy industry

4th March 2011

Introduction & Key Issues

With the initiation of the current milk price war, dairy farmers and their families in Queensland and across the nation are questioning their future in the industry, having endured a decade with severe droughts, floods, cyclones, increasing operational costs and low farm gate returns for much of the period.

In Australia half of the annual milk sales in the domestic milk industry occur through major supermarket chains and the other half of sales occur through the ‘route’ trade of which the major supermarkets also now have a growing market share.

Major supermarkets, which hold some 80% of the grocery market, are using supermarket ‘store brand’ milk as a close to or below cost discount price ‘marketing agent’ in a manner which is devaluing milk nationally and undermining the sustainability of the Australian domestic dairy industry value chain.

If the situation continues it will cause major irreversible damage to the Australian domestic dairy industry affecting investment and employment from the dairy farming sector right through the industry value chain and undermine the production and supply of fresh milk in a number of regions across Australia, particularly in states such as Queensland. The loss of fresh milk production in regions could result in milk having to be freighted further at higher costs and or loss of fresh milk choices for consumers.

On the 26th January, Wesfarmers owned company Coles launched a national advertising campaign using Coles store brand milk at a discounted price of up to 33 percent reducing the price to $1 per litre, following which Coles also discounted other dairy products including cream and butter. Immediately following the Coles announcement Woolworths dropped their price of Woolworths brand milk to match the price and other stores followed suit with some such as Aldi, cutting the price even further to $1.99 for 2 litres and $2.89 for 3 litres.

The discounting of milk by Coles and as followed by other retailers will inevitably force down farm gate prices for milk, which has been supported by public statements from Woolworths and other retailers stating that the reduction in price is unsustainable.

The discount of milk is part of Coles “Down And Staying Down” campaign and Coles has promoted the milk discount as a win for consumers. Coles also present in their advertising that the price is not a ‘special’, ‘it’s Down and Staying Down!’.

The strategy is aimed at using milk as a marketing agent as an every day inelastic staple to attract more consumers to Coles stores to grow customer market share and at the same time grow the market share of the Coles supermarket brand milk, at the demise of processor proprietary brands. This in effect is sacrificing the value of milk to serve an advertising function.

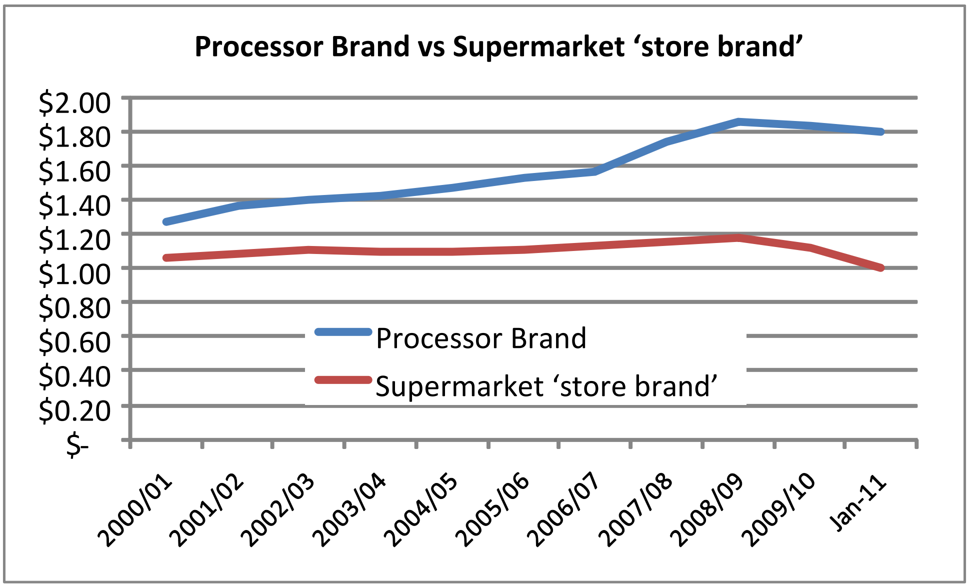
Coles has sought to defend its actions publically, however a number of statements they have made are misleading or completely wrong. Coles have stated that “Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased.” Coles has also given this assurance to senior Government Ministers. In stark contrast to the Coles’ claims, as stated above, during 2010 farm gate prices for a large proportion of Queensland and New South Wales dairy farmers was reduced in some cases by some 18 percent.

Reduced returns to the dairy industry value chain from major supermarket chains ‘store brand’ strategies is already undermining the profitability, sustainability and viability of the dairy farming sector. A large number of dairy industry organisations and retailers, including Woolworths have stated publically that this practice is unsustainable.

Over the last ten years it has become well known in the dairy industry that cut price predatory type marketing tactics by major supermarket chains drives the price of fresh milk down in the market place. As other retailers have the choice of losing market share or having to drop their price as well to compete, this has resulted in lower returns to the dairy industry value chain and prices to farmers.

The Coles “Down And Staying Down” campaign has involved a significant amount of advertising expenditure over and above other retailers and Coles has gained a significant increase in market share at the expense of other retailers and proprietary brand products. Wesfarmers and Coles executives have publically reported sales growth of their Coles brand milk of between 15 and 20 percent in the first few weeks of the discount campaign.

This price drop increases the price difference between supermarket ‘store brand’ milk and processor branded milk. Generic supermarket ‘store brand’ milk, due to its lower price and margins, gives a lower return to processors and farmers than processor branded milk.



Source Dairy Australia

With Coles gaining increases in market share with its ‘Coles store brand’, there has been a loss of market share and thus sales of processor proprietary brand milk. With this, farm gate prices for farmers supplying milk into these proprietary brand milk products will start to drop this month with the lower sales volumes. This evidence completely discredits the public claim by Coles that farm gate prices would not be affected.

Supermarket ‘store brand’ products generally provide lower margins to both the retailers and manufacturer, but offer greater control of the supply chain, and reinforcing loyalty to the retailer rather than processor brand.

Increasingly, the use of supermarket ‘store brand’ products has seen supermarkets reducing the shelf space available to branded products, narrowing the range of branded suppliers within each category and driving consumers toward supermarket ‘store brand’ products.

This in turn increases competition amongst manufacturers for the supermarket ‘store brand’ contracts, in order to access this important channel to producers, often driving down wholesale prices.

As the major supermarkets have increased the market share of the grocery market they have been able to use their market position to their advantage in a number of different ways. The major example being the implementation of tendering processes for the packing and supply of ‘store brand’ milk supplies. These tenders have ranged in size, but due to their increasing size in overall milk sales volume, have pressured processors to secure these important volumes of product sales turnover to ensure plant efficiencies in key capital city plants. This pressure has seen the negotiation over lower prices for milk to a point where there is no profits – thus processors are now paying unsustainable prices to farmers for the same milk.

While consumers on the whole have benefited from the shift towards a cheaper milk product in this scenario, with a range of choices currently existing between processor proprietary ‘branded’ and supermarket ‘store brand’ products, the increasing market share enjoyed by the supermarket brands creates a risk that at a future point in time supermarkets will start to limit choice as it will not be economical for processors to support proprietary branded products and the innovation in speciality milk products that service a range of preferences for a smaller volume of sales.

This effect over time may limit product choices for consumers and prices could well increase to consumers over time, with no ability from suppliers to influence price other than offering competing products through other outlets. With the major supermarkets taking a larger share of the fuel convenience retail market, the alternate channels to the consumer that are not affected by these influences has also declined.

In recent times with the impact of the economic downturn, major supermarkets have benefited from consumers seeking to economise by moving to lower cost products within product categories such as moving from purchasing processor proprietary ‘branded’ milk to purchasing supermarket ‘store brand’ milk. This transition places processors under further pressure as average returns per litre from processors declines and thus places pressure on processors to reduce prices paid to dairy farmers.

In recent years, the pressure on processors has been a significant factor in further rationalisation and concentration of the processing sector, which has the consequence of presenting fewer options for dairy farmers to negotiate with, for supply of their highly perishable fresh milk product.

For processors seeking to retain margins, this has meant that they have had to increase wholesale prices to other retail channels. This however has had the impact of placing other retail channels under further price competition with major supermarkets. The long term affect of such an environment could be to the detriment of competition and consumers choice.

For processors it is difficult to differentiate regular white milk in the market place. Processors have moved more to the modified milk products with different fat and taste profiles, added nutrients and levels of functionality for consumers.

Processors have been able to capture the benefits of this innovation with more sustainable margins for their branded product, which in turn has supported category development. However, the latest round of retailer price cuts have targeted at this modified milk market segment, and initially reports have presented that processor modified milk brands have lost a significant amount of market share to the heavily discounted supermarket ‘store brand’ modified milk.

If these discount tactics significantly change the market share to be dominated by supermarket 'store brands' it will significantly limit the ability or willingness of processors to invest in new product development, given their inability to capture the benefits in higher margin branded products.

The outcome for the category could be similar to the United Kingdom milk market, where the dominance and periodic price cutting of the supermarket chain 'store brand' product has stifled innovation and new product development.

In the months ahead, the supermarkets will need to renegotiate contracts with processing companies for the milk in the bottles of their 'store brands'. The pressure will then again be on the entire milk value chain for lower and lower prices, even though there is nothing left to trim from the value chain. There is already little to no margin in major supermarket brand milk.

National Foods, which is now the largest milk processor in Australia supplying the domestic market including a number of supply contracts to Coles, has publically stated this week that they "currently make a profit margin of less than 2 per cent on white milk processed for the Australian market" and that "No business would find these returns acceptable, especially given the need to collect milk daily from more than 1000 farmers, maintain a national network of milk factories and also 700 distributors."

Processors are understandably cautious about pushing back on large retailer pressure in relation to 'store brand' tenders as the major supermarket chains provide the largest retail avenue to consumers in Australia for processor branded product sales.

Major supermarket chains, with their own 'store brand' are no longer just retailers, they are manufacturers and brand owners as well with significant brand market share.

The industry is surviving on the value generated by processor branded milk products – and unfortunately the cut-throat pricing is eroding market share from these brands, whilst at the same time placing downward pressure on the value of all milk categories in the market.

The major supermarkets have the ability to sell milk at a lower price than other smaller retailers can buy it at from normal channels and as such smaller retailers cannot compete. Already the vending sector is losing business as small retailers such as coffee shops etc are buying their milk supplies from major supermarkets. A number of vendors have reported drops in deliveries of over 20 percent since the Coles discounting started.

In addition, the major supermarkets with huge market share of all groceries are in a position where they have to cover the costs of these marketing tactics by putting the margin up on other products which consumers do not see. Where as, the smaller retailers and vendors have no such choice and as such suffer losses and eventually face erosion of the viability of their businesses.

It has been reported that the cost to Coles from the milk price cut alone, if as they claim they do not pass on the price cut, would be approximately $60 million per annum and that Coles is spending a record amount of marketing being reported at around $6 million. The cost to Coles and Woolworths is significant and they will not be able to absorb this for any length of time – it will be passed on to consumers through higher prices on other products and recouped from processors and dairy farmers.

A representative from Coles gave evidence to a Senate Inquiry last year that would indicate a similar lack of profit with such cheap milk.

Coles told the inquiry that margins were about 24 percent on previous prices of about $1.20 per litre. With new prices at $1/litre, the previous 24 percent margin would now seem non-existent. It is therefore believed there is a prima facie case for the ACCC to immediately investigate the potential of ‘loss leader’ predatory marketing.

Over the last decade it is clearly evident that the consumer has been a major beneficiary from the deregulation of the domestic milk price and the growth of major supermarket chain ‘store brand’ procurement and marketing strategies. However, the benefits consumers have derived and major supermarket chain have procured have come at the cost of the dairy industry production and processing sectors.

In another context the price difference between supermarket ‘store brand’ prices and proprietary brands is the equivalent of what the major supermarket chains are willing to spend, through foregoing the return on advertising their own supermarket ‘store brand’, to grow their own market share in the product category, as a mechanism to attract consumers and locate them in the store.

From data presented by the Queensland Dairy Accounting Scheme (QDAS), dairy farm production costs increased by more than 48 percent over the last ten years from 35 cents per litre in 1999/00 to 52 cents per litre in 2009/10. Where as the price received per litre at farm gate was recorded as 39 cents per litre in 1999/00 and for the year ahead of 2010/11 the price will be approximately 53 cents per litre, an increase of just 36 percent. For a lot of farmers who suffered significant price cuts last year this will be less, with negative returns for many. For the Queensland average dairy farm a one cent per litre drop in price will reduce the bottom line of the farm by $9,000.

This situation presents that the viability and sustainability of the production sector has been slowly eroded over the last decade. This is due to the returns to the dairy industry value chain and through the farm gate declining as the major supermarket ‘store brand’ procurement and marketing strategies have grown the amount of market share major supermarkets have with their own brands.

Reduced returns to the dairy industry value chain from major supermarket chains ‘store brand’ strategies is already undermining the profitability, sustainability and viability of the dairy farming sector which produces milk on an ‘every day of the year’ basis for the domestic fresh drinking milk market.

Recent market analysis presents that the average retail price and supermarket ‘store brand’ price of milk is lower in Queensland than in NSW and Victoria. An analyst presented that they attributed this to competitive forces between major retailers for market share in the growing market of South East Queensland. The major contrast to this situation is that to produce milk in northern Australia, ie northern NSW and Queensland every day of the year is more costly than in temperate environments, however in these regions the retail prices are the lowest.

The QDO has lodged a formal complaint with the ACCC and called for an ACCC investigation into the practices of Coles in relation to potential breaches of the Competition and Consumer Act 2010 including predatory pricing, anti-competitive practices and false advertising.

Unless their practices are stopped the dairy industry will suffer further losses which will lead to farms exiting the industry and causing the loss of employment through the whole dairy industry value chain, especially in states which produce the majority of their milk for the domestic market such as Queensland.

Facts and Figures - Australian Dairy Industry & Domestic Milk Market

2009/10 (p)	Australian fresh milk sales = 2,269 million litres Per capita consumption = 102.4 litres per head
2009/10 (p)	Total milk sold through major supermarket chains accounted for 1,161 million litres or 51% of total domestic milk sales
2009/10	The two major processors supplying the domestic market with drinking milk is National Foods and Parmalat
1999 to 2010	major supermarkets have doubled their 'store brand' market share
1999/2000	major supermarket chain 'supermarket brand' sales accounted for some 25% of total supermarket sales, compared to
2009/10 (p)	major supermarket chain 'supermarket brand' sales doubling to account for some 50% of total supermarket sales or approximately 585 million litres.
2008/09	major supermarket chain 'supermarket brand' volume growth was 6.5%
2009/10 (p)	major supermarket sales grew by 3.8%
2010/11 (f)	major supermarket discounting of milk from the 26th January 2011 has already seen sales growth of 'supermarket brand' milk of between 15 and 20 percent,
2000/2001	difference in price between proprietary 'branded' milk products and major supermarket chain 'supermarket brand' label products in 1999/2000 was $0.18 per litre and for whole milk the difference in price was $0.07 per litre,
2009/10 (p)	the difference in price between proprietary 'branded' milk products and major supermarket chain 'store brand' products in 2009/10 (p) was $0.71 per litre and for whole milk the difference in price was $0.71 per litre,
2010/11 (f)	if the major supermarkets continue to discount milk to $1 per litre then the price difference will increase to over $0.87, assuming no other price changes occur in milk processor proprietary 'branded' products,
1999/2000	'supermarket brand' label price for regular whole milk was $1.26 per litre, and supermarket market share of whole milk sales through supermarkets was 31 percent and processor brands 69 percent,
2009/2010(p)	'supermarket brand' label price for regular whole milk had dropped to $1.12 per litre or 11% and supermarket market share of whole milk sales through supermarkets increased to 71 percent and processor brands declined to 29 percent,
2010/2011(f)	the current discounting has seen prices drop to between $0.96 and $1.00 per litre,
1999/2000	proprietary 'branded' price whole milk was $1.33 per litre,
2009/2010(p)	proprietary 'branded' price whole milk was $1.83 per litre up 38%,
1999 to 2010	inflation increased by approximately 36%,

The following Table 1 provides Dairy Australia's figures for 2009/10 (p) and 1999/2000 for branded and supermarket 'store brand' milk sales volumes and average prices sold through supermarkets.

Over the last ten years supermarkets have more than doubled their supermarket milk brand market share through using a range of discount and marketing tactics.

When this value difference of milk sales is equated across the market share of major supermarket chain ‘supermarket brand’ sales for 2009/10 (p) compared to the value of proprietary brand sales through supermarkets the difference is $414 million and some $90 million per year in the Queensland market. In 1999/2000 the value difference amounted to some $44.5 million.

As a result processor brands have lost market share and the margin to the industry has been reduced to a point where the loss in value to the dairy industry is over $414 million per annum, compared to $44 million ten years ago.

If this amount of money, $414 million, was retained at the farm gate it would translate to an increase in farm gate price for dairy farmers of 18 cents per litre for milk supplied for the domestic fresh drinking milk market.

This is the amount the large retailers have taken out of the value chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry value chain.

To get a further insight into the impact of the current discounting of milk Table 1 also provides a forecast impact analysis.

The first forecast is based on 2009/10 milk volumes, with the assumption that the discounting runs for a year and results in an average price for supermarket brand whole and lite milk of a $1 per litre with no change in market share of supermarket “store brands”.

The result is that the 2009/2010 value of all milk sold through supermarkets was $1.92 billion but with the supermarket discounted ‘store brand’ milk the value of milk sold through supermarkets for the year would be devalued by $96 million to $1.82 billion.

In addition the accumulated value difference would increase from 71 cents to per litre to 87 between the two categories of milk, being supermarket ‘store brand’ and processor proprietary brands, with the current supermarket price cuts. This increasing price difference between the categories provides the supermarkets with a larger price marketing advantage over processor proprietary brands.

The second forecast includes in an increase in market share of 15 percent of whole and lite milk supermarket “store brands” at the expense of a loss of market share of 15 percent by processor whole and lite milk proprietary brands.

The result is that the movement of market share from processor proprietary brands to supermarket “store brands” combined with the discount of whole and lite milk supermarket “store brands” to $1 per litre further devalued milk sales from $1.92 billion to $1.75 billion being a reduction of $158 million.

This data clearly presents that the large discounting of milk by Coles is devaluing the value of milk sold through supermarkets nationally and is causing a significant loss in returns to the dairy industry value chain which is not sustainable.

Table 1 Comparison of National Milk Sales through Supermarkets

	1999/2000			**2009/10 (p)**			**2010/11 (f) Price Cut & 15% Market Share Change**		
	Branded Milk Sales			**Branded Milk Sales**			**Branded Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	325,000,000	$ 1.33	$ 432,250,000	148,000,000	$ 1.83	$ 270,840,000	94,150,000	$ 1.83	$ 172,294,500
Reduced Fat	168,000,000	$ 1.47	$ 246,960,000	185,000,000	$ 2.03	$ 375,550,000	158,450,000	$ 2.03	$ 321,653,500
Low Fat	88,000,000	$ 1.53	$ 134,640,000	59,000,000	$ 2.07	$ 122,130,000	59,000,000	$ 2.07	$ 122,130,000
Flavoured	36,000,000	$ 2.36	$ 84,960,000	74,000,000	$ 3.72	$ 275,280,000	74,000,000	$ 3.72	$ 275,280,000
UHT	70,000,000	$ 1.33	$ 93,100,000	110,000,000	$ 1.63	$ 179,300,000	110,000,000	$ 1.63	$ 179,300,000
Other	17,000,000	$ 1.57	$ 26,690,000						
	704,000,000	$ 1.45	$ 1,018,600,000	576,000,000	$ 2.12	$ 1,223,100,000	495,600,000	$ 2.16	$ 1,070,658,000
	Private Label Milk Sales			**Private Label Milk Sales**			**Private Label Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 1.26	$ 185,220,000	359,000,000	$ 1.12	$ 402,080,000	412,850,000	$ 1.00	$ 412,850,000
Reduced Fat	22,000,000	$ 1.37	$ 30,140,000	177,000,000	$ 1.30	$ 230,100,000	203,550,000	$ 1.00	$ 203,550,000
No Fat	3,000,000	$ 1.47	$ 4,410,000	4,000,000	$ 1.63	$ 6,520,000	4,000,000	$ 1.63	$ 6,520,000
Flavoured	-	$ 2.74	$ -	5,000,000	$ 2.01	$ 10,050,000	5,000,000	$ 2.01	$ 10,050,000
UHT	74,000,000	$ 0.90	$ 66,600,000	40,000,000	$ 1.15	$ 46,000,000	40,000,000	$ 1.15	$ 46,000,000
Other	-	$ -	$ -						
	246,000,000	$ 1.16	$ 286,370,000	585,000,000	$ 1.19	$ 694,750,000	665,400,000	$ 1.02	$ 678,970,000
	950,000,000	$ 1.37	$ 1,304,970,000	1,161,000,000	$ 1.65	$ 1,917,850,000	1,161,000,000	$ 1.51	$ 1,749,628,000
	Difference in Branded & Private Label Milk Sales			**Difference in Branded & Private Label Milk Sales**			**Difference in Branded & Private Label Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 0.07	$ 10,290,000	359,000,000	$ 0.71	$ 254,890,000	412,850,000	$ 0.83	$ 342,665,500
Reduced Fat	22,000,000	$ 0.10	$ 2,200,000	177,000,000	$ 0.73	$ 129,210,000	203,550,000	$ 1.03	$ 209,656,500
No Fat	3,000,000	$ 0.06	$ 180,000	4,000,000	$ 0.44	$ 1,760,000	4,000,000	$ 0.44	$ 1,760,000
Flavoured	-	-$ 0.38	$ -	5,000,000	$ 1.71	$ 8,550,000	5,000,000	$ 1.71	$ 8,550,000
UHT	74,000,000	$ 0.43	$ 31,820,000	40,000,000	$ 0.48	$ 19,200,000	40,000,000	$ 0.48	$ 19,200,000
Other	-	$ 1.57	$ -						
	246,000,000	$ 0.18	$ 44,490,000	585,000,000	$ 0.71	$ 413,610,000	665,400,000	$ 0.87	$ 581,832,000

Further to the above, this impact is also increasing across the whole Australian milk market as the major supermarkets are now actively pursuing market share from the 'route' trade including from independent fuel stations, corner stores, other small retailers, and distributors and vendors.

While the price cuts to supermarket 'store brands' announced by Coles and Woolworths are currently being absorbed by the retailers, if they are maintained they can be expected to flow on to other branded products and market channels.

This is an extreme concern to the dairy industry as the margin from processor proprietary brands sustain the dairy industry value chain at this time compared to the extremely slim margins available from supermarket 'store brand' milk sales.

The current aggressive move by the major supermarket Coles is aimed at changing consumer behaviour and increasing market share and other retailers are seeking to protect their market shares.

The table below outlines a possible scenario for the whole national drinking milk category, as consumers shift to supermarket 'store brands'. This is a static analysis for indicative purposes only, note the assumptions that have been made, which are detailed below. The total changes quoted in the table assume that all these impacts occur, and there is no subsequent response from consumers in terms of their buying behaviour.

Table 2	**Retail value of drinking milk category ($mill)**		
	Supermarket	**Route***	**Total**
2009/10	$1,916	$2,350	$4,266
Initial price cut to $1 per litre for all supermarket whole and reduced fat 'store brand' products (absorbed by retailers)	$1,820	$2,350	$4,171
15% shift to supermarket price cut whole and reduced fat 'store brand' product with no overall consumption increase*	$1,750	$2,350	$4,100
15% shift from route trade to supermarket 'store brand' label product at price cut whole and reduced fat supermarket 'store brand'	$1,903	$2,025	$3,928
15% decrease in branded price to compete with lower supermarket 'store brand' label products	$1,703	$1,721	$3,424
Change from 2009/10 benchmark*	-$213	-$629	-$842

***Assumptions:** *route retail price is equivalent to branded supermarket retail price, cuts to branded prices are made in both supermarket and route outlets, no overall consumption increase reflecting limited price elasticity of milk consumption, price cut maintained for 12 months*

Source: Extrapolated from Dairy Australia Data 2011

As illustrated in this scenario, while the initial cuts estimated at $96 million may be absorbed by the supermarkets, the flow on effects could be significantly higher, dependent on the degree of consumer shifts, and the adjustments made to branded prices.

As is expected if discounting battles continue between major supermarkets the reduction in supermarket 'store brand' will have flow on impacts including;

- devaluing all supermarket 'store brand' milk sales as major supermarket compete with other to protect market share and continue to use 'store brand' milk as an advertising agent,
- devalue processor proprietary brands of milk as processors either resort to discounting and or increase advertising to try and mitigate market share losses across both supermarket and route trade market channels,
- reductions in the retail price of processor proprietary branded product and supermarket 'store brand' products will necessarily flow through to wholesale prices and processor profitability, as will any shift to lower margin resulting from these price discounts.

In order to demonstrate the potential impact, if it was assumed that the devaluation of milk was shared equally amongst the three main sectors of the dairy industry value chain, being retailers, processors and dairy farmers then the following would occur;

- overall milk value chain loss is estimated at $842 million,
- each value chain sector would have to absorb a loss of approximately $281 million,
- average dairy farmer would see a reduction of 12.4 cents per litre or for a average farm with a production of 1 million litres a loss of $124,000, which for the majority of dairy farmers at this size would render them unviable.

Background to the Dairy Industry

Australian Dairy Industry

There are around 7500 dairy farms in Australia and 1.6 million dairy cows producing 9 billion litres of milk annually (*Australian Dairy Industry In Focus 2010*).

This makes the dairy industry Australia's third largest rural industry with a farm gate value of $3.4 billion. It is estimated that approximately 40,000 people are directly employed on dairy farms and manufacturing plants. Related transport and distribution activities, and research and development projects, represent further employment associated with the industry.

The dairy industry is one of the largest value added rural industries with most milk produced in regional areas and generating more then $9 billion in ex-factory sales each year.

In 2009/10 approximately 55 percent of national milk production is consumed domestically and states such as Queensland the domestic market consumes some 95 percent of production. Approximately 45% of annual milk production is exported to a large number of different countries in a range of different dairy products. Domestic drinking milk consumption makes up around 25% of all Australian milk production.

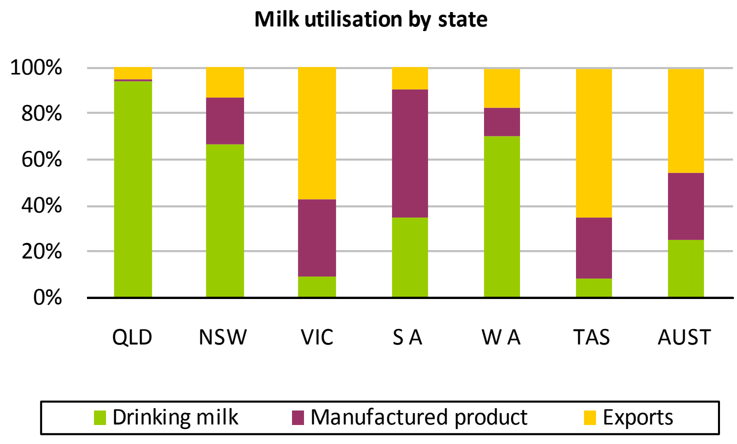
So therefore on average of every 100 litres of milk produced in Australia, 25 litres is consumed as drinking milk, 30 litres is consumed domestically in form of manufactured dairy products and 45 litres is exported in the form of dairy manufactured products.

Due to the effects of several years of drought, national milk production has reduced below the peak reached in 2001/02, with minimal growth in output over the past few years. With this, the Australian market has steadily grown in importance and influence in recent years as overall milk output has fallen. Supply to the domestic market has grown slowly whilst the volume and share of exports has declined.

The Australian market has offered good value and volume growth, although the recent economic downturn has also weakened consumer markets as households have economised on food spending, limiting the gains in average unit selling prices across the dairy category.

The Australian dairy industry is unregulated with no trade support mechanisms. The industry has to compete in the world market in a trade environment which is often deemed to be the most distorted of any agricultural commodity, with many countries using export subsidies, tariffs and a range of other protectionist mechanisms which distort the international supply and demand functions, price and resource flows.

Many protectionist trade policies have heightened the impact of the Global Financial Crisis on international prices and trade of dairy commodities.



Source: Dairy Australia

Across the different production regions of Australia the price for dairy products and drinking milk is influenced by different market forces.

In the south eastern milk production regions such as Victoria where the majority of milk production is manufactured into products for export, farm gate prices are largely influenced by the international price for dairy commodities and the exchange rate.

The majority of wholesale dairy product prices in the domestic retail, foodservice and industrial product markets are more influenced by prevailing international prices than the domestic market. This reflects the share of exports in processed dairy products, longer shelf life of processed dairy products, as well as the virtually free access to the domestic market for dairy imports, however this international price influence changes with transport distance between competitors.

In milk production regions such as Queensland, New South Wales and Western Australia where the majority of milk produced is consumed by the domestic market as drinking milk, farm gate prices are more influenced by contract negotiations between processors and retailers, regional milk production levels, location of regional milk production pools and processing plants, the distance milk can be viably transported both in terms of cost, maintenance of quality and the location of markets.

In milk production regions such as Queensland, New South Wales and Western Australia the majority of milk produced is now consumed by the domestic market as drinking milk, as over the last ten years since deregulation these states have produced less milk leading to the rationalisation and closure of dairy product and UHT processing plants.

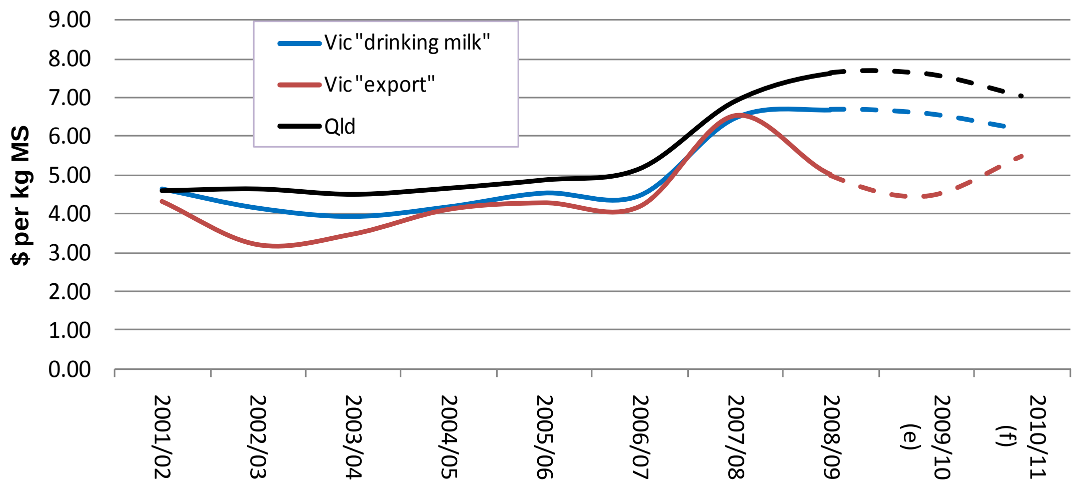
These differences in product and market mix mean that there are differences between the regions in production systems, costs of production and farmgate price drivers.

Farmgate price drivers in the regions that primarily service the drinking milk market mostly reflect the balance between local demand for drinking milk and security of supply.

The lack of relationship between international dairy price movements and domestic price movements in recent years is demonstrated by the following graph from Dairy Australia.

This is in contrast to recent public claims by Coles executives that, “The farm gate price dairy farmers receive is set by the world price because most Australian milk products are exported. (Coles statement 15th February 2011), which as demonstrated by the following graph is incorrect.

Average farmgate milk price comparison



In the absence of any manufacturing infrastructure, milk production in the region has had to be closely matched with daily fresh demand in recent years. This is a challenge for both farmers and processors, as either over or under supply represents significant issues for the regional market, producing a flat supply curve is costly for farmers, while coping with seasonal peaks and troughs imposes costs on the processing sector.

Given these dynamics it would be hard to argue that farmgate prices in Queensland, parts of New South Wales and Western Australia aren’t significantly influenced by retail prices for drinking milk.

The Northern Dairy Industry

The northern dairy region incorporating Queensland and northern NSW currently supports approximately 800 dairy farms producing around 820 million litres of milk annually, (QDO estimate from Dairy Australia 2009/2010 Data).

Within the region there are seven major processing plants operated by two companies and one co-operative, being National Foods, Parmalat and Norco (producer owned co-operative) and more than 50 minor processing factories (refer to Figure 1 for location of dairy farming regions and processing factories).

The northern dairy industry employs approximately 4500 people, incorporating some 2700 on farm and the remainder in processing and distribution.

On an annual basis, the northern dairy industry is valued ex-factory at approximately $1 billion.

Figure 1: Map indicating the location of northern dairy industry farms and processing plants.

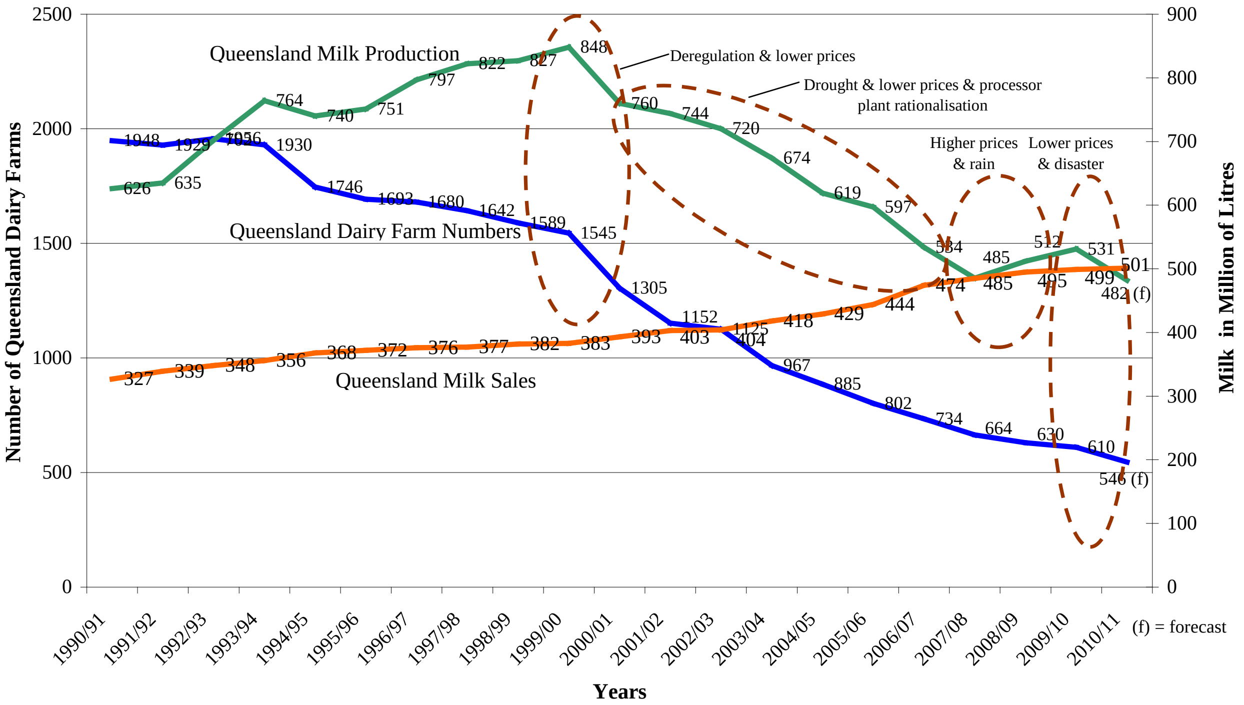
Population growth in the coastal regions of Queensland and northern NSW has in recent years been driving ongoing expansion in fresh milk and dairy product markets in retail and food service sectors. At the same time, increases in per capita consumption of fresh milk products and effective brand marketing of flavoured and functional milk products have also contributed to this increase.

Fresh milk sales growth for Queensland has over several years been the fastest of the Australian states, with sales volumes in the year to June 2008 up 5.5% over the prior year, compared to a national volume increase of just 2.0% (Dairy Australia, 2008). However in the past year, the economic downturn has influenced an easing in the demand growth in milk sales in the Queensland market as consumers tightened their spending on discretionary purchases. Sales growth in Queensland for the year to June 2010 slowed to less then 1 percent compared to 1.8 percent nationally and to the end of January 2011 sales have dropped to a negative 0.5 percent.

Queensland dairy industry

Deregulation, natural disasters, increasing operational costs and poor farm gate returns have seen the dairy farm population of Queensland fall by more then 60 percent over the last decade from 1,545 in 2000/01 to around 582 currently. Even with these many challenges dairy farmers have continued to improve their productivity.

Comparison of Queensland Dairy Farm Numbers, Milk Production & Sales from 1990/91 to 2010/11



Over the last decade milk production has fallen from 848 million litres in 1999/2000 to 531 million litres in 2009/10.

- The dairying regions of southern Queensland, including the Wide Bay Burnett, Darling Downs and South East Queensland regions combined have some 465 dairying enterprises. The majority of these farms supply one of three main processors including Parmalat, National Foods and Norco.
- Far North Queensland dairying region of the Atherton Tablelands is made up of 66 dairy farms supplying one processing plant at Malanda owned by National Foods. The region also has a few small niche market processing plants producing cheese and organic dairy products.
- The Central Queensland has approximately 51 dairy farms that supply the Parmalat owned processing plant at Rockhampton.

Of the current 582 Queensland dairy farms approximately;

- 269 supply National Foods,
- 264 supply Parmalat,
- 33 supply Norco,
- 15 supply small micro processors.

In Queensland there exist a number of collective bargaining groups or co-operatives that represent dairy farmers including:

- Premium, which is a registered Collective Bargaining Group that represents dairy farmers which supply Parmalat.
- Port Curtis Dairies which supplies the Parmalat Rockhampton plant,
- Progressive Dairies, which is a registered Collective Bargaining Group, under the Australian Dairy Farmers ACCC authorisation, that represents a small group of dairy farmers that supply National Foods,
- Dairy Farmers Milk Co-operative, which is owned by dairy farmers which supply National Foods,
- Norco Co-operative, which is owned by dairy farmers which supply the market with their own Norco branded milk and a range of other dairy products.

Producers in Queensland are paid to supply milk all year round to meet the fresh daily drinking milk market demand and that to produce milk year round in northern subtropical production environments is a higher cost production system. As such prices paid to dairy farmers in Queensland have generally been higher than to producers in southern dairying regions due to the fact that the Queensland dairy farmers are supplying a fundamentally different market than their southern counterparts.

The only alterative would be for processors to transport milk long distances to service Queensland markets which would be at a high cost and the quality and shelf life of the end product would decline. In addition, the southern dairy industry seasonally produces milk and would at times of the year not meet the volume or quality requirements of the northern industry for fresh daily product every day of the year.

During 2010 there has been significant downward pressure on farm gate prices for Queensland dairy farmers with contracts that have come due for renegotiation.

The majority of the farm contracts which came due involve dairy farmers which supply National Foods, with a smaller number with short term supply contracts with Parmalat and Norco.

Farm, gate prices have been dropped by approximately 15 to 18 percent for the majority of farmers, which includes farmers that supply milk for Coles supermarket branded milk, and approximately 10 percent for a smaller number of farmers for milk which is sold as fresh drinking milk.

In addition a major processor has introduced a two Tier pricing system with the first Tier reflecting fresh bottled milk sales and the second Tier milk used for manufacturing with a lower price. The price offered for Tier is around 47 cents per litre for some 70 percent of the farmers' production, based on last year's contracted production volume. For Tier Two the price on offer is around 30 cents per litre on the remaining milk production. These reductions are not sustainable for dairy farmers operating in the Queensland environment and will result in many farms experiencing negative returns this year.

In has been publically reported by Coles that they had awarded an increase in price to milk processor National Foods in January 2011, however there has been no increased price to farmers at this stage. It is understood however negotiations are still in process with the largest dairy farmer supplier group Dairy Farmers Milk Co-operative (DFMC).

Over the last decade the Queensland dairy industry has experienced a number of major impacts following deregulation, including;

- the longest drought in recorded history for many regions,
- severe floods and cyclones,
- poor farm gate returns for much of the period,
- a continual erosion of returns from the market place due to the growth in market share of major supermarket milk brands at the expense of processor proprietary brands,
- rising costs of production,
- an increase in government regulation and redtape,

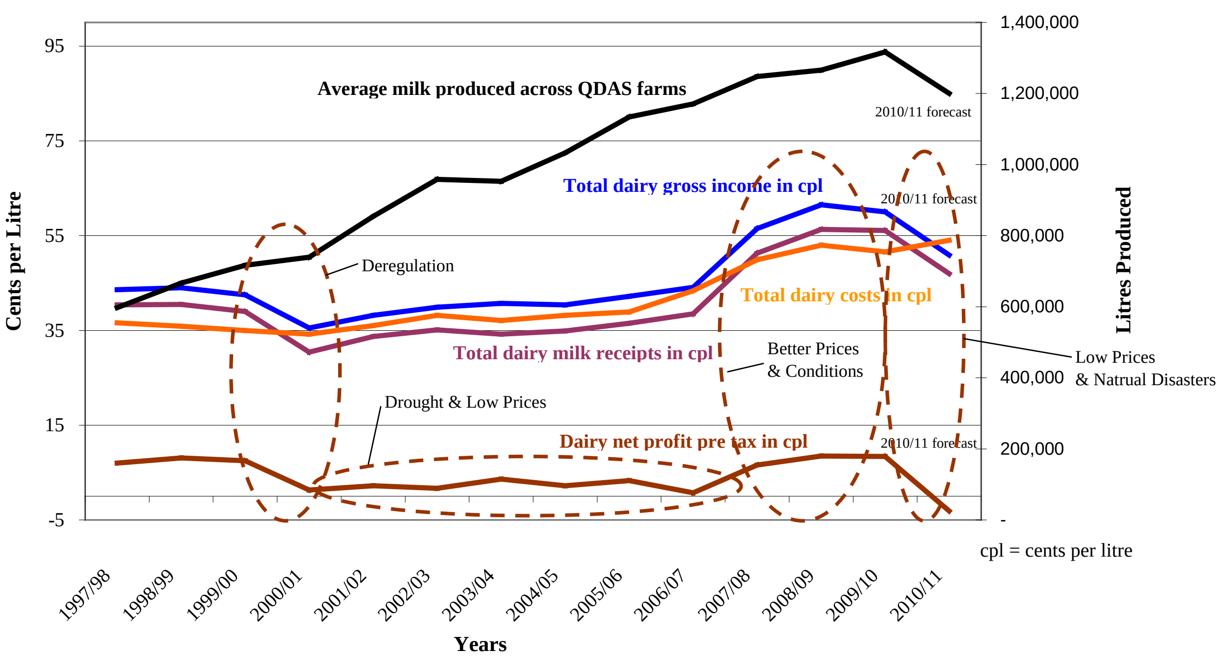
2008 saw a return to confidence in the industry with increases in milk price and expanding consumer demand. This confidence was reflected in the 2008 National Dairy Farmer Survey results with 80% of respondents in the northern dairy region responding to a national dairy farmer survey expressing a positive attitude. Along with this improved confidence attributed to higher milk prices, 54% of surveyed farms in the region indicated investment intentions across a variety of asset types including improving farm systems, machinery, dairy and feed infrastructure (Freshlogic, 2008).

This sentiment however has declined significantly in the last year with farm gate prices being dropped and even further with the impact of severe flooding and cyclones and even further with the initiation of a domestic market milk price war by Coles.

With the harsh operational conditions, poor farm gate returns and poor outlook with the devaluation of milk at retail level, the QDO has forecast that more then 60 Queensland dairy farms could exit the industry this year.

The following graph provides a presentation of data from the Queensland Dairy Accounting Scheme (QDAS) for income, costs and returns from 1997/08 to 2009/10 with the addition of a forecast for the 2010/2011 financial year.

Queensland Dairy Accounting Scheme Data 1097/98 to 2010/11



QDAS is an industry program developed and delivered by Queensland Primary Industries and Fisheries (QPI&F) to improve the understanding of business principles by providing farm management accounting information and analysis to northern dairy farmers and advisors. It is important to note that QDAS does not present a picture of the average performance of Queensland farms and in fact presents a picture of above average. The number of farms involved in QDAS has declined with the drop in farm numbers over the last decade. In 1997/98 there were 346 farms involved in QDAS whereas in 2009/10 there were 54 dairy farms involved.

This graph presents key financial performance data of dairy farmers which have participated in QDAS over the last 13 years. The 2010/11 figures presented are estimates produced from a forecasting model based on current changes to and information on impacts on key dairy farm variables gained from a survey of dairy farms.

Prior to deregulation regulated milk prices provided a stable return to the farm enterprise and even in times of natural disasters such as the severe droughts of the 1980’s and 1990’s the QDO was able to negotiate a price increase to cover the costs of the impacts and to ensure a stable supply of fresh milk to the domestic market.

Following deregulation prices to dairy farmers in Queensland dropped significantly from a regulated price of 54.9 cents per litre and an average farm price (weighted average of combination of regulated drinking milk price and manufacturing milk price) of 36.82 cents per litre in 1999/2000 to a single farm gate price of approximately 31 cents per litre 2000/2001.

The significant drop in price, even with the provision of the deregulation support packages saw the exodus of many dairy farmers from the industry. Following deregulation the Queensland dairy industry was again plagued by severe drought for over a decade and this impact combined with low farm gate prices and higher operational costs saw farm numbers and milk production continue to decline through to 2007/2008.

At this level of production from the region it barely met annual supply requirements of the market and at various times of the year fell well below market requirements.

With this situation, combined with repeated calls from dairy farm organisations processors increased farm gate prices and offered longer term contracts. With a return to more normal seasons milk production increased to be in surplus of market needs, however with the impact of sever flooding and cyclones and lower farm gate prices it is forecast that production will decline by more then 12 percent this year and again create a shortfall of milk to market needs.

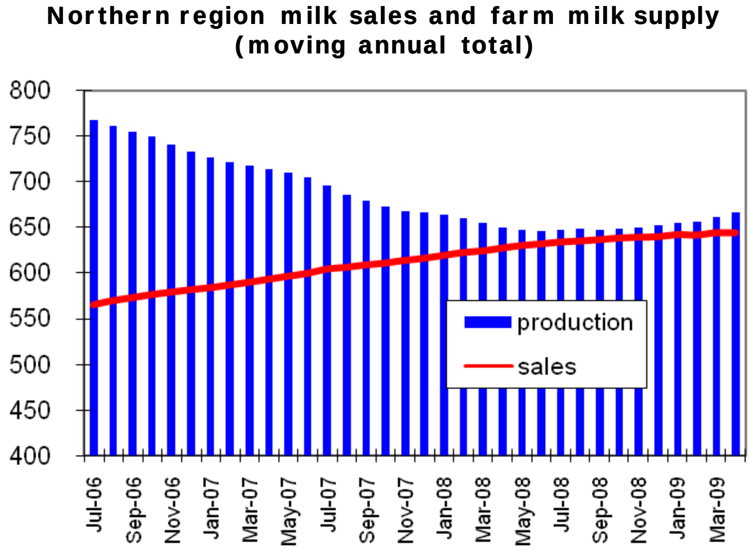
For many farmers the passing through of any margin losses by processors would eliminate their profits altogether. It is estimated by Dairy Australia that in the most exposed region of Queensland and northern New South Wales a 10 percent shift toward supermarket ‘store brand’ label alone would halve farmers’ 2009/10 profits should the processor be forced to pass the impact on to farmers. Average farm incomes for the region are already set to be drastically reduced in 2010/11 for many farmers due to lower average farmgate price, as well as the impact of natural disasters.

Regional Demand and Supply

Milk production in the northern region (Southern Qld and Northern NSW) steadily declined for about 8 years. This was due to prolonged drought, relatively low milk prices, irrigation water shortages, farm size constraints, rising input costs, and the incapacity of farm operators to cope with an increasing complex operating environment.

The conditions combined with an ongoing low milk price outlook exposed producers to volatility and weakening confidence in returns from the regional supply chain.

During the 2007/2008 financial year regional milk supply fell to levels barely sufficient to meet local fresh milk demand, affecting processors' ability to manage their supply chains and confidently meet customer requirements.



At this time alternate milk supply options were also under stronger competitive threat due to the lack of growth in southern milk supplies and the strong export demand for dairy products at historically high export prices.

Over the last decade due to a lack of economic milk throughput, processors have rationalised and closed a number of processing plants that processed milk excess to fresh daily demands into a range of products including Ultra High Temperature (UHT) milk, cheese, butter and milk powders.

Dairy processing plants which have been closed have included Toowoomba, Warwick and currently Booval. In addition a number of current plants have had their operations rationalised and dairy processing lines closed and moved to southern regions. As a result, the region no longer possesses production facilities that can cope with converting milk, that is in excess of fresh product demand, into storable dairy products, requiring careful logistical management and milk balancing to avoid incurring excessive costs.

The absence of any material volumes of milk being converted into commodity dairy products enabled processors to offer milk prices that better reflected returns from the fresh milk market. In effect, regional milk prices had been suppressed for many years because of the existence of a "surplus" of milk above economic processing volumes, as regional manufacturing plants were small in capacity and therefore less able to compete with the cost and reliability of the supply of product from larger southern facilities in the marketplace.

After some delay in farmgate prices reflecting the fragility supply/demand situation, milk prices in the northern region rose significantly in 2007/08 and have been reflected in milk supply contracts of up to 5 years in length being offered by Parmalat, the largest processor of milk in the region, which compelled other companies to match these levels. This has resulted in a "decoupling" of milk prices in the Northern region from the influence of southern milk values.

In 2008/09, a combination of the higher milk prices, existence of long-term milk supply contracts and the best seasonal conditions seen for many years and reduced bought-in feed costs has resulted in stronger milk supply and a strong improvement in producer confidence in 2009/10.

The recent strong recovery in milk production coupled with a slowing in demand growth created an over-supply of milk to regional milk processing plants in 2009/2010 (based on regional market demand). With the absence of regional manufacturing plants to process such surplus, processors have incurred higher costs in moving milk to plants in NSW. As a result of the surplus milk issue processors have or are moving toward a two price structure system where by one price reflects milk which is sold as drinking milk and the other reflects milk being sold for other purposes.

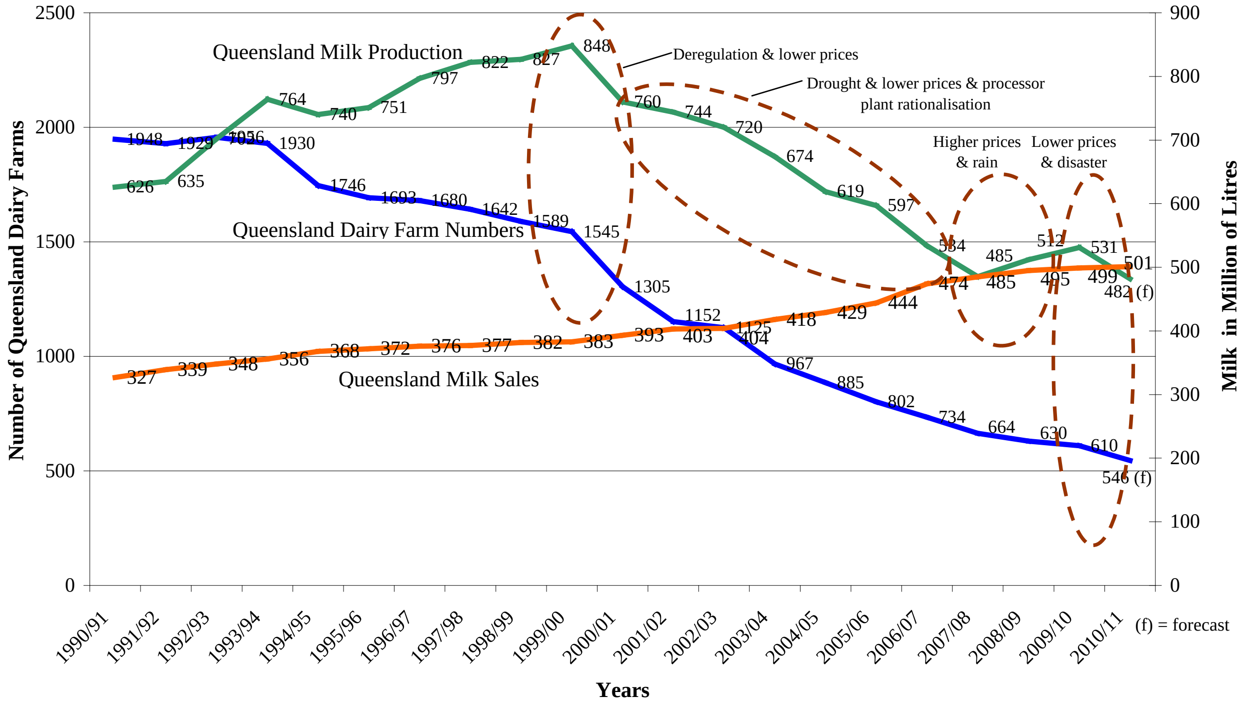
While the permanence of price signals is important to future producer and investor confidence, over-supply of milk in the region may weaken milk prices if suitable returns for surplus milk volumes cannot be sustained.

In the last three months however lower prices combined with natural disasters is forecast to see a fall in production which has already and will continue to test the ability of the industry to meet market demand.

Regional Demand Forecasts

Ongoing milk sales growth continues to provide the industry with the opportunity for further production growth in order to meet market demands. The following graph presents the annual figures for drinking milk sales for Queensland over the last two decades compared to Queensland milk production.

Comparison of Queensland Dairy Farm Numbers, Milk Production & Sales from 1990/91 to 2010/11



The graph demonstrates that Queensland milk production now closely aligns with the market demand for fresh drinking milk.

Milk is moved within the northern region, which includes Northern NSW, as required as surpluses and shortages occur. In worse case scenarios milk is sent and or brought in from regions further south.

The population of South East Queensland (Brisbane and Moreton Statistical Divisions) is projected to increase by 2 million people to 4.4 million people by 2034, up from 2.4 million people recorded in 2001. With this forecast growth in population over the next two and a half decades there is expected to be an equal to greater increase in the regional domestic market demand for dairy products.

It is estimated that for every one million people in the domestic market there is a demand of more than 105 million litres per annum of drinking milk. In addition to this there is also a demand for manufactured products which we have factored on the same ratio above. As such with the forecast population growth over the next two and a half decades it is estimated that there will be an increase in demand for milk and dairy products in excess of 210 million litres of milk.

Wholesale milk prices

While the QDO is not privy to the wholesale price of milk between processors, vendors and retailers, we are aware that it varies considerably between the vendoring sector with small retail shops and that between processors and major retailers.

In relation to farm gate prices at the current time in Queensland, it varies between processor and farmer and also with different forms and lengths of contract.

During 2010 farm gate prices were reduced significantly for dairy farmers who had supply contracts that came due during 2010. Reductions in prices for milk used for drinking equated to some 18 percent for many producers.

Table 3: Landed cost comparison – projected 2010-11 season				
	Cents per litre at “reference litre” milk components			
	Sth Qld	Nth NSW	Mid NSW	Nth Vic
Farmgate	47-58 ~ 30**	47-52	45-50	42-44
Freight	3-4	5-6	10	17-20
Landed cost	50-62	52-58	55-60	59-64
* This assumes milk prices on a year-round basis, given likely pricing by fresh milk processors in that region. ** price for milk used for manufacturing offered by some processors				

Whether such a price reduction is anti-competitive

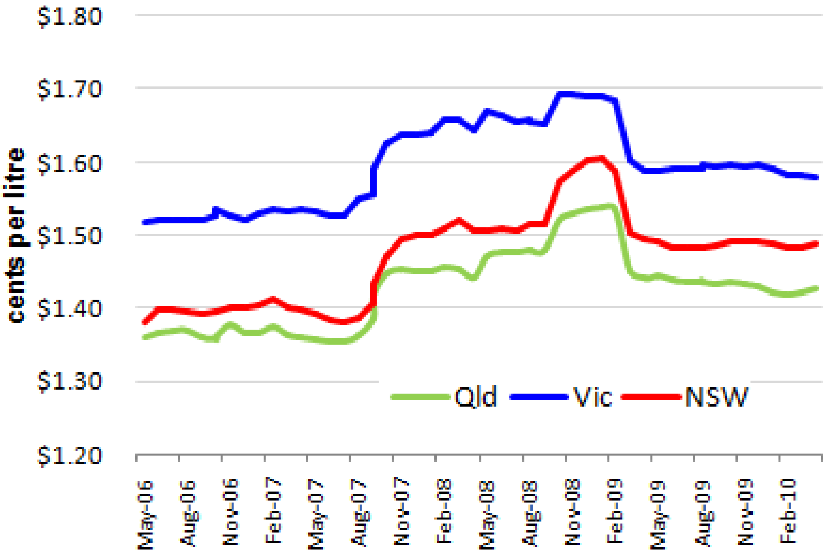
All of Coles’ major competitors have stated, both publically and privately, that these price cuts are unsustainable. Further to this we believe there is a strong prima facie case under section 46, including 46 (1AA) of the Trade Practices Act 1974 (now the Competition and Consumer Act 2010) that Coles’ actions constitute predatory pricing.

We note the following extract from the ACCC website: *"Section 46(1AA) applies to business conduct occurring on or after 25 September 2007. It prohibits businesses with a substantial share of a market, having regard to the number and size of its competitors in the market, from selling goods or services for a sustained period at a price below their relevant cost of supply. As with s. 46(1), a business must act with an anti-competitive purpose.*

It is the presence of a clear anti-competitive purpose that may turn price cutting by a company with substantial market power or market share into predatory pricing. Once competitors are damaged or eliminated, the likely results are that the company can raise its prices and exploit consumers."

From market research we have carried out comparing retail milk prices for southern Queensland compared to other states including New South Wales and Victoria, presents that retail milk prices for Southern Queensland are on average less than that of New South Wales and Victoria. The following graph provides an illustration on the difference between retail prices between different eastern seaboard states.

Average fresh white milk supermarket retail prices



In contrast to this, prices paid to dairy farmers by milk processors in Southern Queensland are higher than that paid to dairy farmers in New South Wales and even more so in Victoria. Dairy Australia data presents that for the 2009/2010 financial year Victorian dairy farmers were paid 33.9 cents per litre and in NSW 48.7 cents per litre and Queensland 55.8 cents per litre. The difference between farm gate prices between the three states relates to different market mixes and production costs.

In Queensland, the dairy industry supplies the majority of milk consumed by the Queensland domestic market and to meet the market requirements, this milk needs to be produced every day of the year. The Queensland environment poses higher production costs for milk compared to Victoria where the majority of milk is processed for export products and produced seasonally with lower production costs.

Within the dairy industry's domestic value chain, milk processors compete in a national fresh milk retail market, whereas major supermarket chains now operate national uniform pricing policies. These policies do not take account of differential costs to producers and suppliers.

As such in the Queensland domestic market the cost of milk to processors is higher than NSW and Victoria, yet Coles is applying a national discounted price of $1 per litre. When this is combined with evidence about margins presented by a Coles representative to the Senate Economic References Committee's inquiry into the Australian dairy industry in February 2010, we believe there is a prima facie case of breaching the Competition and Consumer Act 2010. We believe this case is in relation to selling milk as a 'loss leader' in a predatory manner to gain market share from competitors in the Queensland market place.

It is our belief that Coles' actions have the specific purpose and likely effect of damaging their competitors, such as other major retailers, corner stores, independent petrol stations and other small retailers of milk, and will lead to a substantial lessening of competition in the market place over time. This impact will also flow through to affect dairy farmers, service businesses, transport operators, processors, distributors and vendors and threaten the jobs of employees throughout the whole industry.

Furthermore, we believe this action by Coles impacts the viability of processor owned branded dairy products and thus lead to the loss of consumer choice and competition, as has been the experience in other countries where these marketing tactics have been applied.

In addition, for local markets in a number of rural communities where a major retailer is the only major retailer of grocery products for the community and is the 'defined market' such discounting practices as currently practised by Coles would be anti-competitive as it is resulting in the undermining of competition within the store by undercutting proprietary brands yet consumers are left with no other option within the 'defined market' to purchase their groceries.

Coles and Wesfarmers executives have publically stated that farm gate prices for dairy farmers have increased in the last year. However milk prices too many farmers have actually fallen by approximately 12 – 18 percent in Queensland and 10 percent in NSW and Victoria in the last 12 months, which includes the Tier One price dairy farmers are paid by National Foods that supply the milk for Coles supermarket branded milk.

In addition dairy farmers which have their farm gate price linked directly to processor branded sales will see their milk cheque drop in early March as a result of the Coles cut throat discount campaign increasing the market share of the Coles branded milk at the expense of market share of other brands, including processor brands.

Wesfarmers executive Richard Goyder has publically stated that the sales of the Coles brand milk has increased by some 15 to 20 percent since the products were discounted by some 33 percent on Australia Day 26th January 2011.

For Coles to publically promote that "*Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased.*" (Coles media release 26th January 2011 and various public statements), is tantamount to false advertising, in that it is seeking to promote to consumers that if they buy Coles branded milk at this dramatically discounted prices it will not have a negative impact on dairy farmers whom supply Coles.

As such we believe there is a prima facie case of false advertising that also should be investigated by the ACCC.

The UK Experience

Wesfarmers has introduced new management for Coles with the engagement of a management and marketing team from the United Kingdom where these types of ‘home brand’ discount price tactics has been common place to get market share from their competitors and to grow their own store brands.

In the United Kingdom independent branded products are now a rarity; they are all supermarket brands now and in some European countries fresh milk is getting harder to find and consumers are left little options but to purchase Ultra High Temperature (UHT) treated milk.

A 2008 study by Oxford University estimated the big four accounted for 70% of the milk market in the UK. In turn supermarket ‘store brand’ products account for around 71% of total milk sales. UK retailer brands have been highly successful due to the strength of the parent brand. Consumers identify strongly with the brand values of Sainsbury, Tesco et al, believing they confer attributes of quality and supply chain values.

In response, processors have struggled to develop viable differentiated brands in this market. The effect of this supermarket ‘store brand’ dominance has been to stifle innovation, as evidenced by the lack of product differentiation in the UK milk market. The Oxford Study noted the shift in dominance in the dairy industry supply chain from processors to retailers, with only a small percentage of the supply chain profits attainable for farmers and processors.

A 2010 study by DairyCo on dairy supply chain margins noted the absence of any decline in retail prices for milk at a time of falling commodity and farmgate prices, concluding that processors and farmers absorbed the full impact of the decline in the dairy market.

Comparing 2009/10 with 1999/2000 indicated the retail price of milk increased 60% compared to a general food price increase of 36%. Over the same period the average farmgate price increased 34% and the estimated wholesale price increased 31%.

Before major supermarket chain ‘supermarket brand’ pricing and marketing strategies, these returns flowed to the processor and then to farmers. The loss of these returns to the industry is not sustainable.

The suitability of the framework contained in the Horticulture Code of Conduct to the Australian dairy industry

The QDO believes that a dairy industry Code of Conduct could provide some distinct benefits for the industry and dairy farmers if it covered the entire value chain including dairy farmers, processors and retailers.

Benefits could include;

- providing greater transparency through the industry value chain,
- providing a better understanding amongst all industry value chain sectors of the issues and needs of each sector,
- provide much clearer information for dairy farmers to be able to make more informed business decisions,
- discouraging unconscionable and anti-competitive conduct,
- provide a dispute resolution process,

The Horticultural Code of Conduct's purpose is to "improve the clarity and transparency of transactions between growers and wholesalers of fresh fruit and vegetables."

While the dairy farmers have a range of challenges dealing with corporate milk processors under Collective Bargaining authorisations by the ACCC, the major challenge for the farming and processing sector is currently the treatment of milk as a discounted, at or below cost, advertising agent by major retailers to attract customers to their stores while at the same time growing their owned supermarket branded milk.

For a Code of Conduct to be effective for the dairy industry value chain it would need to include the retail sector, which the Horticultural Code of Conduct does not, as the Horticultural Code of Conduct was designed to address the agent and merchant issues between wholesalers and growers.

The requirement of the Horticultural Code of Conduct that all traders to prepare, publish and make publicly available a document that sets out the general terms and conditions under which they will trade with growers of horticulture produce, is of interest as a similar provision in a Dairy Industry Code of Conduct could help improve transparency and assist dairy farmers make more informed business decisions. Currently it is extremely difficult for dairy farmers to compare prices and supply conditions between different milk processors.

The provision within the Horticultural Code of Conduct for minimum requirements for what must be included in contractual agreements could also be applicable to the dairy industry in relation to contractual agreements between dairy farmers and milk processors and milk processors and retailers.

The provision of a dispute resolution mechanism as established with the Horticultural Code of Conduct could be of assistance to individual and groups of dairy farmers in resolving break downs in price and supply negotiations.

The QDO would also like to further investigate potential initiatives which have been introduced by the United Kingdom by the Competition Commission including the Grocery Supply Code of Practice.

The recommendations of the 2010 Economics References Committee report, Milking it for all it's worth – competition and pricing in the Australian dairy industry and how these have progressed

The QDO welcomed the last Senate Inquiry into competition and pricing in the Australian dairy industry and provided a submission to and appeared before the inquiry as well as providing supplementary information. The QDO also publically welcomed the report and recommendations from the Senate Inquiry "Milking it for all it's worth".

In late 2010 the QDO enquired of the Federal Government if progress had been undertaken on the recommendations, in particular in relation to recommendation three, however to date we have had no response.

In relation to the recommendations presented from the last inquiry the QDO recommends that a strategic working group is established between Government and industry to further recommendations that provide an opportunity to derive positive outcomes for the dairy industry and the Australian community and economy.

Recommendation 5: "The Committee recommends that the Productivity Commission reviews and evaluates the effectiveness of the national competition policy and publish its report by 30 April 2011."

The QDO supports this recommendation as there is circumstantial evidence that the objectives of the policy are not being met as retailers are using their significant market share to undermine competition in the market place, thereby lessening competition in the long run, which as experienced in some other countries such as the United Kingdom, has led to the loss of choice and higher prices for consumers.

Recommendation 3: "The Committee recommends that the Government requests the Australian Competition and Consumer Commission to use its information-gathering powers, and draw on its work for its recent report on grocery pricing, to provide more accurate estimates of the proportions of the retail price of milk that reflect (i) the costs and (ii) the profits, of farmers, processors and retailers and publish the results of that review by 30 September 2010.

The QDO supports this recommendation as there is a real need for greater transparency through the value chain of the dairy industry, particularly at the processor and retail sectors of the value chain.

Recommendation 2: The Committee recommends that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

The QDO supports this recommendation as there is a real need for greater transparency and comparability for dairy farmers with regard to contracts offered by processors.

Recommendation 12: The Committee recommends that the Government reviews the collective bargaining provisions of the Trade Practices Act with a view to strengthening that framework to create a more equitable balance of power between the negotiating parties and report by 30 April 2011.

The QDO fully supports this recommendation.

Recommendation 13: In reviewing the collective bargaining provisions the Committee requests that the Government considers the effectiveness of any existing alternative dispute resolution mechanisms and investigates:

- allowing collective bargaining groups to merge to address imbalances in bargaining power;
- the introduction of a requirement that the ACCC facilitate the timely appointment of a mediator should a party to a negotiation require such assistance; and
- the introduction of a requirement that cooling off periods be mandatory in contracts between dairy farmers and processors.

The QDO supports the recommendation and concepts of allowing Collective Bargaining Groups to merge, provision of a meditation process and a cooling off periods, however the QDO would like to further assess the specific elements of the recommendations.

Recommendation 11: The Committee recommends that the Federal Government commissions an independent report into the main impediments to the establishment of new processors owned by farmer cooperatives and how these impediments could best be overcome and requests that the report be tabled by 30 April 2011.

The QDO supports this recommendation.

Recommendation 1: The Committee recommends that the Government requests that the National Competition Tribunal reviews the effectiveness of section 46 of the Trade Practices Act in preventing price discrimination and considers reinstating anti-price discrimination provisions, particularly to protect those parties participating in industries dominated by multinational corporations.

The QDO supports the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 4: The Committee recommends that the Government requests the ACCC to undertake monitoring of the pricing practices within the dairy chain with a view to establishing whether predatory pricing or misuse of market power is occurring.

The QDO supports this recommendation.

Recommendation 6: The Committee recommends a moratorium on further takeovers and mergers in the milk processing industry until the Productivity Commission has published its report on the effectiveness of the national competition policy.

The QDO would like to gain further information on the recommendation.

Recommendation 7: The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provisions and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

The QDO supports the concept of the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 8: The Committee recommends that the ACCC conducts further study into the implications of increasing shares of the grocery market being taken by the generic products of the major supermarket chains. The Committee recommends that the terms of reference of any such inquiry include not just the current and future impact on prices paid by consumers but also the needs of Australia in terms of food security and economic and environmental sustainability, as well as the economic viability of farmers and processors. The Committee requests that the findings of these reviews be reported by 30 April 2011.

The QDO supports this recommendation. As presented in the QDO submission the marketing, advertising and pricing tactics of major supermarkets with store branded milk is a major concern for the sustainability of the dairy industry particularly in regions which principally supply the Australian domestic market, such as Queensland.

Recommendation 9: The Committee recommends the Productivity Commission considers, in its review of national competition policy, the appropriateness of separating the functions and powers of the ACCC with the effect that separate agencies are responsible for the approval of mergers and the assessment of whether concentration is subsequently excessive.

The QDO supports this recommendation. The QDO believes that the functions of the ACCC need to be reviewed given the nature of a number of recent decisions. The QDO would like to obtain further information on this recommendation to be able to provide a more informed response.

Recommendation 10: The Committee recommends that the topic of competition and pricing in the dairy industry be again referred to the Senate Economics References Committee in May 2012 to assess whether progress has been made or whether tougher and more interventionist measures need to be adopted.

The QDO supports this recommendation to ensure that appropriate transparency and issues of market power market manipulation are adequately addressed to enable the dairy industry to be sustainable into the future.

Recommendation 16: The Committee recommends that the Australia and New Zealand Food Regulation Ministerial Council acts to ensure that labelling on dairy products adequately and accurately informs consumers about the provenance, manufacturer and contents of the product.

The QDO supports labelling laws which accurately inform consumers on the provenance, manufacturer and contents of products.

Recommendation 14: The Committee recommends that the Government addresses the issues of food security and the future sustainability of the dairy industry at a federal level. The Committee suggests to the Government that this review be facilitated through the Primary Industries Ministerial Council to ensure it receives the commitment and attention required. The Committee recommends that any review include the role of the ACCC and federal, state and territory agricultural departments in ensuring Australia's food security.

The QDO agrees with this recommendation and ADF is currently participating in the Primary Industries Ministerial Council review relevant to these matters including the review of research and development investment in agricultural industries. The QDO with other industry stakeholders have supported the development of a Sustainable Milk Production Model as a decision support tool which could provide a national reference tool for dairy farm sustainability.

Recommendation 15: In the light of the Tasmanian experience the Committee recommends that where industry bodies are encouraging increased production, all agencies involved in those bodies have regard to issues of long term sustainability in the context of long term trends. They should identify the source of increased demand, adopt cautious language and indicate the degree of uncertainty around any projections.

The QDO agrees with this recommendation as increases in production should be driven by market needs and opportunities. The QDO also encourages dairy farmers to seek professional independent advice when seeking to make business decisions.

The need for any legislative amendments

The QDO believes there is a need to make legislative amendments as well as a range of other measures.

The QDO is currently seeking further advice on the recommendations we wish to make and as such the QDO will be seeking to provide a supplementary submission to the Senate Inquiry to present these recommendations.

Other related matters

Collective Bargaining

Milk producers in Queensland avail themselves of a number of collective bargaining arrangements in their negotiation of milk supply arrangements with processors, including the following:

- Premium Milk Group which supplies Parmalat's South Queensland operations. Premium operates within an ACCC-approved arrangement,
- Port Curtis Dairies which supplies Parmalat milk for the Rockhampton plant,
- DFMC, which negotiates on behalf of its members with National Foods,
- Collective bargaining groups that operate under the arrangements administered through ADF Limited, which include the National Foods suppliers group and Progressive Dairies,

The ACCC ruling achieved by ADF in 2006 facilitates this option on a regional level. The authorisation also permits:

(a) groups of dairy farmers to form collective bargaining groups through which they may collectively negotiate terms of supply, including price, with a dairy processing company that each member of the group wishes to supply and,

(b) the ADF to hold general, non-specific discussions with supermarkets, on an individual and voluntary basis, regarding the impact of tender processes on dairy farmers subject to the certain conditions.

QDO supports continuity of these arrangements to support achievement of fair returns to dairy farmers in a consolidating dairy supply chain.

The QDO has supported the collective bargaining provision authorisations which were originally given to Premium in Queensland and then nationally to the Australian Dairy Farmers.

The QDO believes that this provision by the ACCC is essential for groups of dairy farmers to be able to be able to collectively discuss and negotiate outcomes with the processor they supply. This provision has provided the means for dairy farmers to be able to negotiate in a more balanced 'market power' environment.

There currently exist some good examples of effective collective bargaining groups whom have developed good working relationships with the processor they supply and have used the collective bargaining provisions to not only negotiate on issues of price, but to develop a better understanding of each others business needs, to collectively seek to improve systems to reduce costs, and to structure business arrangements to better reflect the needs of both businesses, which can cover supply arrangements, transport, seasonal incentives, risk management etc. Recently a collective bargaining group negotiated for a slightly lower price in return for longer contract conditions.

Over recent years the processing sector has continued to consolidate and with this, the market share that remaining processing entities hold, has increased. With this consolidation within the processing sector the QDO believes that the Collective Bargaining provisions for farmer groups should be reviewed to ensure that the current provisions provide a reasonable balance for farmer group collective negotiation in the current processing sector environment. Some Collective Bargaining groups are severely constrained by regional boundaries and now with the consolidation of processors and expansion of their milk collection base, these regional limitations on dairy farmer Collective Bargaining groups should be reviewed.

One of the critical requirements for Collective Bargaining groups to be successful over time is that they have sufficient professional skills development and support.

The Australian Government should consider making resources available specifically to assist farmer collective bargaining groups to increase their skills and knowledge and business acumen for the role of collective bargaining, managing a collective bargaining group and developing effective working relationships with processors.

Other Issues

Other current threats to the sustainability of the Queensland dairy industry include:

- the potential flow on impacts to dairy farmers from the planned introduction of a tax on carbon, unless there are viable options for offsets re available for dairy farmers,
- lessening of water security for dairy farmers from ongoing changes to water planning and legislative mechanisms that place lower priority on food producing industries over other priorities,
- increasing Government regulation which impose additional costs and restrictions on farm operations,
- declining investment into initiatives which assist industry to continue to achieve productivity and sustainability gains,

The QDO would like to see the Australian Government increase its investment and effort in;

- Supporting the Dairy Industry's Flood and Cyclone Recovery Program,
- Supporting resource use efficiency programs within the industry, such as the QDO's Dairy Water for Profit program,
- Increase the investment from the Australian Government into research, development and extension, which is critical to ensuring the Australian dairy industry continues to make advances in productivity and sustainability,
- Provide further support to the Australian Dairy Industry's Natural Resource Management program, Dairying for Tomorrow, which is critical for the industry's future sustainability and dealing with impacts such as climate change.

Queensland Dairyfarmers' Organisation

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Senator Alan Eggleston
Chairman
Senate Economics References Committee
Parliament House
CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

30th April 2011

Dear Senator Eggleston,

Re: Inquiry into the impacts of supermarket price decisions on the dairy industry

The Queensland Dairyfarmers' Organisation (QDO) would like the opportunity to response to the additional information and answers to questions on notice that Coles Supermarkets Pty Ltd has responded to the Senate Economics References Committee on the 19th April 2010.

Firstly we appreciate that under your chairmanship the Committee has had to deal with a large amount of submissions and that understand that further time is required to analyse all of this information, in addition to the response from Coles Supermarkets Pty Ltd to questions on notice from the Committee being only provided to you on the 19th April, one day before you where due to provide a report on the inquiry.

We are extremely frustrated and angry that Coles Supermarkets Pty Ltd has continued to delay the progression of the inquiry in this manner, as this is delaying the implementation of a solution to the problem and the fact that dairy farmers in Queensland are already being affected with lower returns due to the cutthroat discounting on milk initiated by Coles.

Primary Producers House, 183 North Quay, Brisbane. Postal Address: PO Box 13061, George Street, Q. 4003.
Telephone (07) 3236 2955, Facsimile (07) 3236 2956

Luscombe comments – will not be first to change

- QLD impact

"There's no doubt we've been publicly critical [of the price drop], and it's not a sustainable position," he told ABC Radio National's Bush Telegraph.

"What we've seen since then, are reports - especially from south-east Queensland - that dairy farmers are seeing a reduction in income.

"Also, the two major processors have indicated they might not go ahead with much needed reinvestment in processing facilities."

Woolworths says the current price of milk isn't sustainable, something its competitor Coles' has long denied.

"Once one of the links breaks down, it becomes sustainable. You can see in the UK a lot of fresh milk comes from outside of the UK into the marketplace," he said.

"I'm not sure I want to see that happen in Australia."

Consumers have benefited from the price cuts by getting cheaper milk, but some wonder what they buy to help farmers.

"Buying branded rather than private label milk can have a better outcome [for farmers]," Mr Luscombe said.

That's because farmers get a bonus for selling branded milk.

Coles and Woolworths sales growth figures

Mr Tessmann added that comments from Woolworths CEO Michael Luscombe this week, stating that Woolworths would not be the first to move its milk prices upwards, highlighted the urgency for the Government to act.

"Clearly there is a major standoff occurring between the major retailers," Mr Tessmann said. "And dairy farmers are the ones caught in crossfire. We need urgent action from the government to ensure the long-term viability of the industry and to ensure drinking milk States such as Queensland have fresh milk in the future.”

"We've said it's unsustainable for a lot of the dairy farming community, and clearly they've had a reduction in their income, and if that is sustained their businesses will be under threat," Mr Luscombe said.

"But whatever happens, Woolworths will make sure that our customers get the same price as the cheapest in the marketplace . . . we didn't take it down first, we're not going to take it up first."

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The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to provide to the Senate Standing Committee on Economics the following supplementary submission containing a set of recommendations for the Committee's consideration.

The QDO has been heavily involved with the development of recommendations as a member of the Australian Dairy Farmers (ADF) and as such many of the following recommendations directly reflect ADF's recommendations to the Senate Inquiry.

The QDO stands ready to, where possible, provide any further information Committee members may require and would welcome the opportunity to discuss any of the recommendations presented.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd

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Supplementary Submission to the

Senate Standing Committee on Economics

Inquiry into the impacts of supermarket price decisions on the dairy industry

Recommendations

8 April 2011

Introduction

The Queensland Dairyfarmers' Organisation (QDO) presents and commends the following recommendations to the Senate Standing Committee on Economics Inquiry into the impacts of supermarket price decisions on the dairy industry.

The following should also be read in conjunction with QDO's submission and response to Questions on Notice to the Senate Inquiry.

A number of the following recommendations are also reflected in the recommendations being submitted by Australian Dairy Farmers.

Recommendation Summary

QDO Recommendation 1
That the relevant Federal Minister to give a direction to the ACCC to undertake an immediate investigation of Coles for a potential breach of section 46, of the Competition and Consumer Act 2010 in relation to predatory pricing.

QDO Recommendation 2
That the relevant Federal Minister to give a direction to the ACCC to;

1. investigate the pricing of all major retailers for potential breaches of the Competition and Consumer Act 2010 in relation to the sale of 'loss leaders' and;
2. undertake ongoing price, cost and marketing surveillance of the fresh milk supply chain.

QDO Recommendation 3
That the relevant Federal Minister to give a direction to the ACCC to investigate Coles' advertising of their discounted store brand milk for potential breaches of the Competition and Consumer Act 2010 in relation to false, deceptive and or misleading conduct.

QDO Recommendation 4
That the Senate Inquiry and the Government examine the United Kingdom Competition Act 1998 (section 18) with a view to implementing similar legislative provisions to strengthen the anti-competitive price discrimination provisions of the Act, in particular:

- Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom;
- Conduct may, in particular, constitute such an abuse if it consists of:
    - Directly or indirectly imposing unfair purchase or selling prices of other unfair trading conditions;
    - Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.
- That an 'effects test' for both competition and sustainability be reinstated within the Act.

QDO Recommendation 5
That the above definition or a similar definition with the same intent is inserted into the Act. A draft definition of unconscionable conduct is provided by Professor Zumbo in his submission and reads as follows: *'For the purposes of this section 'unconscionable conduct' includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.'*

QDO Recommendation 6
That a statutory duty of good faith be enacted as part of the Act to provide an appropriate and accepted benchmark of standards of ethical conduct.

QDO Recommendation 7
That the Australian Government commission an independent study of the economic impact of supermarket 'store brand' milk, procurement, marketing and pricing practices on;

- the sustainability of the fresh drinking milk supply chain,
- pricing, demand and competition between 'store' and proprietary milk brands in the fresh milk market,
- implications for consumer choice and cost in the longer term,
- implications for investment in product innovation, and
- whether placing limits of market shares of supermarket 'store brands' would derive long term benefits for consumers and the sustainability of the dairy industry fresh drinking milk supply chain.

QDO Recommendation 8
That a mandatory Australian Drinking Milk Code of Conduct be developed, under the Act, in consultation with industry, dealing with the relationship between dairy farmers, processors, distributors/vendors and retailers. That the Code have a Commissioner appointed with a head of power including the authority to apply a Sustainability Test and direct mediation and or apply arbitration to proposed contracts at any point in the supply chain, whether it be between Collective Bargaining Groups of dairy farmers and processors, processors and retailers.

In addition the QDO supports the recommendations from Associate Professor Frank Zumbo that;

- civil monetary penalties for breaches of mandatory industry codes of conduct be imposed under the *Competition and Consumer Act*, and
- that the Australian Consumer Law framework dealing with unfair contract terms be extended to cover business to business agreements involving small businesses and farmers.

QDO Recommendation 9
That an Ombudsman / Commissioner and or a Supermarket Ombudsman be appointed, with appropriate heads of power, to head the Australian Drinking Milk Code of Conduct.

QDO Recommendation 10
Government to convene, and participate in, an Australian Government and or ACCC authorised forum of the dairy industry supply chain, from farmers to retailers, to constructively discuss solutions for ensuring a sustainable drinking milk market with fair and sustainable returns.

Background - Key Issues and Problems

As an unintended consequence of deregulation, since 2000, due to its unique characteristics, the major supermarket duopoly, with their dominant share and power in the domestic market, has utilised fresh drinking milk as a discount marketing agent to serve a range of purposes. This has led to the progressive unsustainable devaluation of fresh drinking milk products nationally and market failure within the Australian domestic fresh drinking milk market.

The current example of this market failure is clearly evident in southern Queensland where there is a shortage of milk, due to the impacts of natural disasters, and in order to service market needs milk is being transport long distances at much higher costs. However at the same time major supermarkets have reduced the price of their store brand milk, with supermarket using their store brand milk as a discount marketing agent. As the supermarkets are using milk to serve as a discount marketing agent for pursuing the growth in overall supermarket grocery sales, the value of drinking milk is being continually sacrificed for another purpose which does not reflect the true cost and market value of fresh drinking milk.

The consequences of this has been the creation of a situation whereby returns to the supply chain from supermarket store brand milk is not sustainable and are undermining the viability of the fresh milk supply chain, including returns to dairy farmers.

The latest, at near or below cost ‘loss leader’, discounting of fresh drinking milk, which was led by the Coles Supermarkets Australia Pty Ltd (Coles) on the 26th January, and then followed by other retailers, has furthered the devaluation of the fresh drinking milk in the market place and is undermining of the sustainability of the fresh drinking milk supply chain.

If the abuse and devaluation of fresh drinking milk by major supermarkets is not addressed it is feared that significant damage will be incurred by the supply chain, resulting in the further loss of dairy farmers, break down and loss of investment from the fresh milk supply chain, loss of choice and higher costs for consumers and potentially the loss of fresh milk supply for isolated regions.

Fresh Milk is Unique

Fresh drinking milk is a well defined market in Australia. Fresh drinking milk is unique in nature due to it being an every day, fresh, high quality nutritious, dietary staple of our community consumable. Due to this uniqueness fresh drinking milk as a product is also very inelastic in nature.

Fresh milk is a foundation staple of our population’s daily dietary needs and expectations and the vast majority of Australian’s take for granted that they are able to purchase milk from any shop in Australia with a refrigeration unit. Public disturbances due to the shortage of fresh milk during the floods in Queensland highlight that demand and expectation of consumers.

Australians drink some 102.4 litres of fresh milk per year and collectively this equates to the consumption of 2.33 billion litres per year, which makes up some 25 percent of the Australian dairy industry annual milk production (data source Dairy Australia, Australia Dairy Industry In Focus report 2009/2010). As such milk is one of the most frequently purchased items by consumers.

Due to all of these unique characteristics, fresh drinking milk serves as an ideal discount marketing agent for supermarkets and other retailers.

Challenges of Fresh Milk Production and Supply

The production, transport, processing, distribution and retailing of fresh milk entails a significant number of challenges and relative high level of investment and risks compared to other dietary staples and grocery products.

Unlike many other groceries, milk is highly perishable and as such requires a great deal of management and capital to ensure the product is made available to consumers in a fresh, high quality status. Compared to milk, other products such as water and soft drink do not require the same amount of supply chain investment as they are not perishable and or do not require refrigerated storage, as required for fresh milk.

In addition the production of milk comes from a live biological farming system and simply cannot be turned ‘on or off’ as other manufactured drink products can be.

To produce milk, dairy farmers carry the highest investment and risks per litre of milk and the most volatile returns of the whole fresh milk supply chain.

The huge amount of investment, effort, and risk required to produce, transport, process, distribute and deliver fresh milk on a daily basis is not reflected in the current discount price of milk by major retailers at $1 per litre, which was the price of whole milk back in 1992.

Retailing Tactics and Impacts

As fresh milk is unique in nature as a perishable every day inelastic dietary staple of our community major supermarkets continue to use fresh milk as a near or below cost ‘loss leader’ discount marketing agent, including as a;

1. ‘door opener’ to attract consumers away from their competitors to increase their own market share,
2. sales ‘multiplier’ to entice consumers to purchase other products while visiting the store to purchase milk being a every day staple,
3. ‘locator’ to make people walk through the store to be able to reach the milk cabinet and in so doing seeking to entice them to purchase other products while they are there,
4. means to grow their own supermarket brand market share at the expense of the market share held by processor proprietary brands, and
5. de-facto wholesaler to sell discounted milk to milk ingredient users such as coffee shops and or small retailers.

These marketing tactics in effect sacrifices the value of milk to serve an advertising function. The latest marketing tactics of Coles has seen the discounting taken to levels which simply are not sustainable for anyone in the fresh milk supply chain and are already causing significant negative impacts on the supply chain and dairy farmers.

The unique nature of milk provides retailers with an effective tool to grow their market share and power, however the consequences for the sustainability of the domestic fresh milk supply chain is significant to a point where if left unchecked it will result in undermining the viability of the whole fresh milk supply chain and effects the future supply, cost and choice to consumers.

The major two supermarkets in Australia effectively form a duopoly, benefiting from the unprecedented control of some 80 percent of the domestic grocery market and thereby collectively providing the largest avenue for the sale of grocery products to Australian consumers.

Through the above and other marketing tactics, including near or below cost discounting, the major supermarkets have effectively doubled their market share of their own supermarket milk brands over the last decade, to over 50 percent of all milk sold through supermarkets. The major supermarkets have also increased their share of the ‘route’ trade market for example through fuel stations to a point where some in the supply chain estimate that major supermarkets have around 65 percent of overall market share.

This increase in market share of discounted supermarket store brand milk has come at the expense of processor proprietary brands. This change in the market share between the two groups of brands has dramatically affected the returns to the dairy industry supply chain, including to milk processors and dairy farmers.

Under the last year of regulated domestic milk prices, the farm gate price was 54.9 cents per litre and the average retail price for whole white drinking milk was $1.26 per litre for supermarket brands and $1.33 per litre for processor proprietary brands.

Currently in Queensland the price for milk which is sold as fresh drinking milk at farm gate ranges from 47 cents per litre, up to 58 cents per litre for older contracts still in operation and the retail price is $1 per litre for supermarket brands and approximately $1.83 per litre for processor proprietary brands.

Last financial year the value difference of all milk sales during the year between the two groups of milk brands, being supermarket brands versus processor proprietary brands, was more than $414 million. This is the value which is now lost from the supply chain and is undermining its viability.

It is expected that if the current milk discount battles continue between major supermarkets the unsustainable reduction in supermarket ‘store brand’ price will have further flow on impacts including;

- further devaluation of all supermarket ‘store brand’ milk sales as major supermarkets compete with one another to protect market share and continue to use ‘store brand’ milk as a near or below cost ‘loss leader’ advertising agent;
- further devaluation and reductions in margins of processor proprietary brands of milk as processors either resort to discounting and or increasing advertising to try and mitigate market share losses across both supermarket and route trade market channels;
- reductions in the retail price of and margins from both processor proprietary and supermarket ‘store brand’ products will inevitably flow through to wholesale prices and processor profitability;
- increasing pressure on the viability of smaller retailers and the route trade operatives such as vendors;
- increasing downward pressure on farm gate prices and supply conditions;
- lower returns for the fresh milk resulting in impacts on investment and employment throughout the supply chain;
- divestment from the supply chain, threatening supply security in many regions, especially for more isolated regional areas;
- little or no investment in product innovation, less competition, choice and inevitably higher prices for consumers.

As major supermarket store brand sales increase, they obtain more market power to be able to dictate the price and supply conditions at which suppliers sell to them, across both supermarket and proprietary brands. The supermarkets also then get to dominate shelf space and as a result the choice to customers declines. This vicious cycle will in the long-term result in supermarket store brand domination of the market, less or no customer choice, little or no product innovation and worst of all for consumers, increases in the price, as has been the experience in the United Kingdom.

As presented in the QDO's submission to the Senate Inquiry, (refer to page 11 of QDO submission), across the whole domestic fresh milk market, including supermarket and route trade milk sales, if the current extreme, near or below cost, discounting by major supermarkets continues it could result in causing;

- overall milk value chain loss is estimated at $842 million per annum,
- each value chain sector, being retailers, processors and dairy farmers, would have to absorb a loss of approximately $281 million,
- an average dairy farmer seeing a reduction of 12.4 cents per litre or for an average farm with a production of 1 million litres a loss of $124,000, which for the majority of dairy farmers at this size would render them unviable.

The current further devaluation of fresh drinking milk will affect all sectors of the dairy industry including farmers, transport operators, service and supply businesses, processors, vendors, distributors etc and will lead to the loss of jobs throughout the supply chain.

In the interests of maintaining the sustainability of the domestic fresh drinking milk supply chain and all Australian consumers this situation needs to be addressed as a matter of urgency.

Recommendations

Major Supermarket Predatory Pricing

Coles' major competitor and other retailers have publically stated that the current discounting of fresh milk to $1 per litre is unsustainable. As such the question is asked why would a major retailer price fresh drinking milk at an unsustainable price?

It is evident from recent Senate Inquiry hearings and from other submissions presented to the Senate Inquiry that for the current discounting of milk to $1 per litre not to be a 'loss leader' defies logic, especially when taking into account the cost of distribution, refrigerated storage and retail in regional areas.

We also believe that from the recent actions of Coles and from evidence presented to the Senate Inquiry that there is a prima facie case of predatory pricing under section 46, including 46 (1AA), of the Competition and Consumer Act 2010, which the ACCC should be investigating as matter of urgency.

Market research comparing retail milk prices for southern Queensland compared to other states including New South Wales and Victoria presents that retail milk prices for Southern Queensland are on average less than that of New South Wales and Victoria, (refer to page 23 of the QDO submission to the Senate Inquiry, Sub. No. 94).

In contrast to this, prices paid to dairy farmers by milk processors in Southern Queensland are higher than that paid to dairy farmers in New South Wales and even more so in Victoria. Dairy Australia data presents that for the 2009/2010 financial year Victorian dairy farmers were paid 33.9 cents per litre and in NSW 48.7 cents per litre and Queensland 55.8 cents per litre. The difference between farm gate prices between the three states relates to different market mixes and production costs.

In Queensland, the dairy industry supplies the majority of milk consumed by the Queensland domestic market and to meet the market requirements, this milk needs to be produced every day of the year. The Queensland environment poses higher production costs for milk compared to Victoria where the majority of milk is processed for export products and produced seasonally with seasonal on farm fodder production and thus lower production costs. The higher cost of production in Queensland is due to the requirement for dairy farmers to supply of milk every day of the year, requiring the purchase of additional fodder, when on farm fodder production is not sufficient, and more intensive management systems, as well as constraints associated with tropical environments.

Within the dairy industry's domestic supply chain, milk processors compete in a national fresh milk retail market, whereas major supermarket chains now operate uniform pricing policies nationally. These policies do not take account of differential costs to producers and suppliers or different transport and storage costs to deliver products to more isolated markets from where the product is processed.

As such in the Queensland domestic market the cost of milk to processors is higher than NSW and Victoria, yet retailers such as Coles etc are applying a national discounted price of $1 per litre. When this is combined with evidence about margins presented by a Coles' representative to the Senate Economic References Committee's inquiry into the Australian dairy industry in February 2010, we believe there is a prima facie case of breaching the Competition and Consumer Act 2010. We believe this case is in relation to selling milk as a 'loss leader' in a predatory manner to gain market share from competitors.

From the market share figures presented on page 10 of QDO submission to the Senate Inquiry it is not difficult to conclude that the major objective of the Coles cutthroat discounting, in addition to using milk as a overall marketing agent to lure more costumers, is to target the next major market share growth opportunity being the reduced fat milk category

Coles has discounted the Coles brand reduced fat milk category by up to 33 percent to $1 per litre as that is the next main target for market share from processor proprietary brands. Over the last decade the major supermarkets have increased their market share of supermarket sales of milk of their own supermarket store brand for whole milk from 31 to 71 percent at the expense of processor proprietary brands, as well as growing their share of the route trade. This is similar to the market share penetration by supermarket store brands in the United Kingdom.

However the supermarkets' share of the reduced fat category of milk at the end of 2009/10 was still less then 50 percent of all supermarket sales of reduced fat milk. As such it is not difficult to conclude that Coles sees this as the next best market share growth target yield per promotional dollar spent. By targeting this category with near or below cost discounting over time could render some processor reduced fat propriety brands unviable, thus resulting in less choice for consumers.

It is our belief that Coles' actions have the specific purpose and likely effect of damaging their competitors, such as other major retailers, corner stores, independent petrol stations and other small retailers of milk, and over time will lead to substantially less competition in the market place.

This impact will also flow through to affect dairy farmers, service businesses, transport operators, processors, distributors and vendors and threaten the jobs of employees throughout the whole industry.

Furthermore, we believe this action by Coles impacts the viability of processor owned branded dairy products and thus will lead to the loss of consumer choice and competition, as has been the experience in other countries where these marketing tactics have been applied.

In addition, for local markets in a number of rural communities where a major retailer is the only major retailer of grocery products for the community and is the 'defined market' such discounting practices as currently practised by Coles would be anti-competitive as it is resulting in the undermining of competition within the store by undercutting proprietary brands yet consumers are left with no other option within the 'defined market' to purchase their groceries.

Recommendation: That the relevant Federal Minister to give a direction to the ACCC to undertake an immediate investigation of Coles for a potential breach of section 46, of the Competition and Consumer Act 2010 in relation to predatory pricing.

Use of Loss Leaders

Given the high concentration of the retail and processing sectors and that following Coles discounting their store brand milk to $1 per litre on the 26th January 2011, Woolworths dropped their price of Woolworths brand milk to match the price and other stores followed suit with some such as Aldi, cutting the price even further to $1.99 for 2 litres and $2.89 for 3 litres (96.33 cents per litre), the ACCC should investigate potential breaches of the Act and undertake an ongoing monitoring of the sector.

Recommendation: That the relevant Federal Minister to give a direction to the ACCC to;

3. investigate the pricing of all major retailers for potential breaches of the Competition and Consumer Act 2010 in relation to the sale of 'loss leaders' and;
4. undertake ongoing price, cost and marketing surveillance of the fresh milk supply chain.

Misleading and Deceptive Conduct

Coles and Wesfarmers executives have publically stated that farm gate prices for dairy farmers have increased in the last year. However milk prices to many farmers have actually fallen by approximately 12 – 18 percent in Queensland and 10 percent in NSW and Victoria in the last 12 months, which includes the Tier One price dairy farmers are paid by National Foods that supply the milk for Coles supermarket branded milk.

In addition dairy farmers who have their farm gate price linked directly to processor branded sales have seen their milk cheque drop in early March as a result of the Coles cut throat discount campaign increasing the market share of the Coles branded milk at the expense of market share of other brands, including processor brands. This impact on these farmers will continue to increase over the coming months as Coles and other supermarkets milk brands gain an increasing share of the milk sales and the share of proprietary milk branded sales declines.

Wesfarmers executive Richard Goyder has publically stated that the sales of the Coles brand milk has increased by some 15 to 20 percent since the products were discounted by some 33 percent on Australia Day 26th January 2011.

For Coles to publically promote that *"Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased."* (Coles media release 26th January 2011 and various public statements), is tantamount to deceptive and misleading advertising, in that it is seeking to promote to consumers that if they buy Coles branded milk at this dramatically discounted prices it will not have a negative impact on dairy farmers.

In addition there seems to be inconsistencies in the presentations of Coles print advertising compared to the Coles promotional press release of the 26th January, which may also be tantamount to misleading consumers and such should be investigated by the ACCC.

Further more, while Coles is saying in their submission that they 'just' reduced the Coles brand milk by 4.3% or 4.5 cents per litre, which is a reference to Coles reducing the price of its Coles supermarket brand from $2.09 to $2.00 for two litres, the full truth is that Coles stopped one line of Coles brand 'Smart Buy' effectively reducing the price of those sales from $2.47 to $2 per two litres or by 19% and reducing Coles litre milk from $2.99 to $2.00 for two litres or by 33%.

Coles promoted in its Press Release dated the 26th January 2011 stating that, "The price of Coles Brand fresh milk is being cut by as much as 33% from today……"

"Significantly the price cut also includes Coles Brand reduced fat milk which will be cut to the same low price of $2 for a two litre bottle, bringing it into line with full cream milk so customers will no longer have to pay a price premium for a lower fat milk option.

"By offering the same low price on Coles Brand reduced fat milk we are also enabling more customers to switch to the lower fat option at a price they can afford which is clearly a significant health benefit." (We note that Coles has not made the same health claim with the discounting of alcohol, in relation to the converse health effects that would come from increased alcohol consumption vis-a-vis cheaper prices)

Recommendation: That the relevant Federal Minister to give a direction to the ACCC to investigate Coles' advertising of their discounted store brand milk for potential breaches of the Competition and Consumer Act 2010 in relation to false, deceptive and or misleading conduct.

Strengthening the Competition and Consumer Act 2010

Given the ongoing and worsening situation for the Australian domestic fresh drinking milk industry over the last eleven years, which has been amplified by the further discounting and devaluation of fresh milk by Coles, it is seen that the only long term solution to dealing with issues raised is to make further amendments to strengthen the Competition and Consumer Act 2010 (hereafter 'the Act') to ensure such abuse of market power is outlawed once and for all.

Misuse of Market Power (section 46 of the Act)

Section 46 of the Act is designed to prevent corporations with a substantial degree of market power from taking advantage of that power for the purposes of eliminating or substantially damaging a competitor, thereby preventing the entry of a person into that or any other market or deterring or preventing a person from engaging in competitive conduct in that or any other market.

Predatory Pricing (subsection 46 (1AA) of the Act)

Subsection 46(1AA) of the Act is designed to prohibit businesses with a substantial market share (having regard to the number and size of its competitors in the market) from selling goods or services for a sustained period at a price below their relevant cost of supply, for an anti-competitive purpose.

Coles' current tactics in using its supermarket store brand milk as a near or below cost advertising agent, is designed to achieve a number of goals including:

1. seeking to promote a perception to consumers that Coles is a cheaper grocery provider then their competitors;

2. luring more consumers into their stores on a more regular basis, away from other retailers, in particular to take market share away from its main large retail competitor Woolworths. It should be noted that Woolworths has stated publicly that the milk price cuts are unsustainable.
3. increasing the sales and market share of Coles' store brand milk at the expense of the market share of other brands, particularly in the reduced fat milk category;
4. increasing the size and purchasing power of Coles' store brand milk tenders, as well as other dairy product tenders; and
5. to gain greater market share in the 'route trade' by taking business away from its smaller retailers such as corner stores and vendors, which could see many smaller operators become unviable.

As Coles' sales of its supermarket store brand milk increases, as a result of it's near or below cost 'loss leading' discounting, the following impacts are occurring;

- Devaluation of fresh drinking milk across the nation as other major retailers have reduced their retail prices as well, which is resulting in lower returns to the fresh milk supply chain;
- Processors financial returns are impacted due to the loss of market share of their own proprietary brands, which have sustainable margins compared to the unsustainable supermarket brand milk contracts. This will inevitably mean that further downward pressure will be place on farm gate prices when processors seek to renew contracts with dairy farmers;
- Dairy farmers which have farm gate price contracts that are linked with processor proprietary brand sales have already seen a drop in their milk cheques as processors proprietary branded milk lose market share to supermarket store branded milk;
- Smaller retailers are placed at a significant competitive disadvantage because of the higher wholesale prices they pay for branded milk;
- Milk vendors are placed at a significant competitive disadvantage as their regular customers, for example coffee shops, move to purchase milk at a lower price from supermarkets rather then from the vendor;
- The combined impact of lower returns to the fresh milk supply chain will have resulting impacts on investment and employment throughout the supply chain.

It is the contention that Coles is selling their supermarket store brand milk below their relevant cost of supply through to the supermarket 'check out', for an anti-competitive purpose through both misuse of market power and predatory pricing as outlined above, and in particular in the case of regional and remote areas of Australia.

In addition the QDO believes there is a prima facie case of price discrimination from supermarket store brands against processor proprietary brands, where the supermarket has specifically sought to target their supermarket store brand discounting against comparable processor proprietary brands.

The long term risk of continuing to allow major supermarkets to continue to use their market power to take control of more market share, as has been the experience in the United Kingdom, that once such an environment is allowed to result, particularly at the retail level where supermarket store brands dominate the market, it will result in;

- Devaluation of fresh milk as supermarkets use it as a loss leader marketing agent,
- Unsustainable returns to the supply chain,
- Less competition, choice and higher prices for consumers,
- Little or no investment in product innovation,
- Divestment from the supply chain, threatening supply security.

It is the contention that;

- Coles is currently selling their supermarket store brand milk below their relevant cost of supply and retail;
- The practice is anti-competitive, discriminatory and predatory in nature through the misuse of market power and pricing;
- The history of the removal of the anti-discrimination clause Section 49 in 1974 from the then Trade Practices Act, should not be forgotten;
- That subsection 46 of the Act was supposedly designed to do the task that section 49 was originally designed for, however in practice this has not been the case and as such anti-competitive behaviour continues to occur;
- That the Act needs to be strengthened to stop the current anti-competitive price discriminatory behaviour;
- Australia has been presented as having the 'weakest competition laws' of any OEDC country;
- That anti-price discrimination is prohibited in every OECD country except New Zealand, where New Zealand has more comprehensive provisions for the prohibition of the misuse market power;
- If the current situation of the growing market power of the supermarket duopoly is not addressed then the current imbalance in market power and function will increase to a point where significant damage to the supply chain will result and inevitably consumers will be left worse off;
- Even though there is prima facie evidence of anti-competitive price discrimination, the ACCC has not yet been seen to take action. As such the inclusion of more effective anti-competitive price discrimination legalisation to provide the necessary means for the ACCC to take action to stop and prevent further cases of anti-competitive price discrimination;
- The reintroduction of an anti-price discrimination clause into the Act is absolutely warranted and should be a foundation recommendation from the current Senate inquiry;
- That the Australian Government and the ACCC has not, in recent years, taken enough consideration of longer term issues and consequences of decisions and or inaction. As highlighted by the current 'milk price war' there is a critical need to not only assess the immediate impacts on the market and supply chain but also the potential future impacts and consequences, particularly in the case of the misuse of market power which can be disguised as creating competition in the short term. The former Section 49 included an 'effects' test to test if the conduct in question has the effect or the likely effect of bringing about a substantial lessening of competition. The reintroduction of an 'effects test' into the Act, for both competition and sustainability, would assist the ACCC in assess longer term potential consequences of issues requiring consideration.

Associate Professor Frank Zumbo, of the School of Business Law and Taxation at the University of New South Wales, in his submission to the Senate Economics References Committee Inquiry into the impacts of supermarket price decisions on the dairy industry outlined several practical international precedents that deal with anti-competitive price discrimination. These included the United States *Robinson-Patman Act of 1936* and the *United Kingdom Competition Act 1998 (section 18)*. The following recommendations to amend the Act are aimed at more effectively prohibiting predatory pricing, which is something that the current legislation has failed to demonstrate in action.

Recommendation: That the Senate Inquiry and the Government examine the United Kingdom Competition Act 1998 (section 18) with a view to implementing similar legislative provisions to strengthen the anti-competitive price discrimination provisions of the Act, in particular:

- Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom;
- Conduct may, in particular, constitute such an abuse if it consists of:
  - Directly or indirectly imposing unfair purchase or selling prices of other unfair trading conditions;
  - Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.
- That an ‘effects test’ for both competition and sustainability be reinstated within the Act.

Unconscionable Conduct (section 51 of the Act)

Unconscionable conduct is unfair or unreasonable conduct in business transactions that goes against good conscience. This can occur in transactions between businesses or in transactions between businesses and consumers.

The exact meaning of ‘unconscionable conduct’ is not defined in the Act. The Act lists several factors that the court considers when deciding if a party has acted unconscionably. However, the court is able to consider any other matters it believes are relevant.

Associate Professor Frank Zumbo in his submission to the Senate Inquiry recommends inserting a definition of the word ‘unconscionable’ into Section 51AC of the Act. Section 51AC of the Act was introduced in 1998 to address the problem of small businesses facing power imbalances while dealing with larger commercial entities.

He believes this would be an ‘obvious way to provide clear statutory guidance as to what is meant by the term as used in Section 51’ and ‘would send a clear parliamentary signal to the Courts that the concept is not only broader than the equitable concept, but that s51AC is intended to promote ethical business conduct.’

Associate Professor Frank Zumbo believes the courts are currently defining the term and ‘are taking such an onerous view of what constitutes ‘unconscionable’ that there is a growing danger that s51AC will fall into disuse.’

It is contended that Coles’ recent actions are unconscionable. This is particularly highlighted when Coles’ promotional and advertising material is compared with impacts on the fresh drinking milk supply chain and other retailers, which are already occurring.

Recommendation: That the above definition or a similar definition with the same intent is inserted into the Act. A draft definition of unconscionable conduct is provided by Professor Zumbo in his submission and reads as follows: *‘For the purposes of this section ‘unconscionable conduct’ includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.’*

Enacting a Statutory Duty of Good Faith

It is contended that Coles has not conducted its recent supermarket store brand milk discounting in good faith with either consumers or dairy farmers – even though Coles does not have direct contract relationship with dairy farmers.

There are several reasons for this contention including that:

- Coles has repeatedly presented misleading information in the media to present the perception to consumers that farmers are doing better financially than is the reality and that the Coles discounting will not harm dairy farmers. These misleading statements have included but are not limited to;
  - That farm gate prices went up last year, when the fact it that milk prices to farmers have dropped by some 10 percent in NSW and Victoria and more then 15 percent in Queensland in the last 12 months, which includes farmers that supply milk which goes into the Coles supermarket branded milk bottles, and
  - That their discount will not affect farm gate prices, when the fact is a significant number of Queensland dairy farmers which have their farm gate price linked directly to processor branded sales have seen their milk cheque drop already in March as a result of the Coles cut throat discount campaign increasing the market share of the Coles branded milk at the expense of market share of other brands, including processor brands.
- Coles has refused to acknowledge the almost immediate impact of its actions on a significant number of dairy farmers in Queensland;
- Coles has repeatedly refused to rule out dropping prices for processors and farmers in future contracts; and
- Coles' strategy will ultimately lead to a fundamentally unsustainable devaluation of drinking milk across the whole domestic market.

It is contended that 'acting on good in faith' does not equate to situations where a dominant player in the retail market undertakes a near or below cost 'loss leader' discount marketing strategy and presents that it is about competition and presenting better outcomes for consumers and at the same time presenting that it is not having an affect on the supply chain, when in fact it is.

Associate Professor Frank Zumbo in his submission to the Senate Inquiry highlights the fact that Courts are giving growing attention and support to an implied duty of good faith in commercial contracts.

Associate Professor Zumbo states that, 'Clearly the concept of good faith has not only received strong judicial support, but now has reached the point in Australia where its nature and scope is being defined with an increasing degree of precision. Consequently, there is a ready body of law on which a statutory duty of good faith could quite readily and usefully draw upon in seeking to promote ethical business conduct.'

Recommendation: That a statutory duty of good faith be enacted as part of the Act to provide an appropriate and accepted benchmark of standards of ethical conduct.

Limitation of Supermarket Brand Market Share and Power

The current supermarket duopoly in Australia currently controls the majority of the grocery market.

These major supermarkets are able to use supermarket 'store brand' milk as a near or below cost discount price 'marketing agent' in a manner which is devaluing milk nationally and undermining the sustainability of the Australian domestic dairy industry supply chain.

Major supermarket chains, with their own 'store brand' are no longer just retailers, they are manufacturers and brand owners as well, with significant overall grocery sale and brand market share.

In 2009/2010 the total amount of milk sold through major supermarket chains accounted for 1.16 billion litres or 51% of total domestic milk sales.

It is estimated that when the major supermarket share of national milk sales through the supermarket channel is added to supermarket share of the 'route trade' for example sales through fuel stations, supermarkets now account for some 65% of all milk sales nationally.

Over the last decade major supermarkets have more than doubled their supermarket milk brand market share through using a range of discount and marketing tactics, however primarily as a near or below cost discount price 'marketing agent'.

The major supermarket chains now provide the largest retail avenue to consumers in Australia for grocery sales, in addition to supermarket 'store brand' tenders now accounting for more then 25% of the national fresh drinking milk market.

Major supermarket discounting of milk from the 26th January 2011 has already seen sales growth of 'supermarket brand' milk of between 15 and 20 percent, as publically reported by Coles owner Wesfarmers.

In 2000/01 the difference in price between proprietary 'branded' milk products and major supermarket chain 'supermarket brand' label products in 1999/2000 was, on average, $0.18 per litre and for whole milk the difference in price was, on average, $0.07 per litre. However in 2009/10 (p) the difference in price between proprietary 'branded' milk products and major supermarket chain 'store brand' products in 2009/10 (p) was, on average, $0.71 per litre and for whole milk the difference in price was also, on average, $0.71 per litre (data source Dairy Australia, Australia Dairy Industry In Focus reports).

If the major supermarkets continue to discount milk to $1 per litre then the price difference will increase, on average, to over $0.87, assuming no other price changes occur in milk processor proprietary 'branded' products.

In 1999/2000 the 'supermarket brand' label price for regular whole milk was, on average, $1.26 per litre, and supermarket market share of whole milk sales through supermarkets was 31 percent and processor brands 69 percent. By 2009/2010(p) the 'supermarket brand' label price for regular whole milk had dropped to, on average, $1.12 per litre or 11% and supermarket market share of whole milk sales through supermarkets increased to 71 percent and processor brands declined to 29 percent.

In contrast the price of proprietary 'branded' price whole milk has increased from, on average, $1.33 per litre in 1999/2000 to, on average, $1.83 per litre in 2009/2010(p) was up 38% compared to inflation rising approximately 36% during the same period.

When this value difference of milk sales is equated across the market share of major supermarket chain ‘supermarket brand’ sales for 2009/10 (p) compared to the value of proprietary brand sales through supermarkets the difference is $414 million nationally. In 1999/2000 the value difference amounted to some $44.5 million.

This is the amount the large retailers have taken out of the supply chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry supply chain.

As presented previously, it is expected that if the current milk discount battles continue between major supermarkets the unsustainable reduction in supermarket ‘store brand’ price will have further flow on impacts including;

- further devaluation of all supermarket ‘store brand’ milk sales as major supermarkets compete with one another to protect market share and continue to use ‘store brand’ milk as a near or below cost ‘loss leader’ advertising agent;
- further devaluation and reductions in margins of processor proprietary brands of milk as processors either resort to discounting and or increasing advertising to try and mitigate market share losses across both supermarket and route trade market channels;
- reductions in the retail price of and margins from both processor proprietary and supermarket ‘store brand’ products will inevitably flow through to wholesale prices and processor profitability;
- increasing pressure on the viability of smaller retailers and the route trade operatives such as vendors;
- increasing downward pressure on farm gate prices and supply conditions;
- lower returns for the fresh milk resulting in impacts on investment and employment throughout the supply chain;
- divestment from the supply chain, threatening supply security in many regions;
- little or no investment in product innovation, less competition, choice and inevitably higher prices for consumers.

As major supermarket store brand sales increase, they obtain more market power to be able to dictate the price and supply conditions at which suppliers sell to them. The supermarkets also then get to dominate shelf space and as a result the choice to customers declines. This vicious cycle will in the long-term result in supermarket store brand domination of the market, less or no customer choice, little or no product innovation and worst of all for consumers, increases in the price, as has been the experience in the United Kingdom.

As presented in the QDO’s submission to the Senate Inquiry, (refer to page 11 of QDO submission), across the whole domestic fresh milk market, including supermarket and route trade milk sales, if the current extreme, near or below cost, discounting by major supermarkets continues it could result in causing;

- overall milk value chain loss is estimated at $842 million per annum,
- each value chain sector, being retailers, processors and dairy farmers, would have to absorb a loss of approximately $281 million,
- an average dairy farmer seeing a reduction of 12.4 cents per litre or for an average farm with a production of 1 million litres a loss of $124,000, which for the majority of dairy farmers at this size would render them unviable.

As a comparison in the United Kingdom major supermarkets have virtually taken over milk retailing with their own supermarket store brands and as a result independent proprietary brands are now a rarity. A 2008 study by Oxford University estimated the big four accounted for 70% of the milk market in the UK.

In the United Kingdom processors have struggled to develop viable differentiated brands in this market. The effect of this supermarket 'store brand' dominance has been to stifle innovation, as evidenced by the lack of product differentiation in the UK milk market. The Oxford Study noted the shift in dominance in the dairy industry supply chain from processors to retailers, with only a small percentage of the supply chain profits attainable for farmers and processors.

A 2010 study by DairyCo on dairy supply chain margins noted the absence of any decline in retail prices for milk at a time of falling commodity and farmgate prices, concluding that processors and farmers absorbed the full impact of the decline in the dairy market.

Comparing 2009/10 with 1999/2000 indicated the retail price of milk increased 60% compared to a general food price increase of 36%. Over the same period the average farmgate price increased 34% and the estimated wholesale price increased 31%.

Recommendation: That the Australian Government commission an independent study of the economic impact of supermarket 'store brand' milk, procurement, marketing and pricing practices on;

- the sustainability of the fresh drinking milk supply chain,
- pricing, demand and competition between 'store' and proprietary milk brands in the fresh milk market,
- implications for consumer choice and cost in the longer term,
- implications for investment in product innovation, and

whether placing limits of market shares of supermarket 'store brands' would derive long term benefits for consumers and the sustainability of the dairy industry fresh drinking milk supply chain.

Code of Conduct for the Australian Fresh Drinking Milk Industry

Since the deregulation of the domestic fresh drinking milk price in the year 2000, major supermarkets have utilised their market position and power to their advantage resulting in;

- major supermarkets doubling their market share of discounted supermarket 'store brand' milk at prices equivalent to the early 1990s and also increasing their market share of overall domestic milk sales to significant levels;
- major decline in supply chain earnings from fresh milk sales as major supermarkets have increased their market share of discounted supermarket 'store brand' milk;
- major rationalisation of industry assets;
- significant decline in farm numbers;
- decline in milk production, especially in regions producing milk primarily for the domestic market.

The above situation has led to the progressive devaluation of the fresh drinking milk nationally and market failure within the Australian domestic fresh drinking milk market.

The current example of this market failure is clearly evident in southern Queensland where there is a shortage of milk, due to the impacts of natural disasters and in order to service market needs milk is being transport long distances at much higher costs. However at the same time major supermarkets have reduced the price of their store brand milk, with supermarket using their store brand milk as a discount marketing agent. As the supermarkets are using milk to serve as a discount marketing agent for pursuing the growth in overall supermarket grocery sales, the value of drinking milk is being continually sacrificed for another purpose which does not reflect the true cost and market value of fresh drinking milk.

The latest discounting of drinking milk by major retailers is seen as unsustainable by both industry operatives and some of the major retailers.
Over the last decade the major supermarket chains have procured significant market share and with that, market power.

This market power combined with the lack of transparency through the domestic dairy industry supply chain has created significant problems for the dairy farming sector which has been amplified by the latest discounting campaign instigated by Coles.

As previously presented processors are in ‘catch 22’ position with major supermarkets chains as they are the largest sales avenue to consumers for the sale of their own proprietary branded products, whilst also the supermarket ‘store brand’ milk tenders are now a major component of the overall domestic drinking milk market.

Between the sectors of the supply chain, being from farm to processor and then to retailer, there are major difficulties with the timing, time period of and complexity of supply contracting arrangements.

At the farm sector, dairy farmers currently carry the highest investment and risk and lowest returns in the supply chain per litre of milk and as such require higher returns and longer term contracts to be able to successfully manage the every increasing cost base and risk of farming.

However at the retail sector, major supermarkets offer one to two year contract to processors of different geographic sizes.

Dairy farming organisations accept that dairy farmers can not be expected to be paid a higher price for milk in excess of the drinking milk market demand. However, in the current environment a large number of dairy farmers are being paid some 10 % less than the regulated price of drinking milk back in 1999/2000 of 54.9 cents per litre, while over that period of time the costs of milk production has risen significantly.

With the current situation Coles has sought;

- to target blame at the processing sector for having excessive margins, which the processors have denied,
- blame processors for not paying enough to farmers,
- to deny having any impacts on returns to farmers, even though through their discounting the major supermarkets have devalued the whole fresh milk category nationally which is already seeing lower returns to the supply chain, including dairy farmers,
- to use misleading information to seek to create the perception that Coles discounting is not to blame for impacts on the supply chain.

While for dairy farmers, Collective Bargaining provisions have been made available under the Act, dairy farmers do not currently have the ability to directly address the issues created by the major supermarket chains in sacrificing the value of fresh drinking milk to use it as an advertising and sales leverage agent for other grocery product sales and growing market share.

To address this unsustainable situation, dairy farmers must have the ability enact a process to address any negative behaviour of retailers and or processors.

The current environment within the domestic dairy supply chain needs to be modified to;

- prevent the misuse of market power,
- provide greater transparency through the supply chain,
- provide dairy farmers with more effective collective bargaining provisions which allows dairy farmers to form collective groups to more closely align the market power of processors and retailers,
- provide dairy farmer collective bargaining groups with improved legal resources and training to strengthen their bargaining position in relation to processors and retailers;
- to ensure that supermarket brand milk tendering and contracts and proprietary brand supply arrangements do not undermine margins in a way that affects the sustainability and viability of the dairy industry supply chain,
- provide a more effective means of resolving disputes in a timely and cost effective manner,

The QDO believes that a dairy industry Code of Conduct could provide some distinct benefits for the industry and dairy farmers if it covered the entire value chain including dairy farmers, processors and retailers.

Benefits should include;

- provision of greater transparency through the industry supply chain;
- providing a better understanding amongst all industry value chain sectors of the issues and needs of each sector;
- providing much clearer information for dairy farmers to be able to make more informed business decisions;
- discouraging unconscionable and anti-competitive conduct;
- providing a timely and cost effective dispute resolution process, including both mediation and arbitration options;
- protection of the sustainability of the industry supply chain, whilst not hindering competition.

In relation to the issue of the need to ensure that undesirable practices do not undermine margins in a way that affects the sustainability and viability of the dairy industry supply chain, a supply chain sustainability index could be developed as a reference for the application of a sustainability test.

Over the last two years the Northern Dairy Industry has developed a Sustainable Milk Production Model to assess the requirements for sustainable dairy farming in the Northern Industry region covering Northern NSW and Queensland and to provide a long term planning and decision support tool for dairy farmers and industry stakeholders. This project is now being expanded as a national project.

There is the option to transform this model it into a regionally relevant sustainability index model which could provide accurate guidance on the key sustainability factors for milk production in key production regions for the domestic fresh milk market. Such an index system would help processors and retailers in their consideration of milk supply contracts, pricing and supply conditions, to assist in avoiding making decisions that would undermine the sustainability of milk production for the domestic fresh milk market. An independent body, acceptable to the supply chain stakeholders, could be appointed to maintain a regionally relevant fresh drinking milk supply sustainability index from which the sustainability test would be based.

The QDO believes that a similar approach to the sustainable return type model utilised in the United Kingdom has relevance if attached to a mandatory Whole of Supply Chain, Code of Conduct under the Competition and Consumer Act, with a Commissioner which has the authority to apply a Sustainability Test and direct mediation and or apply arbitration to proposed contracts at any point in the supply chain, whether it be between Collective Bargaining Groups of dairy farmers and processors, or between processors and retailers.

In regard to the Produce and Grocery Industry Code (PAGIC) and the Produce and Grocery Ombudsman, dairy farmers cannot take action through the Ombudsman directly with retailers as they do not contract directly with them but rather with processors.

In regard to the Horticultural Code of Conduct it does not directly relate to the issues being faced by the domestic dairy industry, but has a number of elements which should be considered including;

- setting general terms and conditions of trade,
- minimum contractual standards,
- provision of a dispute resolution mechanism,

In addition further investigation needs to be undertaken of the potential initiatives which have been introduced by the United Kingdom by the Competition Commission including the Grocery Supply Code of Practice.

Recommendation: That a mandatory Australian Drinking Milk Code of Conduct be developed, under the Act, in consultation with industry, dealing with the relationship between dairy farmers, processors, distributors/vendors and retailers. That the Code have a Commissioner appointed with a head of power including the authority to apply a Sustainability Test and direct mediation and or apply arbitration to proposed contracts at any point in the supply chain, whether it be between Collective Bargaining Groups of dairy farmers and processors, processors and retailers.

In addition the QDO supports the recommendations from Associate Professor Frank Zumbo that;

- civil monetary penalties for breaches of mandatory industry codes of conduct be imposed under the *Competition and Consumer Act*, and
- that the Australian Consumer Law framework dealing with unfair contract terms be extended to cover business to business agreements involving small businesses and farmers.

Code of Conduct Ombudsman / Commissioner

The QDO believes that for the proposed mandatory whole of supply chain Australian Drinking Milk Code of Conduct to be effective an Ombudsman or Commissioner with specific heads of power would need to head and oversee the operation of the Code and have a charter of improving the functionality and sustainability of the dairy industry supply chain for fresh drinking milk in Australia.

Any Ombudsman / Commissioner, be it a dairy specific role or an expanded Produce and Grocery role must be able to investigate complaints from across the whole of supply chain, from farm to retail.

The need for a whole of value chain Code of Conduct is highlighted by the current situation with Coles' implementing near or below cost 'loss leader' discount milk prices for their supermarket store brand milk leading to the devaluation of drinking milk nationally and the undermining of the sustainability of the fresh drinking milk supply chain.

Over the last decade major supermarket chains, especially the two major supermarket duopoly, in Australian have significantly increased their market share and power, which is a situation that has been allowed to develop by Government and the ACCC. As this has occurred, the processing sector been left with less market power and options and avenues to sell fresh milk and other dairy products to consumers.

With this development, major supermarkets chains have used their purchasing power to place considerable pressure on suppliers, especially for the supply of supermarket branded products. This increasing pressure on suppliers has over time led to downward price pressure on the supply chain and which inevitably flow through to lower returns to dairy farmers at the bottom of the supply chain.

Processors are understandably cautious about pushing back on large retailer pressure in relation to 'store brand' tenders as the major supermarket chains now provide the largest retail avenue to consumers in Australia for processor proprietary branded product sales, in addition to supermarket 'store brand' tenders now accounting for more then 25% of all fresh milk sales nationally. In addition the major supermarkets are also growing their 'store brand' market share and control across a range of other dairy products and food staples.

The discounting of milk by Coles and as followed by other retailers will inevitably force down farm gate prices for milk, which has been confirmed by public statements from Woolworths and other retailers stating that the reduction in price is unsustainable.

While for dairy farmers, Collective Bargaining provisions have been made available under the Act, dairy farmers do not currently have the ability to directly address the issues created by the major supermarket chains in sacrificing the value of fresh drinking milk, to use it at as an advertising and sales leverage agent for other grocery product sales.

To address this unsustainable situation, dairy farmers must have the ability enact a process to address the behaviour of retailers and equally processors.

The Ombudsman / Commissioner must be empowered to vet proposed contracts at any point in the supply chain, to apply a sustainability test and to direct mediation and or apply arbitration.

The Ombudsman / Commissioner must also be empowered to direct parties in dispute to behave in a way that promotes ethical business conduct.

It is noted that the consumer organisation Choice has recommended the establishment of an Australian Supermarket Ombudsman ‘to tackle competition and fairness across the grocery sector.’ Choice explains that the Supermarket Ombudsman would be dedicated to the task of promoting and protecting competition in the supermarket industry through the better enforcement of existing legislation. They advise that the UK Government is currently implementing a ‘Groceries Code Adjudicator’ under its Office of Fair Trading.

Associate Professor Frank Zumbo in his submission to the Senate Inquiry recommends “the establishment of a new Federal Government agency to be called the Australian Small Business and Farming Commissioner would ensure that there was a suitably qualified and independent person with specific responsibility for;

1. researching and identifying existing and emerging areas of disputation with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and
2. assisting industry participants to resolve disputes.”

Associate Professor Frank Zumbo further stated that, “While the ACCC should be concerned with identifying and prosecuting breaches of the *Competition and Consumer Act*, there will clearly be instances where the viability of industry participants is the central issue and resolution of that issue needs a business assessment by an independent party such as the proposed Commissioner rather than a legal assessment by the ACCC.”

Recommendation: That an Ombudsman / Commissioner and or a Supermarket Ombudsman be appointed, with appropriate heads of power, to head the Australian Drinking Milk Code of Conduct.

Whole of Industry Forum ACCC Authorisation

It is presented that in order to effectively identify, develop, test and implement solutions to the current problems facing the domestic fresh milk market supply chain, the collective involvement of all major participants in the supply chain from production through to retail would be required.

In order for this to occur within the current boundaries of the Act we believe an Australian Government and or ACCC authorisation would be required.

The goal of the discussions would be to improve the sustainability of supply chain through an open dialogue with industry stakeholders about the true costs, margins and sustainability of production, processing, distribution and retailing through the supply chain and business practices within the industry, with the aim of addressing and improving the current unsustainable situation.

The terms of reference for such a forum could include:

- Examining the dairy industry supply chain from farmgate to retail outlet (including major retailers, route trade and small retailers of milk);
- Analysing the different markets, risks and returns across Australia, with a particular emphasis on regions where drinking milk production is the dominant section of the industry such as in Queensland, Western Australia, Northern New South Wales and then to a lesser extent South Australia and Victoria;
- Reviewing past farmgate, processor and retail prices and compare them to the current price of drinking milk including both processor proprietary and supermarket store brands; and

- Providing data and recommendations to the ACCC, Senate Economics References Committee, the Minister for Agriculture, Fisheries and Forestry and the Treasurer for actions to ensure a sustainable industry for all.

The QDO believes that the proposed Code of Conduct, Ombudsman / Commissioner and the whole of industry forum need to be directly linked to the National Food policy and planning process.

Recommendation: Government to convene, and participate in, an Australian Government and or ACCC authorised forum of the dairy industry supply chain, from farmers to retailers, to constructively discuss solutions for ensuring a sustainable drinking milk market with fair and sustainable returns.

The recommendations of the 2010 Economics References Committee report, Milking it for all it's worth – competition and pricing in the Australian dairy industry and how these have progressed

In relation to the recommendations presented from the last inquiry the QDO recommends that a strategic working group is established between Government and industry to further recommendations that provide an opportunity to derive positive outcomes for the dairy industry and the Australian community and economy.

Recommendation 5: "The Committee recommends that the Productivity Commission reviews and evaluates the effectiveness of the national competition policy and publish its report by 30 April 2011."

The QDO supports this recommendation as there is circumstantial evidence that the objectives of the policy are not being met as retailers are using their significant market share to undermine competition in the market place, thereby lessening competition in the long run, which as experienced in some other countries such as the United Kingdom, has led to the loss of choice and higher prices for consumers.

Recommendation 3: "The Committee recommends that the Government requests the Australian Competition and Consumer Commission to use its information-gathering powers, and draw on its work for its recent report on grocery pricing, to provide more accurate estimates of the proportions of the retail price of milk that reflect (i) the costs and (ii) the profits, of farmers, processors and retailers and publish the results of that review by 30 September 2010.

The QDO supports this recommendation as there is a real need for greater transparency through the supply chain of the dairy industry, particularly at the processor and retail sectors of the supply chain.

Recommendation 2: The Committee recommends that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

The QDO supports this recommendation as there is a real need for greater transparency and comparability for dairy farmers with regard to contracts offered by processors.

Recommendation 12: The Committee recommends that the Government reviews the collective bargaining provisions of the Trade Practices Act with a view to strengthening that framework to create a more equitable balance of power between the negotiating parties and report by 30 April 2011.

The QDO fully supports this recommendation.

Recommendation 13: In reviewing the collective bargaining provisions the Committee requests that the Government considers the effectiveness of any existing alternative dispute resolution mechanisms and investigates:

- allowing collective bargaining groups to merge to address imbalances in bargaining power;
- the introduction of a requirement that the ACCC facilitate the timely appointment of a mediator should a party to a negotiation require such assistance; and
- the introduction of a requirement that cooling off periods be mandatory in contracts between dairy farmers and processors.

The QDO supports the recommendation and concepts of allowing Collective Bargaining Groups to merge, provision of a meditation process and a cooling off periods, however the QDO would like to further assess the specific elements of the recommendations.

Recommendation 11: The Committee recommends that the Federal Government commissions an independent report into the main impediments to the establishment of new processors owned by farmer cooperatives and how these impediments could best be overcome and requests that the report be tabled by 30 April 2011.

The QDO supports this recommendation.

Recommendation 1: The Committee recommends that the Government requests that the National Competition Tribunal reviews the effectiveness of section 46 of the Trade Practices Act in preventing price discrimination and considers reinstating anti-price discrimination provisions, particularly to protect those parties participating in industries dominated by multinational corporations.

The QDO supports the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 4: The Committee recommends that the Government requests the ACCC to undertake monitoring of the pricing practices within the dairy chain with a view to establishing whether predatory pricing or misuse of market power is occurring.

The QDO supports this recommendation.

Recommendation 6: The Committee recommends a moratorium on further takeovers and mergers in the milk processing industry until the Productivity Commission has published its report on the effectiveness of the national competition policy.

The QDO would like to gain further information on the recommendation.

Recommendation 7: The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provisions and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

The QDO supports the concept of the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 8: The Committee recommends that the ACCC conducts further study into the implications of increasing shares of the grocery market being taken by the generic products of the major supermarket chains. The Committee recommends that the terms of reference of any such inquiry include not just the current and future impact on prices paid by consumers but also the needs of Australia in terms of food security and economic and environmental sustainability, as well as the economic viability of farmers and processors. The Committee requests that the findings of these reviews be reported by 30 April 2011.

The QDO supports this recommendation. As presented in the QDO submission the marketing, advertising and pricing tactics of major supermarkets with store branded milk is a major concern for the sustainability of the dairy industry particularly in regions which principally supply the Australian domestic market, such as Queensland.

Recommendation 9: The Committee recommends the Productivity Commission considers, in its review of national competition policy, the appropriateness of separating the functions and powers of the ACCC with the effect that separate agencies are responsible for the approval of mergers and the assessment of whether concentration is subsequently excessive.

The QDO supports this recommendation. The QDO believes that the functions of the ACCC need to be reviewed given the nature of a number of recent decisions. The QDO would like to obtain further information on this recommendation to be able to provide a more informed response.

Recommendation 10: The Committee recommends that the topic of competition and pricing in the dairy industry be again referred to the Senate Economics References Committee in May 2012 to assess whether progress has been made or whether tougher and more interventionist measures need to be adopted.

The QDO supports this recommendation to ensure that appropriate transparency and issues of market power market manipulation are adequately addressed to enable the dairy industry to be sustainable into the future.

Recommendation 16: The Committee recommends that the Australia and New Zealand Food Regulation Ministerial Council acts to ensure that labelling on dairy products adequately and accurately informs consumers about the provenance, manufacturer and contents of the product.

The QDO supports labelling laws which accurately inform consumers on the provenance, manufacturer and contents of products.

Recommendation 14: The Committee recommends that the Government addresses the issues of food security and the future sustainability of the dairy industry at a federal level. The Committee suggests to the Government that this review be facilitated through the Primary Industries Ministerial Council to ensure it receives the commitment and attention required. The Committee recommends that any review include the role of the ACCC and federal, state and territory agricultural departments in ensuring Australia's food security.

The QDO agrees with this recommendation and ADF is currently participating in the Primary Industries Ministerial Council review relevant to these matters including the review of research and development investment in agricultural industries. The QDO with other industry stakeholders have supported the development of a Sustainable Milk Production Model as a decision support tool which could provide a national reference tool for dairy farm sustainability.

Recommendation 15: In the light of the Tasmanian experience the Committee recommends that where industry bodies are encouraging increased production, all agencies involved in those bodies have regard to issues of long term sustainability in the context of long term trends. They should identify the source of increased demand, adopt cautious language and indicate the degree of uncertainty around any projections.

The QDO agrees with this recommendation as increases in production should be driven by market needs and opportunities. The QDO also encourages dairy farmers to seek professional independent advice when seeking to make business decisions.

Queensland Dairyfarmers' Organisation

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Senator Alan Eggleston
Chairman
Senate Economics References Committee
Department of the Senate
PO Box 6100
Parliament House, CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

31st August 2011

Dear Senator Eggleston,

Re: Inquiry into the impacts of supermarket price decisions on the dairy industry

The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to provide to the Senate Economics References Committee with the following supplementary submission, which contains new and updated information relevant to the inquiry, for the Committee's consideration.

In particular the QDO wishes to address the statement contained in the Senate Committee's Second Interim Report, "The impacts of supermarket price decisions on the dairy industry", being,

> Page 64, section 5.52, "While the committee is mindful of the many submissions outlining the potential impacts of lower supermarket milk prices on the dairy industry, it is equally cognisant of the benefits to consumers from sustained lower prices. As a general rule, lower prices are good for consumers. Provided farmers have the opportunity to make a reasonable profit and <u>in the absence of substantiated damage to the dairy industry</u>, the interests of consumers must not be overlooked."

The following information is specifically provided to demonstrate and substantiate damage to the dairy industry which is currently being incurred. The current situation, particularly in Queensland is clear evidence of market failure. This failure is further highlighted following the recent devastating impacts of natural disasters on the Queensland dairy industry.

From the evidence presented in the following submission, it is clear that the current use of milk as a close to or below cost 'advertising agent' by major supermarkets is having a direct cumulative and detrimental impact of the domestic fresh milk dairy industry and is progressively undermining the viability and sustainability of the domestic dairy industry.

With this evidence it is clear that the current practices of supermarkets needs to be addressed to ensure the future viability and sustainability of the domestic fresh milk dairy industry, which is in the interests of all in the industry supply chain, including the major supermarkets, all levels of Government and most importantly Australian consumers.

The QDO asks of the members of the Senate Economics References Committee to carefully consider what is the medium to long term implications for dairy farmers, processors, vendors, small retailers etc and employees involved in the fresh milk industry supply chain and to choice and prices to consumers, if the current practices of major supermarkets using fresh milk as a, near or below cost, marketing agent are allowed to continue.

As such, the QDO appeals to you and your committee members to adopt our recommendations and to work with our industry to implement these recommendations as a matter of urgency.

The following submission should be read in conjunction with QDO's other submission's to the Senate Inquiry.

The QDO stands ready to provide any further information, where possible, Committee members may require and would welcome the opportunity to discuss any of the information presented.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd

Queensland Dairyfarmers' Organisation

Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Second
Supplementary Submission to the

Senate Standing Committee on Economics

Inquiry into the impacts of supermarket price decisions on the dairy industry

31ST AUGUST 2011

Contents

Introduction

The current 'milk price war' initiated by Coles supermarkets has major implications for the Australian fresh milk industry.

A range of implications and impacts face the Australian fresh milk industry from the current supermarket discounting, including:

- A higher share of sales of lower-priced, low margin supermarket store brand products, at the expense of higher margin processor proprietary brands, weakening the overall wholesale returns to processors.
- a shift in sales between convenience and food service outlets and supermarket stores, including food outlets sourcing product in supermarket stores rather than the "route trade".
- the flow-on affect of reduced processor margins to farmers in reduced farmgate prices. The impact has already been felt by Parmalat PDA suppliers, as part of their monthly milk payment is directly linked to Parmalat proprietary branded milk sales on a month to month basis.
- A lengthy milk price war will weaken the processor proprietary brand proposition in fresh white milk undermining the viability of marketing and product innovation. Returns from branded products are critical in the mix of returns to processors, which affect affordable prices for milk to dairy farmers at farmgate.
- Lower overall wholesale prices as a result of an increased share of supermarket store brand sales volumes is resulting in greater commoditization of the fresh milk sector. This will force changes in the respective roles and contributions that supermarket store brand supply contracts and branded milk products have in processors' business models.
- The impact on retail sales and wholesale returns has varied state-to-state, due to the differences in retail prices and sales mix. The impacts on supply chain returns are potentially greatest in Queensland, where retail prices of branded lines were typically lower and farmgate prices and production costs for milk typically higher for year-round supply of milk to processors, as opposed to seasonal production in southern states.

Since Coles initiated it's supermarket milk discounting campaign on the 26th January, the Queensland Dairyfarmers' Organisation Ltd (QDO) has been monitoring the impacts in the Queensland market place, to processors and to dairy farmers, in particular for dairy farmers whose milk payments are directly linked to the sales of processor branded milk.

From this monitoring process the QDO has obtained clear evidence that the current, near or below cost, discounting of supermarket store brand fresh milk and associated marketing tactics, initiated by Coles, and followed by other major supermarkets, is directly causing damage to the dairy industry, including through;

1. causing the loss of market share of proprietary brand milk sales as major supermarkets increase the market share of their own supermarket milk brands through discounting their store brands, to near or below cost, which is lowering returns to processors through;
    - processors losing sales and market share of their proprietary branded products which provide processors with sustainable margin,

- forcing processors to increase marketing and advertising expenditure to try and retain market share,
- forcing processors to discount their proprietary branded products to try and retain market share.

Consequently, these impacts on processors undermine the ability of processors to pay dairy farmers sustainable prices.

2. the loss of market share of proprietary brand milk sales to discounted supermarket milk brands causing a direct lowering of milk payments to a group of Queensland farmers whose milk payments are directly linked to the volume of monthly sales of proprietary brand milk.

To date one group of 185 dairy farmers in Queensland, which supply the processor Parmalat, have collectively lost an estimated $767,858 to the end of July, directly due to latest the discount milk price war started on the 26th January 2011, and if the discounting continues this loss could amount to more $1.5 million across twelve months. The impact on this group of farmers will continue to grow if supermarket store brand milk, near or below cost, discounting continues.

At the start of August this year another group of Queensland dairy farmers, which supply the processor Lion (formerly National Foods), had a slight farm gate price increase announced for their new contracts. However the slight increase in price of between half and one cent per litre (1 to 2 percent) for southern Queensland and Far North Queensland respectively is still far below the current rate of inflation and input costs increases, and follows a significant price cut last year of between 15 and 20 percent, which includes for milk which is used to fill Coles store banded milk bottles.

Other analysis of the impacts of the current supermarket milk price war, initiated on the 26th January 2011, clearly demonstrates that impacts are being incurred, particularly with the loss of processor proprietary brand sales and market share to the, near or below cost, discounted supermarket store brand milk.

Analysis of the impacts incurred during 2010/2011 from the current supermarket milk price discounting, compared to 2009/2010, present that the domestic fresh milk industry has lost an additional $77 million in retail value of milk. If the current discounting by supermarket continues through 2011/12, this additional loss of retail value of milk is forecast to increase substantially.

For processors, analysis of the national impacts of the latest supermarket milk price war, present that processors will lose an estimated $44 million in product sale margins for year 2011 if the current discounting continues over a twelve month period and impacts are limited to the current trends in market share shift between processor proprietary brands and supermarket store brands. Whereas, if processors have to resort to discounting proprietary brands to try and protect market share, which has started to occur, the impact to processor margins is forecast to increase to around $199 million. For Queensland these impact estimates are between $6 and $36 million respectively.

For farm gate prices nationally this analysis presents potential impacts of between 4% and 20% respectively. These categories of impact would be catastrophic for the majority of dairy farmers involved in supply fresh milk to the Australian domestic fresh milk market.

In addition to the above direct impacts, the discounting of supermarket store brand fresh milk, to near or below cost, by major supermarkets is also impacting on the dairy industry domestic fresh milk supply chain by causing;

- the postponement of investment in processor infrastructure,
- the postponement of investment in dairy farm capacity and sustainability,
- contributing to dairy farmers deciding to exit the industry and the loss of young dairy farmers to alternative employment.

Further to the above, this impact is also increasing across the whole Australian milk market as the major supermarkets are taking market share from the 'route' trade including from independent fuel stations, corner stores, other small retailers, and distributors and vendors.

Critically in Queensland the supermarket discounting is devaluing milk, lowering returns to processors, undermining the ability of processors to pay dairy farmers sustainable prices at a time when the Queensland dairy industry has been devastated by natural disasters and is currently short of fresh milk to meet the demands of the Queensland market. This situation is a clear example of market failure. Natural disaster damage and losses are estimated to amount to around $80 million for 2011 for the Queensland dairy industry.

From the evidence presented in the following submission, it is clear that the current use of milk as a, close to or below cost, 'advertising agent' by major supermarkets is having a direct cumulative and detrimental impact on the domestic fresh milk dairy industry and is progressively undermining returns, viability and sustainability of the domestic fresh milk industry.

With this evidence it is clear that the current practices of supermarkets needs to be addressed to ensure the future viability and sustainability of the domestic fresh milk dairy industry, which is in the interests of all in the industry supply chain, including the major supermarkets, all levels of Government and most importantly Australian consumers.

As such, the QDO appeals to the Australian Government to adopt the recommendations presented by Australian Dairy Farmers' (ADF) and QDO and to work with our industry to implement these recommendations as a matter of urgency.

In particular the need for;

- a mandatory whole of supply chain code of conduct, headed by an Ombudsman or Commissioner that can enforce the code, and ensure that contracts, prices and supply conditions are not unsustainable,
- strengthening the Competition and Consumer Act 2010 to prevent predatory pricing and deceptive and misleading conduct including that:
  - a definition of unconscionable conduct be inserted into the Act;
  - an 'effects' test be reintroduced; and
  - a statutory duty of good faith be enacted as part of the Act.
- for the ACCC to use its price monitoring powers under the Competition and Consumer Act 2010 to monitor prices, costs and profits relating to the supply of drinking milk and marketing tactics used by major supermarkets over an extended period of time. And for the Senate Economics References Committee to examine this information annually for at least five years.

Why Do Major Supermarkets Use Fresh Milk as a Discount Marketing Agent?

As an unintended consequence of deregulation, since 2000, due to its unique characteristics, the major supermarket duopoly, with their dominant share and power in the domestic market, has utilised fresh drinking milk as a discount marketing agent to serve a range of purposes. This has led to the progressive unsustainable devaluation of fresh drinking milk products nationally and market failure within the Australian domestic fresh drinking milk market.

Fresh drinking milk is a well defined market in Australia. Fresh drinking milk is unique in nature due to it being an every day, fresh, high quality nutritious, dietary staple of our community. Due to this uniqueness fresh drinking milk as a product is also very inelastic in nature.

Fresh milk is a foundation staple of our population’s daily dietary needs and expectations and the vast majority of Australian’s take for granted that they are able to purchase milk from any shop in Australia with a refrigeration unit. Public disturbances due to the shortage of fresh milk during the floods in Queensland highlight that demand and expectation of consumers.

Australians drink some 103 litres of fresh milk per year and collectively this equates to the consumption of 2.31 billion litres per year (2010/2011), which makes up some 25.4 percent of the Australian dairy industry annual milk production (data source Dairy Australia). As such fresh milk is one of the most frequently purchased items by consumers.

Due to all of these unique characteristics, fresh drinking milk serves as an ideal discount marketing agent for supermarkets and other retailers.

Coles’ current tactics, in using its supermarket store brand milk as a near or below cost advertising agent, are designed to achieve a number of goals including:

1. seeking to promote a perception to consumers that Coles is a cheaper grocery provider than their competitors;
2. luring more consumers into their stores on a more regular basis, away from other retailers, in particular to take market share away from its main large retail competitor Woolworths. It should be noted that Woolworths has stated publicly that the milk price cuts are unsustainable.
3. increasing the sales and market share of Coles’ store brand milk at the expense of the market share of other brands, particularly in the reduced fat milk category;
4. increasing the size and purchasing power of Coles’ store brand milk tenders, as well as other dairy product tenders; and
5. to gain greater market share in the ‘route trade’ by taking business away from its smaller retailers such as corner stores and vendors, which could see many smaller operators become unviable.

As Coles' sales of its supermarket store brand milk increase, as a result of it's near or below cost 'loss leading' discounting, the following impacts are occurring;

- Devaluation of fresh drinking milk across the nation as other major retailers have reduced their supermarket store brand retail prices as well, which is resulting in lower returns to the fresh milk supply chain;
- Processors financial returns are impacted due to;
  - the loss of market share of their own proprietary brands, which have sustainable margins compared to the unsustainable supermarket brand milk contracts,
  - the need to discount their proprietary brands to try and retain market share. Already there is evidence that one major processor has dropped the retail price of their whole milk proprietary brand by 15 percent,
  - increasing marketing and advertising expenditure on proprietary brands to try and retain market share,

  All of these affects reduces the financial viability of processors and will inevitably mean that further downward pressure will be placed on farm gate prices when processors seek to renew contracts with dairy farmers;
- Dairy farmers which have farm gate price contracts that are linked with processor proprietary brand sales have already seen a drop in their milk cheques as processors proprietary branded milk lose market share to supermarket store branded milk;
- Smaller retailers are placed at a significant competitive disadvantage because of the higher wholesale prices they pay for branded milk;
- Milk vendors are placed at a significant competitive disadvantage as their regular customers, for example coffee shops, move to purchase milk at a lower price from supermarkets rather than from the vendor,
- The combined impact of lower returns to the fresh milk supply chain will have resulting impacts on investment and employment throughout the supply chain.

It is the contention that Coles is selling their supermarket store brand milk below their relevant cost of supply through to the supermarket 'check out', for an anti-competitive purpose through both misuse of market power and predatory pricing as outlined above, and in particular in the case of regional and remote areas of Australia.

In addition the QDO believes there is a prima facie case of price discrimination from supermarket store brands against processor proprietary brands, where the supermarket has specifically sought to target their supermarket store brand discounting against comparable processor proprietary brands.

The long term risk of continuing to allow major supermarkets to continue to use their market power to take control of more market share, as has been the experience in the United Kingdom, that once such an environment is allowed to develop, particularly at the retail level where supermarket store brands dominate the market, it will result in;

- Devaluation of fresh milk as supermarkets use it as a loss leader marketing agent,
- Unsustainable returns to the supply chain,
- Less competition, choice and higher prices for consumers,
- Little or no investment in product innovation,
- Divestment from the supply chain, threatening supply security.

Impacts of Supermarket Discounting of Fresh Milk in the Domestic Market

On the 26th January, Wesfarmers wholly owned company, Coles launched a national advertising campaign using Coles store brand milk at a discounted price of up to 33 percent reducing the price to $1 per litre.

Immediately following the Coles announcement Woolworths dropped their price of Woolworths brand milk to match the price and other stores followed suit with some such as Aldi, cutting the price even further to $1.99 for 2 litres and $2.89 for 3 litres.

The Coles supermarket strategy of lowering prices of Coles store brand products is targeted at delivering a number of major outcomes;

1. being to attract buyers to shop at Coles stores rather then at their competitors, and
2. to encourage shoppers to buy Coles branded products rather than manufacturer proprietary branded products,
3. attract wholesale and or retail sales away from the ‘route’ trade to their Coles stores.

Over the period from February to the end of June 2011 this discounting has led to a significant change of market share, with discounted supermarket store brands gaining market share at the expense of processor proprietary milk brands, which have lost sales and market share.

By the end of June 2011 discounted supermarket store branded milk sales has grown by 10 percent to account for some 53 percent of total supermarket milk sales nationally and close to 60 percent in Queensland. For the five months from February to June 2011 supermarket store brands increased their market share of all supermarket milk sales by 15 percent.

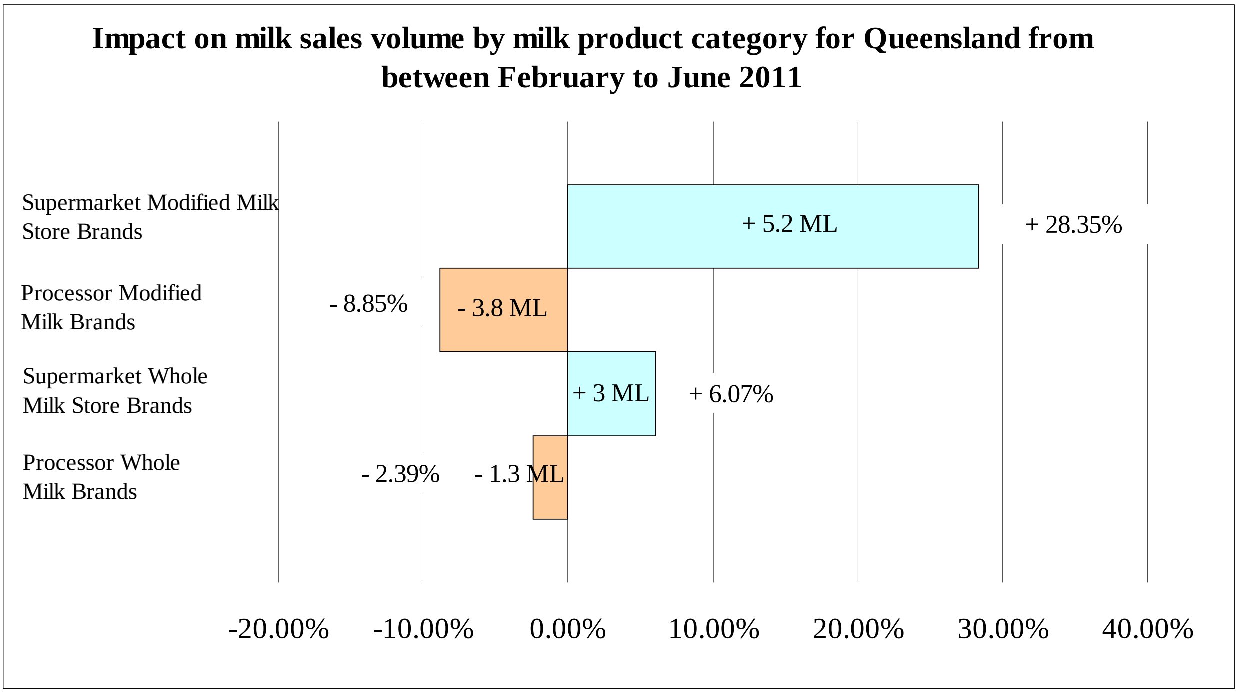
Nationally, from 1999/2000 to 2010/2011 the major supermarkets have used, near or below cost, discounting and other associated marketing tactics to grow their supermarket store brands market shares from;

- 31 percent to 71 percent share of all whole milk supermarket sales, and
- 12 percent to 53 percent share of all modified milk supermarket sales.

The most significant shifts in market share has occurred where the supermarket discounting has been targeted at the highest growth opportunity for Coles from such a strategy, which has been in the modified or reduced fat milk category, where Coles implemented a discount of 33%.

As can be seen from the above market share figures Coles has targeted the largest discount on the modified milk category which has the best opportunity cost for market share growth through the use of near and below cost discounting.

The following graph provides a display of the change in market share for the five months following the initiation of the Coles store brand milk discounting campaign.



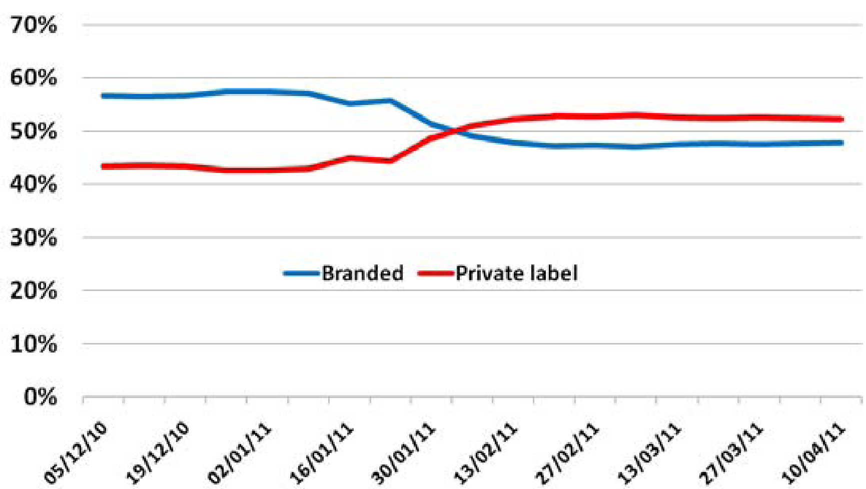
Source: Dairy Australia data

As is presented in the above graph the most significant shift in market share is seen in the modified milk category, where supermarket store brand modified milk over the period of five months has grown by 28.35 percent in Queensland and processor proprietary modified milk brand sales have fallen by 8.85 percent in Queensland.

These changes also indicate that the supermarket store brand modified milk has taken market share from the 'route trade' as well.

Nationally and more so in Queensland the change in market share between the supermarket and processor brands due to the discounting by supermarkets has seen the sales of supermarket store brands exceed the sale of processor brands.

National supermarket sales - % share of fresh white modified milk (Dec 2010 to April 2011)



Source: Dairy Australia

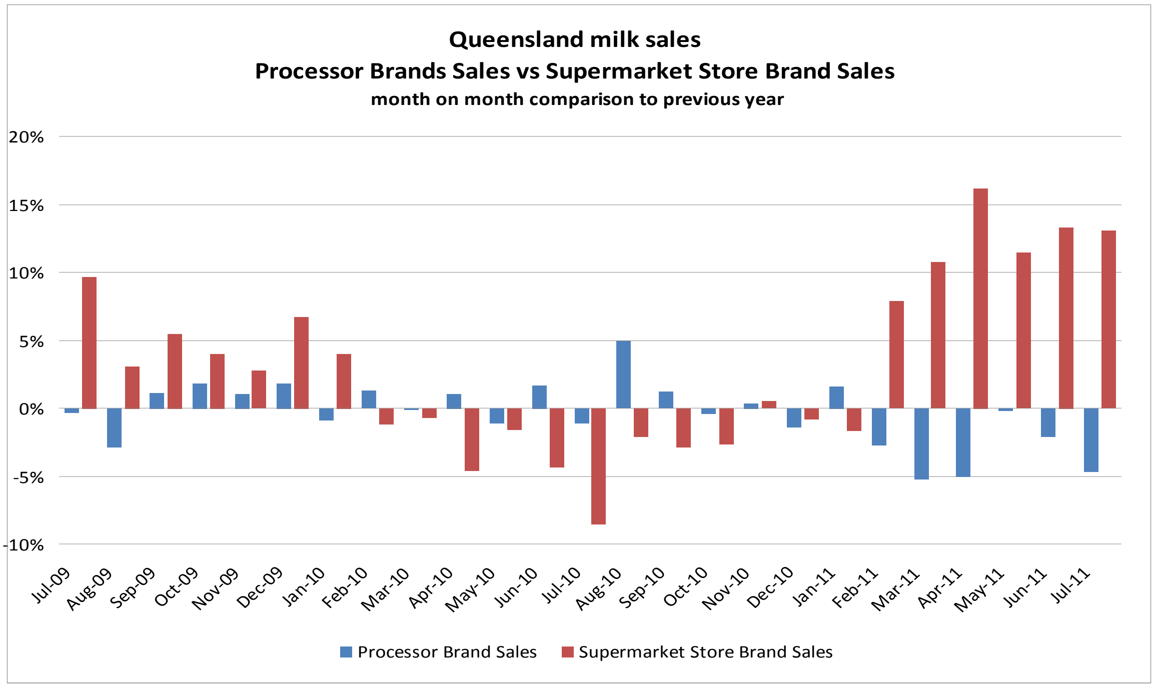
Looking at the supermarket sales trends in more detail, the shift to supermarket store brand in the modified milk segment is dramatic in percentage terms, with a 31% increase in sales compared to the prior year. Conversely sales have been lost from the branded modified category as consumers substitute like for like products. This has particularly affected milk processor returns as this category has provided the greatest scope for brand differentiation and profit margins. As a result, the loss of sales from this category has affected returns much more than the loss of sales from the regular and UHT categories.

The following graph provides a presentation of the impact of the $1 per litre price cut to date, comparing supermarket store brand sales with processor proprietary brand sales for the months from February to June in 2010 and 2011.

While Queensland supermarket sales grew by 4%, total domestic sales data collected by Dairy Australia showed a 2% increase in total milk sales for the state in the five months from February to June 2011 compared to the same period in 2010. The total milk sales increase is broadly consistent with stable per capita consumption rates and population growth in the state which grew 2.0% between 2009 and 2010.

However, the stronger growth in supermarket sales indicates that the non-supermarket or route channel, has lost some share of the milk market to the major retailers. Anecdotally there have been reports of cafes and restaurants substituting Coles branded products for their traditional foodservice distributor.

The supermarket discounts have had a varying impact across the milk category.



Source: Aztec Synovate through Dairy Australia

In December 2010 supermarket store brand regular milk was selling in Queensland for $1.08 per litre on average, while fat modified supermarket store brand products were selling for $1.26.

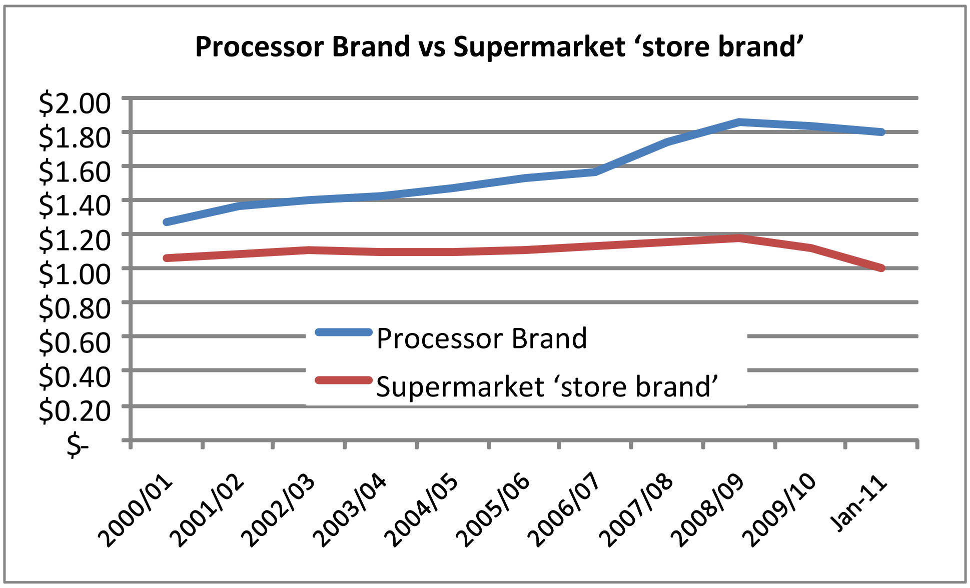
Post the Coles initiated $1 per litre discounting, supermarket store brand regular products have been averaging $1.02 per litre – a 6% decline. However, fat modified products have fallen 20 percent to $1.01. For specific fat modified products the discount cut was even greater – for example Coles dropped the price of their store brand modified milk by 33 percent.

The modified fresh milk category, while smaller in market volume terms, did deliver significant value to the dairy supply chain.

Fat modified products allow for greater differentiation between milk products, and therefore more successful branding opportunities.The erosion of this category has significantly reduced the ability of and incentive for processors to innovate, as they are less able to capture the benefits in a branded product. The level of pricing in supermakrt store brand products provides a significantly lower or neglible margin for both processors and retailers, and limited opportunities to develop the category.

This retail price drop increases the retail price difference between supermarket 'store brand' milk and processor proprietary branded milk. Generic supermarket 'store brand' milk, due to its lower price and margins, gives a lower return to processors and subsequently farmers than processor proprietary branded milk.

As presented by the following graph, over the last decade the retail price per litre for supermarket store brand milk nationally has declined in real terms, while market share of sales have more than doubled. Over the same time the retail price for proprietary brands followed inflation, however sales through supermarkets dropped by more than half.



Source Dairy Australia

In 2000/2001 the difference in retail price between proprietary 'branded' milk products and major supermarket chain 'supermarket brand' label products in 1999/2000 was $0.18 per litre and for whole milk the difference in price was $0.07 per litre.

For 2010/2011 the difference in retail price between proprietary ‘branded’ milk products and major supermarket chain ‘store brand’ products in 2010/11 increased to $0.78 per litre and for reduced fat milk the difference in price increased by 23% over the last year to $0.90 per litre.

When this per litre value difference of milk sales is equated across the market share of major supermarket chain ‘supermarket brand’ sales for 2010/11 (p) compared to the retail value of proprietary brand sales through supermarkets the difference is $490 million and more than $100 million per year in the Queensland market. In 1999/2000 the value difference amounted to some $44.5 million.

As a result processor brands have lost market share and the margin to the industry has been reduced to a point where the loss in retail value to the dairy industry is over $490 million per annum, compared to $44 million in 1999/2000.

If half of this amount of money, $490 million, was retained at the farm gate it would translate to an increase in farm gate price for dairy farmers of 10.5 cents per litre for milk supplied for the domestic fresh drinking milk market.

This is the amount the large retailers have taken out of the value chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry value chain.

For 2011/2012 if the major supermarkets continue to discount milk to $1 per litre then the price difference is forecast to increase to over $0.86, assuming no other price changes occur in milk processor proprietary ‘branded’ products. This would see a value difference between supermarket store brand and processor proprietary brand sales through supermarket chains increase by approximately $53 million to $544 million.

Impacts of Major Supermarket Discounting of Fresh Milk to Date

Supermarket discount impacts on processors

The near or below cost discounting of supermarket store brands by major supermarkets, as demonstrated previously presented in this submission, has;

- led to a significant increase in the sales and market share of discounted supermarket store fresh milk brands, and
- a significant loss of market share of processor proprietary brand fresh milk sales.

The significant loss of market share of processor proprietary brand fresh milk sales has had a major impact on the returns from the market place for processors supplying the domestic fresh milk market.

As is clearly demonstrated in this submission, proprietary brand milk is sold at a higher price then supermarket store brands.

This higher price of proprietary brands provide margins that allow processors to be able to pay sustainable prices to dairy farmers for the milk they produce, whereas the margins on supermarket store brand contracts are extremely small to non existent, as publically stated by processor representatives, and do not provide the ability for processors to be able to afford a sustainable price for dairy farmers for that milk.

Impact Assessment by Dairy Australia

Dairy Australia has undertaken another method of assessment to quantify the impact of supermarket discounting of fresh milk on the Queensland dairy industry if the discounting is maintained.

With this assessment the current trends have been extrapolated over 12 months, and the impact on retail sales value and industry margins annualised.

Two scenarios have been modelled, and the impact on processor profitability and farmgate prices paid by milk processors (representing 100% of milk intake) has been quantified.

Scenario 1: Post-discounting and year to date supermarket trend (February to June 2011) is annualised, branded and non-supermarket channel prices are unchanged.

Scenario 2: Annualised quarterly trend and branded products are discounted to maintain relativity with supermarket store brand price in both supermarket and non-supermarket channel.

Future scenarios for the Queensland dairy industry

		Baseline (2010)	Scenario 1	% chge	Scenario 2	% chge
Total value of milk sales	$ mill	839	828	-1%	797	-5%
Change in processor margin	$ mill		- 6		- 36	
Possible impact on farmgate price*	cpl	56.1	54.7	-2.5%	49	-13%

**Baseline price is average 2009/10 paid by drinking milk processing companies*

To estimate the impact on farmgate price it is assumed that the loss of processor profits will be completely passed through to farmers. That is, the pool of funds paid to farmers in 2009/10 is reduced by the amount of the margin loss, and the impact is expressed as a price differential per litre for farmers supplying milk processors.

Scenario 1 is simply a continuation of current supermarket trends. The impact on industry profits and farmgate price reflects the switch from branded products to lower margin supermarket store brand products.

Assuming the loss of margin is passed on to farmers, and all other price drivers remain the same, farmgate price paid to suppliers of milk processors in Queensland would fall by around 1.4 cent per litre.

Scenario 2 combines the impact of consumers switching from branded to supermarket store brand products, but assumes the impact is compounded when branded products are discounted to maintain their relativities with supermarket store brand prices in an effort to protect market share. This has a much greater impact as the margin on branded products in both supermarket and non-supermarket channels are reduced by approximately $36 million annually. If prices paid to farmers are reduced accordingly, the impact would be in the order of 8 cents per litre.

While scenario 1 is based on current market trends and available data, scenario 2 includes wide spread discounting of processor branded fresh products which to date has occurred to a limited degree at this stage, with evidence to date of some discounting of whole milk brands by some 25 cents per litre and UHT by approximately 10 cents per litre. However, scenario 2 does not allow for processors having to increase marketing and advertising expenditure in an effort to protect market share, which increasing costs and further affecting profitability. This additional expenditure has also been occurring in a number of specific categories in the market place.

The combined impacts to farmers would be greater due to the increase costs of producing milk during this period and for farmers in Queensland the added cost of recent floods and cyclones.

Impact Assessment by Fresh Logic

An assessment of the impacts of the supermarket discounting across the three months from February to April was undertaken by Fresh Logic in June 2011.

The analysis;

- was based on the volumes of milk sales lost by processor proprietary brands following the initiation of the current 'milk price war' in January,
- was based on data for the 3 months to April,
- assessed the difference in pricing structures along the chain between brands and supermarket store brand,
- presented a loss of 14 million litres of processor proprietary brand sales in Queensland,
- presented that the impacts of the loss of market share and margins across fresh white milk sales by processor proprietary brands was estimated at $5 million or approximately 1 cent per litre in gross product margins achieved by processors in Queensland.

Fresh Logic has now reviewed this analysis following the discovery of erroneous assumptions in the analysis and revised the impact to processor gross product margins upwards to $6.2 million or approximately 1.34 cents per litre for the same period.

It needs to be noted that the analysis by Fresh Logic does not include any impacts on processor margins from;

- discounting processor proprietary brand products to try and retain market share, and
- increased marketing and promotional expenditure from processors to try and retain market share.

There is now evidence of both impacts being incurred by processors since this analysis was undertaken.

QDO's Impact Assessment

The QDO has analysed both Dairy Australia's and Fresh Logic's impact assessments, relative to the impact data that has been available to date, including the direct impact on dairy farmers that supply the Parmalat PDA scheme.

The QDO has also taken into account that there is now evidence of processors discounting processor proprietary brands and of outlaying additional resources for marketing and promotion in an effort to maintain market share.

Given the market share impact to date and the above factors the QDO believes the impact on the Queensland industry will lie closer to scenario 2 as presented in the impact assessment undertaken by Dairy Australia.

Supermarket discount impacts on Dairy Farmers

The current discounting of fresh milk by supermarkets is causing a number of direct impacts on dairy farmers, including;

1. causing a reduction in milk payments to dairy farmers that have part of their milk payments linked to the sale of processor branded milk,
2. reducing the ability of processor to offer sustainable prices to dairy farmers for new contracts,
3. severely affecting the confidence of dairy farmers;
    a. contributing to dairy farmers deciding to exit the industry
    b. forcing young farmers to leave the dairy farm to seek work in other industries,
    c. post pone planned investment in their dairy enterprises,

all of which is undermining the future capacity and sustainability of the Queensland industry.

1. In Queensland some 185 dairy farmers have had their monthly milk payments directly affected each and every month since the supermarket discounting was started on the 26th January 2011. This group of dairy farmer's, monthly milk payments is directly linked to the level of processor branded milk sales they supply for the previous month.

This group of farmers supply the processor Parmalat, through Parmalat's PAULS Daily Access Scheme (PDA). The PDA scheme only relates to total PAULS branded milk sales and each farmer in the PDA scheme has an allocated daily milk supply volume under the PDA. PDA dairy farmers can trade PDA volume among themselves according to how much milk they calculated they would want to supply in the coming year.

Parmalat pays a higher price for this PDA (or tier 1 milk) but if the farmer failed to supply the PDA amount across the month as specified by the amount of PDA they held, then penalties would apply. All milk supplied over the allocated PDA amount would be collected but paid at a lower manufactured (or tier 2) price. Currently the average base price for PDA milk is approximately 58 cents per litre.

If Parmalats' PAULS branded milk sales do not reach the total PDA level in the state, then farmers are only paid the percentage that sales were of the total state PDA amount. The rest of the farmer's milk supply would attract the lower manufactured (or tier 2) price, which is currently approximately 44 cents per litre.

The PDA scheme is designed primarily to ensure Parmalat reliably receive enough milk for PAULS branded milk sales but avoid or reduce times of excessive production that would need to be sold as lower priced manufactured (or tier 2) product.

From the farmers payment point of view the sales for each month is expressed as a percentage of each farmers PDA on their payment invoice.

As Coles and other supermarkets have discounted the price of fresh milk to $1 per litre, supermarket discounted branded milk sales and market share have increased and as a result processor branded milk sales and market share has fallen. As the sales and market share of processor branded milk have fallen the percentage of the farmer's milk cheque that relates to these sales falls resulting in a lower payment to the farmer.

As a result PDA dairy farmers have been losing the amount of volume sold at the PDA or tier 1 price to the lower tier 2 price. This equates to these dairy farmers being paid less each month since the supermarket discounting started in January.

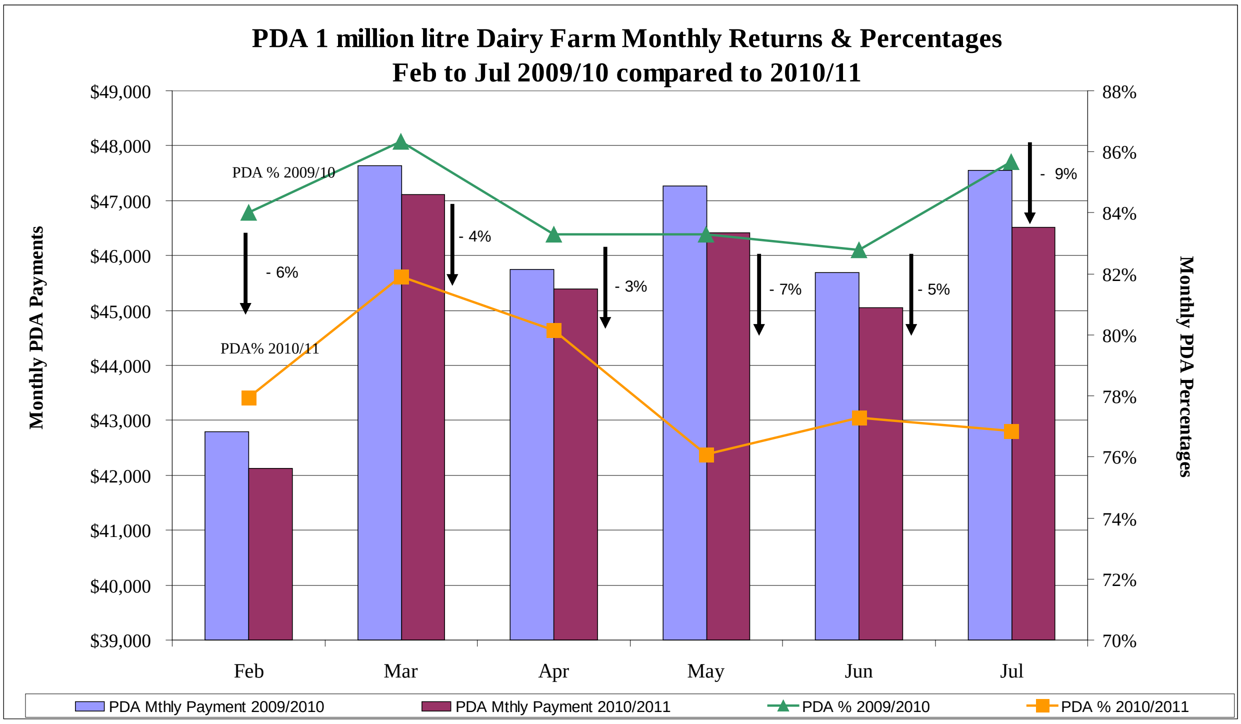
The following figures provide PDA figures from a real dairy farm and thus provide an insight into the impacts being seen already by this group of dairy farmers.

PAULS Daily Access Scheme Results					
Month	PDA Percentage		Change	Farm Result	PDA Group Result*
	Year 2010	Year 2011			
February	84.23%	77.94%	- 6.29%	($676)	($124,973)
March	86.35%	81.92%	- 4.43%	($527)	($97,448)
April	83.30%	80.16%	- 3.14%	($361)	($66,843)
May	83.29%	76.08%	- 7.21%	($857)	($158,600)
June	82.78%	77.29%	-5.29%	($632)	($116,869)
July	85.68%	76.85%	-8.83%	($1,050)	($194,236)
12 Months			-5.90%	($8,205)	($1,517,939)

Source: QDO

*Assumptions

- Based on an average farm production of 1 million litres per annum.
- PDA group farm numbers remain constant at 185.
- The PDA (tier 1) milk priced currently averages around 58 cpl and the manufacture milk (tier 2) price as an average of approximately 44 cpl.



Source: QDO

From the impact already experienced from February until July 2011 the PDA dairy farm above has lost approximately an average of $684 per month and the PDA group collectively has lost an average of $126,495 per month.

The cumulative impact up until the end of July for the individual dairy farm was $4,103 and for PDA group collectively $767,858.

If this impact continues across a full year, the annualised impact can be estimated by extrapolating the average impact per month to the end of July for a full twelve month period.

With an annual impact extrapolation the cumulative impact for the individual dairy farm would be $8,205 and for the PDA group collectively $1,517,939.

This impact will obviously get worse if the $1 per litre discounting and loss of market share by PAULS brands continues and if the rate of loss of market share for processor proprietary brands increases.

This example of direct impact being incurred by dairy farmers due to the action of discounting of supermarket brand milk, to below or near cost, is far from the 'no impact' claim by Coles representatives.

This example does not take into account the potential for much larger impacts as contracts come due for renegotiation with processors with lower returns due to the discounting of supermarket brand milk.

2. The discounting of supermarket store brand fresh milk, to near or below cost, has resulted in supermarkets increasing their sales and market share of supermarket store brand milk at the expense of the sales and market share of processor proprietary brands.

For processors, as publically stated by a number of processor representatives over the last year, supermarket store brand contracts provide poor margins for processors and processors have over the last decade relied more and more on the margins generated from processor owned proprietary brand milk sales to generate the majority of their overall margin and profitability.

As processors proprietary brand milk sales have lost market share to supermarket store brand sales, processor profitability has been lowered. With lower margins processors are then left with less ability to afford to pay dairy farmers higher sustainable prices for milk they supply on new contracts, particularly in relation to milk that is used for supermarket store branded milk.

A clear example of this affect has been seen in the last month where by Lion (formerly National Foods), announced new farm gate prices for the 20011/12 financial year for dairy farmers supplying milk to Lion through the Dairy Farmers Milk Co-operative.

The new farm gate price announcement presented a very slight increase in the base milk price of a half cent per litre for southern Queensland and 1 cent per litre for Far North Queensland for milk sold as fresh bottled milk or what is termed Tier 1 milk.

Tier 1 milk, under the Lion payment scheme, includes all milk sold by Lion as bottled fresh milk including both processor proprietary branded milk and supermarket store brand milk. As such with the current supermarket price war with higher margin processor proprietary branded milk losing market share to supermarket store brand milk with little or no margin, the overall return from the sale of Tier 1 milk by Lion has declined. Consequently Lion’s ability to improve farm gate prices has been undermined directly by the current supermarket price war.

This recent price increase equates to just a 1 and 2 percent increase respectively, which does not even help farmers keep pace with rising input costs, with inflation currently running at 3.6 percent and many farm input costs increasing much more significantly over the last year for example electricity.

To put this into perspective, this announcement follows major cuts to farm gate prices by the then National Foods (now Lion) last year by some 15 percent for one group of Queensland dairy farmers and by more than 20 percent for another smaller group of Queensland dairy farmers. In addition Queensland dairy farmers have suffered major losses from the impact of natural disasters which are estimated to amount to around $80 million for 2011.

In relation to the price announcement, a Lion representative publicly stated that, "We have taken the position that we will hold our prices and slightly increase in south east Queensland when the marketplace is telling we should go the other way."

On the 9th May this year Lion Nathan National Foods, Chief Executive Rob Murray reported publicly that, “NatFoods was under significant margin pressure in both dairy and juice, with supermarkets engaging in deep discounting on supermarket store brand fresh milk, which was reducing returns across the supply chain” and that "In the current year, National Foods' return on invested capital is now expected to be well below an acceptable level."

On the 5th of August, Lion CEO Rob Murray reported publically that, “As previously communicated, conditions in both the dairy and juice sectors remain very difficult for farmers and processors alike. “The dairy and drinks division delivered operating earnings before interest and tax (EBIT) of $68.3 million, a decline of 43.2%. Revenue declined 9.4% to $1.4 billion.” “Lion’s white milk volumes declined 10.9%, largely driven by the supermarket store brand contract losses, however this was compounded as deep discounting saw consumers switch from branded products to supermarket store brand and from convenience stores to grocery – diluting the profit pool available to all players in the supply chain.”

3. The discounting of supermarket store brand fresh milk, to near or below cost, has severely affected the confidence of dairy farmers and contributed to dairy farmers deciding to exit the industry, for farmers’ children to leave the dairy farm to seek work in other industries and post pone planned investment in their dairy enterprises all which is critical for the future capacity and sustainability of the industry.

Since the end of January 2011 to the end of July 2011, approximately 24 Queensland dairy farms have ceased operations and exited the industry. This rate of loss of dairy farmers over this period is much higher then the long term downward trend in farm numbers.

Following severe floods and cyclone impacting all of the Queensland industry during the end of 2010 and start of 2011 the QDO initiated a Natural Disaster Response and Recovery program. As part of that program the QDO contacted all dairy farmers in Queensland to check on their wellbeing, gauge their situation and to assist farmers to access assistance and support services. During April and May the QDO contacted and surveyed all dairy farmers as part of the program. As part of this survey the QDO asked a series of questions including what where key issues, concerns and intentions of dairy farmers.

From the survey results 13% of survey respondents have reported that they intend to exit the industry in the next year and 31% presented that they intend to exit the industry within five years time. These rates of exit, if incurred, are much higher then the long term average of farm number decline of 5.1 % over the last decade.

The majority of dairy farmers interviewed raised serious concerns about impact of the supermarket ‘milk price war’, including dairy farmers with PDA who were already seeing a reduction in their milk payments, and fixed price contracted farmers who were very concerned about the prospects of being able to obtain a price increase and or a sustainable price for their milk in the next round of price negotiations.

A number of farmers have presented during their interview that they have advised their children to seek a career outside of dairying due to the current situation.

The majority of dairy farmers interviewed presented that in the current environment they have decided to postpone planned investment in their dairy enterprises which will delay their recovery from natural disasters.

Of the farmers interviewed that have exited the industry since February, more then 80% have presented that the impacts and outlook due to the supermarket 'price war' was a contributing factor to deciding to exit the industry.

All of these impacts will continue to undermine the future capacity and sustainability of the Queensland dairy industry.

Current and Future Fresh Milk Needs of Queensland

The Last Decade

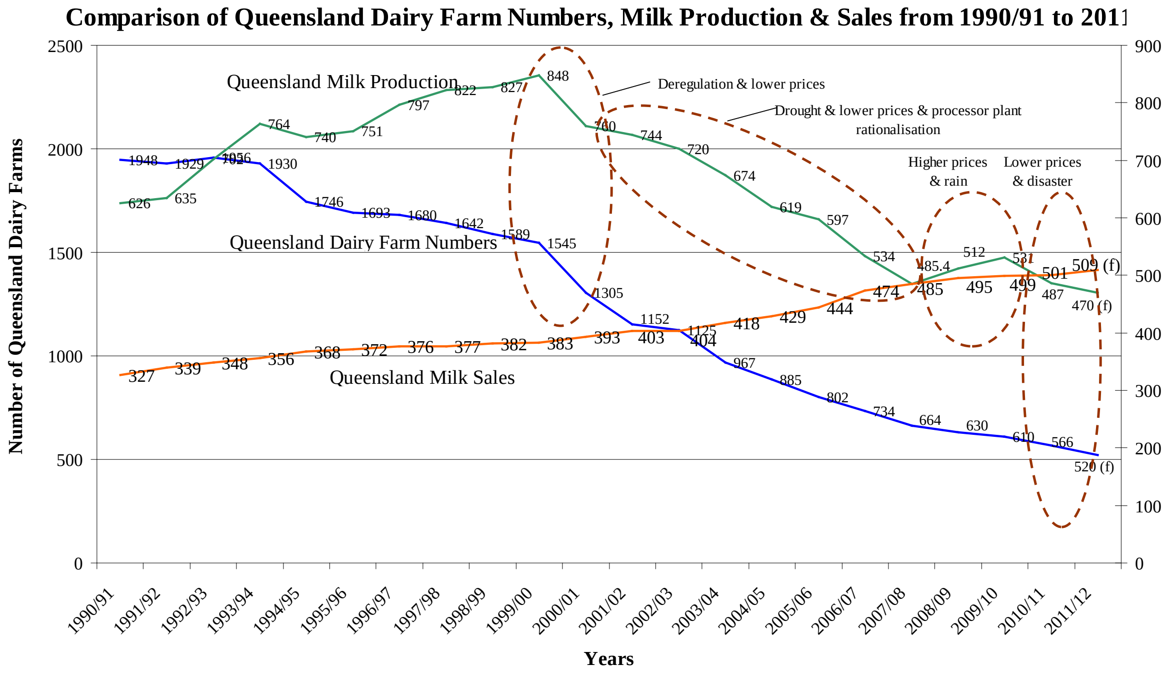
The Queensland Dairy industry has suffered a major contraction in farm numbers and production over the last decade.

Post deregulation, from 1999/2000 to 2010/2011 dairy farm numbers in Queensland have fallen from 1545 to 566, a decline of 63 percent, and production has fallen from 848 million litres to 487 million litres, a decline of 43 percent.

This decline has largely been due to a number of major impacts including;

- flow on affects of deregulation,
- suppressed farm gate prices and poor farm gate returns for much of the decade,
- severe drought for much of the decade,
- severe floods and cyclones,
- a continual erosion of returns from the market place due to the growth in market share of major supermarket store brand milk at the expense of processor proprietary brands,
- rising costs of production,
- competition for resources, and
- an increase in government regulation and redtape.

Even with these many challenges dairy farmers have continued to improve their productivity.



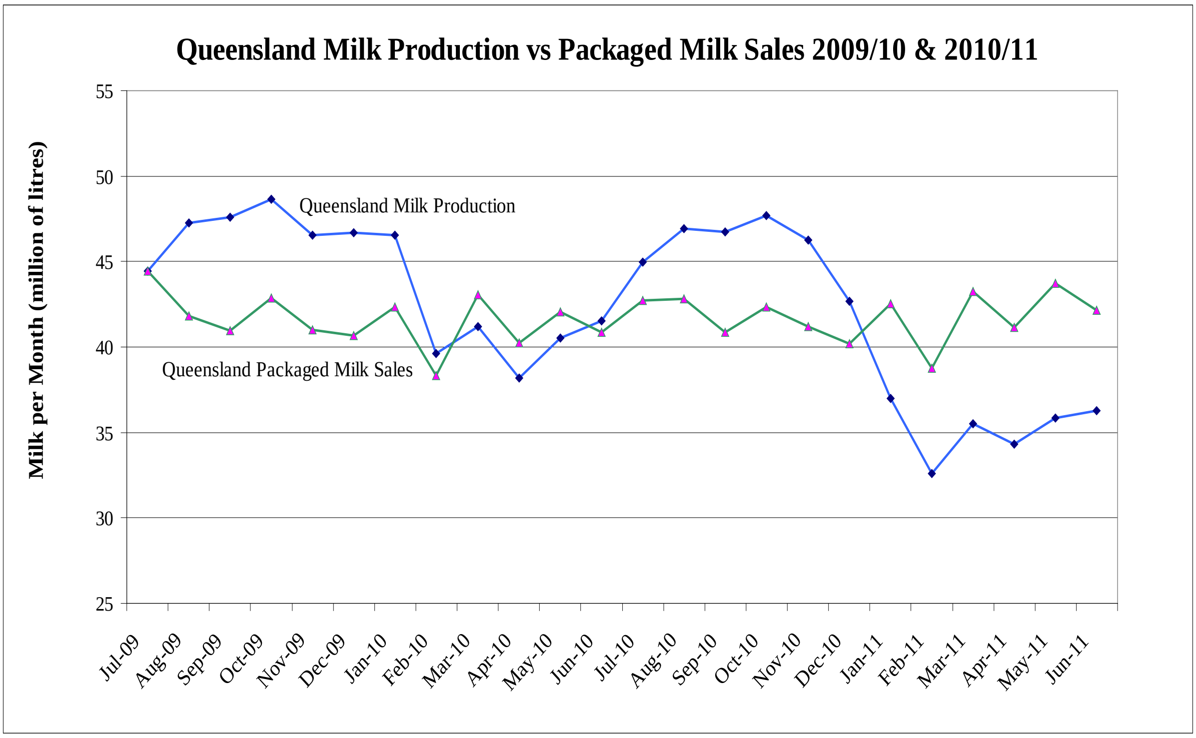
The Current Situation

The Queensland dairy industry is currently short of milk to meet the market demand in Queensland. This shortage situation which started in January 2011, is due to the impacts of natural disasters, poor farm gate returns and farmers leaving the industry. This situation has been exacerbated with the impact of the current Coles initiated milk price war between supermarkets.

The Queensland dairy industry needs to produce more milk to meet the needs of Queenslanders now and even more milk to meet the needs of a growing population into the future.

In the last year Queensland has lost more than 40 dairy farmers, a decline of more than 7 percent, which is extremely concerning to the QDO and reflects the current unsustainable returns that currently exist for dairy farmers.

As presented in the following graph, over the last six months the Queensland dairy industry has not been able to produce enough milk to meet the daily milk needs of Queensland consumers. For this period the Queensland milk production has been approximately 40 million litres under the Queensland market demand requirements.



Source: Dairy Australia data

Based on Queensland Dairy Accounting Scheme data current farm gate prices for many Queensland dairy farmers will barely keep the average sized dairy farmer in Queensland above breakeven, especially given the impacts of natural disasters and rising operational costs. This assessment is also supported by recent survey analysis of the industry undertaken by the ABARE.

The QDO acknowledges that Coles have publicly stated that it had given National Foods a price increase in January this year with new contracts, however at the same time acknowledge that the past head of National Foods publicly stated that there is little or no margin in supermarket store brand milk supply contracts and that has affected their ability to pay dairy farmers who supply that milk.

The QDO had hoped that the price increase Coles had given National Foods would have been passed through to dairy farmers following the large farm gate price cuts last year. However, from the data the QDO has obtained on the market and the growing impact of the Coles led milk price war on processors, is undermining their 'already slim or non-existent' profitability. This impact can be seen with the large loss of sales of processor brand milk across to heavily discounted supermarket brand sales over the last five months and therefore the processors ability to increase farm gate prices to a sustainable level.

The QDO has warned processors, retailers and the Government about these impacts and the implications last year but to date there has been no action to turn around this unfolding disaster.

With natural disasters and the current 'milk price war' the situation has deteriorated. The current situation is not sustainable and needs to change for the betterment of all including dairy farmers, processors, retailers and consumers.

Future Needs

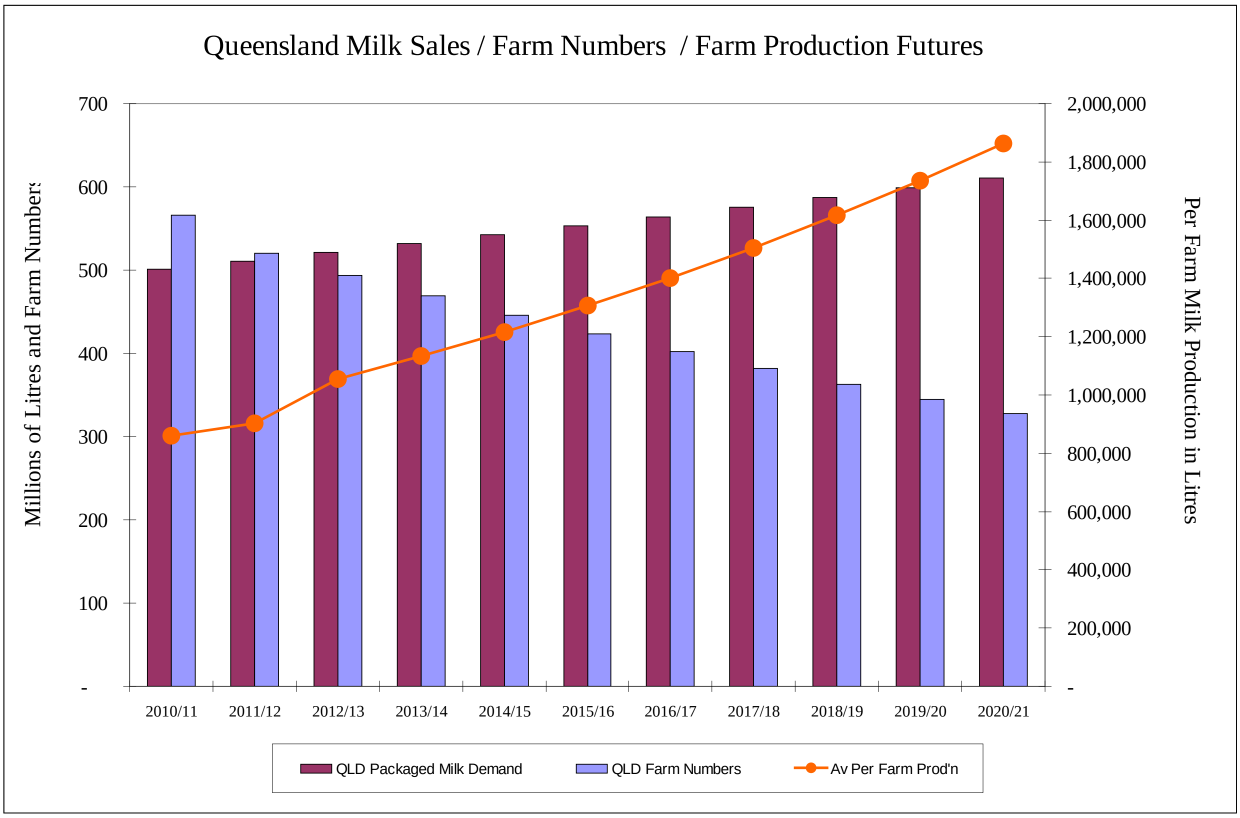
With forecast population growth for Queensland the demand for fresh milk will increase. Medium level Australian Bureau of Statistical (ABS) population growth forecasts for Queensland for the next decade translates the need for more than an additional 100 million of fresh milk per annum.

To meet this increased demand the Queensland dairy industry need to increase its production capacity by at least 22 percent by the year 2020.

A greater challenge to meet this growing demand, in the current environment of declining farm numbers, is the ability of dairy farmers to increase production from their existing farm enterprises.

With the rate of decline in farm numbers of approximately 5 percent per annum over the last decade, Queensland dairy farmers are forecast to potentially decline from 566 currently to approximately 446 by the year 2015 and as low as 328 by the year 2020.

With these forecasts by the year 2015, on average Queensland dairy farmers would need to increase their production by more then 50 percent and by the year 2020 by more then 110 percent.



For Queensland dairy farmers to be able to achieve this dramatic growth in production will require significant new investment.

To produce milk, dairy farmers carry the highest investment and risks per litre of milk and the most volatile returns of the whole fresh milk supply chain.

For farmers to be able justify this investment and risk there will need to be a suitable level of return on that investment.

The current failure of the domestic market caused by major supermarkets using fresh milk as, a near or below cost ‘marketing agent’ is not providing for sustainable returns to the fresh milk supply industry and thus to dairy farmers.

As such for the future demand of the growing domestic market to be met now and into the future in regions such as Queensland sustainable returns from the supermarket store brand contracts need to be restored.

The Need For Sustainable Farm Gate Returns

Prior to deregulation regulated milk prices provided a stable return to the farm enterprise and even in times of natural disasters such as the severe droughts of the 1980’s and 1990’s the QDO was able to negotiate a price increase to cover the costs of the impacts and to ensure a stable supply of fresh milk to the domestic market.

Following deregulation farm gate prices paid to dairy farmers in Queensland for fresh drinking milk dropped significantly from a regulated price of 58.9 cents per litre 1999/2000 to a single farm gate price of approximately 31 cents per litre 2000/2001.

The significant drop in price, even with the provision of the deregulation support packages saw the exodus of many dairy farmers from the industry. Following deregulation the Queensland dairy industry was again plagued by severe drought for over a decade and this impact combined with low farm gate prices and higher operational costs saw farm numbers and milk production continue to decline through to 2007/2008.

At this level of production from the region it barely met annual supply requirements of the market and at various times of the year fell well below market requirements.

With this situation, combined with repeated calls from dairy farm organisations, processors increased farm gate prices and offered longer term contracts. With a return to more normal seasons milk production increased to be in surplus of market needs, however with the impact of severe flooding and cyclones and lower farm gate prices it is forecast that production will decline by more then 12 percent this year and exacerbate the shortfall of milk to market needs.

In the current environment for many farmers the passing through of any margin losses by processors would eliminate their profits altogether.

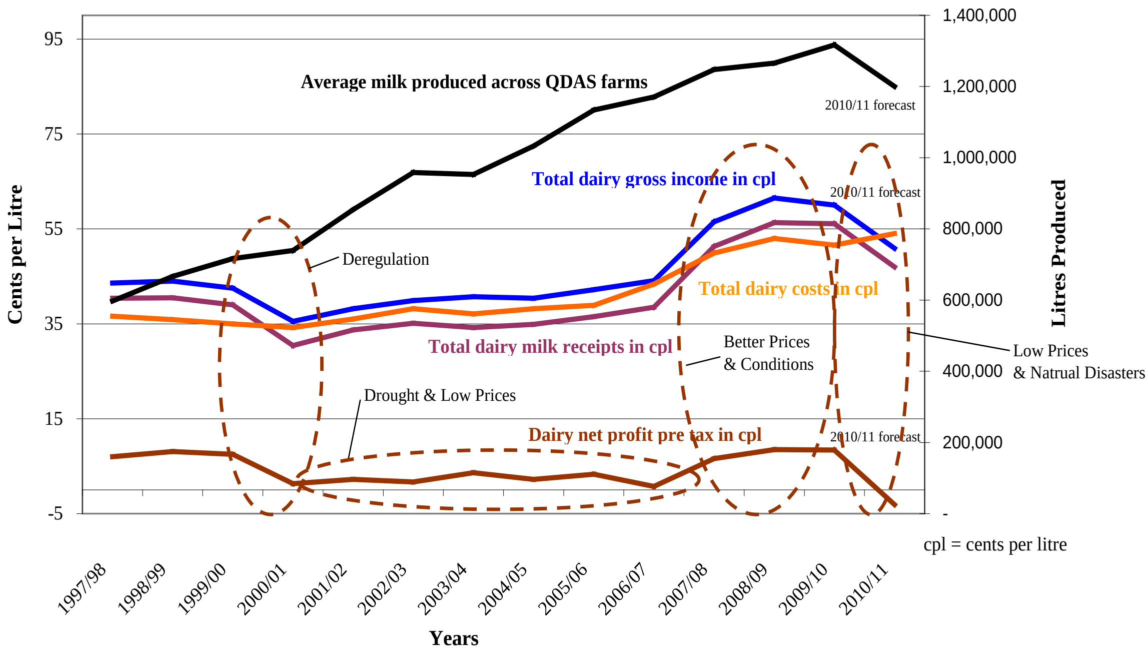
It is estimated by Dairy Australia that in the most exposed region of Queensland and northern New South Wales a 10 percent shift toward supermarket ‘store brand’ label alone would halve farmers’ 2009/10 margins should the processor be forced to pass the impact on to farmers. Average farm incomes for the region have already been drastically reduced in 2010/11 for many farmers due to lower average farmgate price, as well as the impact of natural disasters.

From data presented by the Queensland Dairy Accounting Scheme (QDAS), dairy farm production costs increased by more than 48 percent over the last ten years from 35 cents per litre in 1999/00 to 52 cents per litre in 2009/10. Where as, the price received per litre at farm gate was recorded as 39 cents per litre in 1999/00 and for the year ahead of 2010/11 the price will be approximately 53 cents per litre, an increase of just 36 percent.

It is forecast that farm costs per litre for 2011/12 will increase by at least 2 cents per litre with a range of input cost increases for example with repairs and maintenance, electricity, fuel, labour and animal health.

The following graph provides a presentation of data from the Queensland Dairy Accounting Scheme (QDAS) for income, costs and returns from 1997/08 to 2009/10 with the addition of a forecast for the 2010/2011 financial year.

Queensland Dairy Accounting Scheme Data 1097/98 to 2010/11



For a lot of farmers who suffered significant price cuts last year this will be less, with negative returns for many, as indicated with the above forecast for 2010/2011 year. For the Queensland average dairy farm a one cent per litre drop in price will reduce the bottom line of the farm by $9,000.

This situation presents that the viability and sustainability of the production sector has been slowly eroded over the last decade. This is due to the returns to the dairy industry value chain and through the farm gate declining as the major supermarket ‘store brand’ procurement and marketing strategies have grown the amount of market share major supermarkets have with their own brands.

Reduced returns to the dairy industry value chain from major supermarket chains 'store brand' strategies is already undermining the profitability, sustainability and viability of the dairy farming sector which produces milk on an 'every day of the year' basis for the domestic fresh drinking milk market.

Coles Promotions and Public Statements by Coles Representatives

A number of Coles public promotional statements are incorrect and misleading and as such need to be corrected. The nature of these statements should be investigated by the Federal Government against the legal requirements of the *Competition and Consumer Act 2010,* with the provision of the following information.

With the launch of the Coles 'Down Down' campaign discounting of Coles store brand milk to $1 per litre on the 26th January 2011, Coles stated in their promotional press release that;

1. *"Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them."*

2. *"In fact both farm gate milk prices and contract prices with processors recently increased."*

The QDO has been advised that Coles has also given this assurance to senior Government Ministers that the Coles discount campaign would not affect dairy farmers.

Impact on Processors and Dairy Farmers

The continuous public claim by Coles that their discounting of fresh milk to $1 per litre will not affect processors and dairy farmers is **not correct**.

The discounting of supermarket store brands, to near or below cost, as demonstrated in this submission, has;

- led to a significant increase in the sales and market share of discounted supermarket store fresh milk brands, and
- a significant loss of market share of processor proprietary brand fresh milk sales.

The significant loss of market share of processor proprietary brand fresh milk sales has had a major impact on the returns from the market place for processors supplying the domestic fresh milk market.

As is clearly demonstrated in this submission, proprietary brand milk is sold at a higher price then supermarket store brands.

This higher price of proprietary brands provide margins that allow processors to be able to pay sustainable prices to dairy farmers for the milk they produce, whereas the margins on supermarket store brand contracts are extremely small to non-existent, as publicly stated by processor representatives, and do not provide the ability for processors to be able to afford a sustainable price for dairy farmers for that milk.

Dairy farmers are being impacted by the Coles led fresh milk discounting in a number of ways including;

- As presented in section ## (page##) of this submission, in Queensland a group of dairy farmers who have their farm gate price linked directly to processor branded sales have seen monthly milk payments directly impacted since February 2011, as a result of the Coles led discount milk campaign.

  This impact has occurred as the sales and market share of discounted supermarket store branded milk has increased at the expense of the sales and market share of processor proprietary brands.

  This impact on these farmers will continue to increase over the coming months as Coles and other supermarkets milk brands gain an increasing share of the milk sales and the share of proprietary milk branded sales declines.

- As presented in this submission, as processors proprietary brand milk sales have lost market share to supermarket store brand sales, processor profitability has been lowered. With lower margins processors are then left with less ability to afford to pay dairy farmers higher sustainable prices for milk they supply on new contracts, particularly in relation to milk that is used for supermarket store branded milk. A clear example of this affect has been seen in the last month where by Lion (formerly National Foods), announced new farm gate prices for the 20011/12 financial year for dairy farmers supplying milk to Lion through the Dairy Farmers Milk Co-operative. The new farm gate price announcement presented a very slight increase in the base milk price of a half cent per litre for southern Queensland and 1 cent per litre for Far North Queensland for milk sold as fresh bottled milk or what is termed Tier 1 milk. This equates to just a 1 and 2 percent increase respectively, which does not even help farmers keep pace with rising input costs, with inflation currently running at 3.6 percent. To put this into perspective, this announcement follows major cuts to farm gate prices by the then National Foods last year by some 15 percent for one group of Queensland dairy farmers and by more than 20 percent for another smaller group of Queensland dairy farmers.

Farm Gate Milk Prices

Since the 26th January, Coles and Wesfarmers executives have continued to publicly state that farm gate prices for dairy farmers have increased in the last year.

In stark contrast to the Coles' claims, as stated above, during 2010 the farm gate prices for many dairy farmers was reduced significantly by 10 percent in New South Wales and Victorian and between 12 to 18 percent in Queensland, which includes the Tier One price dairy farmers are paid by National Foods (now Lion) that supply the milk for Coles supermarket branded milk.

The reference Coles makes to increasing farm gate prices reflects prices paid to dairy farmers supplying the export market not the domestic market. As such the statement is very misleading and if purposefully preconceived, it is deceptive.

For Coles to publically promote that "*Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased.*" (Coles media release 26th January 2011 and various public statements), is tantamount to deceptive and misleading advertising, in that it is seeking to promote to consumers that if they buy Coles branded milk at this dramatically discounted prices it will not have a negative impact on dairy farmers.

QDO Meeting with Coles and Wesfarmers

The QDO has met with representatives of Coles on two occasions following the 26th January, including with a representative from Wesfarmers.

At both of these meetings QDO clearly explained;

- that the industry understood that due to the unique nature of fresh milk, as an inelastic every day dietary staple of our community, Coles was using discounted supermarket store brand fresh milk as;
  - a marketing agent to attract customers away from their competition,
  - to lure sales away from other market channels such as the route trade,
  - as a customer locator and grocery sales multiplier within their stores,
  - while also at the same time growing the market share of their supermarket store brand milk at the expense of proprietary brand sales and there by growing the market power and dominance in both retailing and procurement of products.
- the implications of the Coles led discounting of supermarket store brand fresh milk to $1 per litre and the use of fresh milk as a marketing agent, including;
  - the devaluation of fresh milk in the market place,
  - lowering of margins and returns to the fresh milk supply chain,
  - undermining the market share and viability of proprietary branded milk and investment in processing and product innovation,
  - undermining the market share and potentially the viability of alternative retail channels including smaller retailers and the route trade,
- direct impacts affecting milk payments to farmers caused by supermarkets discounting store brand milk,
- that dairy farmers are leaving the industry at a higher rate and the majority that have left in the last few months have cited the 'supermarket price war' as a key factor in their decision,

- that in the last decade the price per litre for supermarket store brand milk had declined in real terms, while market share of sales had more then doubled and that over the same time the price for proprietary brands followed inflation, however sales through supermarkets dropped by more then half,
- that the widening gap between prices and market share and subsequent reduced returns to the fresh milk supply chain is now clearly unstainable, with the difference per annum now amounting to more than $490 million with the potential to increase to over $580 million if the current discounting continued,
- future implications for the sustainability of fresh milk supply chain, including the ability for dairy farmers to afford to maintain farm systems and standards,
- the current situation for the Queensland dairy industry following the impacts of large price cuts for many farmers last year, severe impacts of floods and cyclones and
- that the Queensland industry was currently not producing enough milk to meet the daily demands of the Queensland market and that for farmers to recover and to be able to invest in producing more milk, stronger farm gate prices are required,
- many dairy farmers are questioning their future in the industry, having endured a decade with severe droughts, floods, cyclones, increasing operational costs and low farm gate returns for much of the period,
- that the ongoing and increasing loss of fresh milk production in regions such as Queensland will result in milk having to be freighted further at higher costs.

The QDO also explained to Coles and Wesfarmers representatives why their public claims were not accurate, particularly in regard to the claim that Coles discounting will not affect dairy farmers' returns.

Even though QDO have met with representatives of Coles and Wesfarmers to directly explain the impacts and implications of their discounting campaign, the QDO is continually frustrated by ongoing misleading public statements from Coles representatives, including the following examples;

At the Victorian Farmers Federation annual conference, on the 24th June 2011, Robert Hadler, Coles' General Manager Corporate Affairs, was reported as stating to a conference audience of more then 300 farmers that the Coles Down Down price reduction campaign had no detrimental to farmers and that "no dairy producer has been suffering as a result of Coles discounting."

This statement is simply wrong and totally misleading and farmers at the VFF conference quite rightly corrected Mr Hadler.

On the 9th May 2011, in a Coles Press Release, Coles Managing Director, Ian McLeod stated, "he was pleased that the committee has recognised that there is no evidence that Coles' milk price cut is damaging the dairy industry.", and that "In all of our dealings with the Senate Committee, and with the Australian dairy industry, we have reinforced that our retail milk price cuts will not have a detrimental impact on Australian dairy farmers."

Again this statement is misleading.

On the 25th July 2011, in a Coles Press Release, Coles Managing Director, Ian McLeod stated, “Increased milk consumption over the last six months, well above long term trends, shows that both our customers and the dairy industry are winning as a result of our Down Down milk pricing initiative.”, and “We have always said we are committed to reducing prices for Australian consumers as well as supporting Australian farmers. We are therefore re-assured that farm gate milk prices are increasing for most dairy farmers and domestic milk consumption is up.”

Again these statements are again potentially misleading as;

- domestic fresh milk consumption continues to track trends in population growth and per capita consumption over the last five years (1.8% and 0.6% respectively),
- increasing sales and markets share of supermarket store brands discounted, to near or below cost with little or no margin for processors, has resulted in the loss of sales and market share of processor proprietary brands. This change in market share has resulted in lower returns to processors,
- there is no support for dairy farmers coming from supermarkets discounting and using fresh milk as a, near or below cost, marketing agent and devaluing milk and returns to the fresh milk production and supply chain,
- farm gate prices have been increasing over the last six months for dairy framers in southern production regions which supply milk for the export market. Farm gate prices for the majority of dairy farmers supplying milk for the domestic fresh milk market have been declining in nominal or real terms, as a direct result of the current near or below cost discounting of supermarket store brand milk.

Other Coles Advertising Issues

In addition there seems to be inconsistencies in the presentations of Coles print advertising compared to the Coles promotional press release of the 26th of January, which may also be tantamount to misleading consumers.

Further more, while Coles is saying in their submission, to the Senate Inquiry, that they ‘just’ reduced the Coles brand milk by 4.3% or 4.5 cents per litre, which is a reference to Coles reducing the price of its Coles supermarket brand from $2.09 to $2.00 for two litres, the full truth is that Coles stopped one line of Coles brand ‘Smart Buy’ effectively reducing the price of those sales from $2.47 to $2 per two litres or by 19% and reducing Coles litre milk from $2.99 to $2.00 for two litres or by 33%.

Coles promoted in its Press Release dated the 26th January 2011 stating that, “The price of Coles Brand fresh milk is being cut by as much as 33% from today……”

“Significantly the price cut also includes Coles Brand reduced fat milk which will be cut to the same low price of $2 for a two litre bottle, bringing it into line with full cream milk so customers will no longer have to pay a price premium for a lower fat milk option.

“By offering the same low price on Coles Brand reduced fat milk we are also enabling more customers to switch to the lower fat option at a price they can afford which is clearly a significant health benefit.” (We note that Coles has not made the same health claim with the discounting of alcohol, in relation to the converse health effects that would come from increased alcohol consumption vis-a-vis cheaper prices).

Appendix 1

Facts and Figures - Australian Dairy Industry & Domestic Milk Market

2009/10	Australian fresh milk sales = 2,269 million litres
2010/11	Australian fresh milk sales = 2,315 million litres
	Change = + 2 %
2009/10	Per capita consumption = approximately 102.4 litres per head
2010/11	Per capita consumption = approximately 103 litres per head
2009/10	National population growth 2 percent
2010/11	National population growth 1.5 percent
2010/11 (p)	Total milk sold through major supermarket chains accounted for 1,216 million litres or 54% of total domestic milk sales
1999/2000	major supermarket chain ‘supermarket brand’ sales accounted for some 25% of total supermarket sales, compared to
2010/11 (p)	major supermarket chain ‘supermarket brand’ sales have more than doubled to account for some 54% of total supermarket sales or approximately 625 million litres.
2010/11 (f)	major supermarket discounting of milk from the 26th January 2011 to the end of June 2011 has already seen sales growth of ‘supermarket brand’ milk of 10 percent nationally and for some categories of up to 75 percent in some states and up to 25 percent nationally across the modified or reduced fat fresh milk category.
2000/2001	difference in retail price between proprietary ‘branded’ milk products and major supermarket chain ‘supermarket brand’ label products in 1999/2000 was $0.18 per litre and for whole milk the difference in price was $0.07 per litre,
2009/10	the difference in retail price between proprietary ‘branded’ milk products and major supermarket chain ‘store brand’ products in 2009/10 was $0.71 per litre and for whole milk the difference in price was $0.71 per litre,
2010/11 (p)	the difference in retail price between proprietary ‘branded’ milk products and major supermarket chain ‘store brand’ products in 2010/11 increased to $0.78 per litre and for reduced fat milk the difference in price increased by 23% over the last year to $0.90 per litre,
2011/12 (f)	if the major supermarkets continue to discount milk to $1 per litre then the price difference is forecast to increase to over $0.86, assuming no other price changes occur in milk processor proprietary ‘branded’ products,
1999/2000	‘supermarket brand’ label price for regular whole milk was $1.26 per litre, and supermarket market share of whole milk sales through supermarkets was 31 percent and processor brands 69 percent,
2010/2011	‘supermarket brand’ label price for regular whole milk had dropped to an average of $1.07 per litre or 15% and supermarket market share of whole

milk sales through supermarkets increased to 71 percent and processor brands declined to 29 percent,

2010/2011 the current discounting has seen prices drop to between $0.96 and $1.00 per litre,

1999/2000 proprietary 'branded' price whole milk was $1.33 per litre,

2009/2010 proprietary 'branded' price whole milk was $1.83 per litre up 38%,

1999 to 2010 inflation increased by approximately 36%,

1999/2000 'supermarket brand' label price for modified or 'reduced fat' milk was $1.37 per litre, and supermarket market share of whole milk sales through supermarkets was 12 percent and processor brands 88 percent,

2010/2011 'supermarket brand' label price for 'reduced fat' milk had dropped to an average of $1.14 per litre or 17% and supermarket market share of whole milk sales through supermarkets increased to 53 percent and processor brands declined to 47 percent,

1999/2000 proprietary 'branded' price 'reduced fat' milk was $1.47 per litre,

2009/2010 proprietary 'branded' price 'reduced fat' milk was $2.04 per litre up 39%,

1999 to 2010 inflation increased by approximately 36%,

The following Table 1 provides Dairy Australia's figures for 2010/11 (p) and 1999/2000 for branded and supermarket 'store brand' milk sales volumes and average prices sold through supermarkets.

Over the last decade supermarkets have more than doubled their supermarket milk brand market share through using a range of discount and marketing tactics, using fresh milk as a marketing agent.

When this value difference of retail milk sales is equated across the market share of major supermarket chain 'supermarket brand' sales for 2010/11 (p) compared to the value of proprietary brand sales through supermarkets the difference is $490 million and more than $100 million per year in the Queensland market. In 1999/2000 the value difference amounted to some $44.5 million.

As a result processor brands have lost market share and the margin to the industry has been reduced to a point where the loss in retail value to the dairy industry is over $490 million per annum, compared to $44 million in 1999/2000.

If half of this amount of money, $490 million, was retained at the farm gate it would translate to an increase in farm gate price for dairy farmers of 10.5 cents per litre for milk supplied for the domestic fresh drinking milk market.

This is the amount the large retailers have taken out of the value chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry value chain.

To get a further insight into the impact of the current discounting of milk Table 1 also provides a retail milk sales and price data for 1999/2000, 2009/10, 2010/11 and forecast impact analysis data for 2011/12.

To further assess the impacts of ongoing supermarket discounting in the domestic fresh milk market the following two forecasts have been prepared based on 2010/11 market data.

Forecast 1: The first forecast is based on 2010/11 milk volumes, with the assumption that supermarket $1 per litre discounting continues throughout the year and results in an average retail price for supermarket brand whole and reduced fat milk of a $1.02 and $1.01 per litre, respectively, with no change in market share of either supermarket "store brands" or processor proprietary brands and with consumption growth of 1.5 percent reflecting population growth.

The average retail price for supermarket brand in 2009/10 was $1.19 per litre, where as the average forecast price for supermarket brands if the current discounting at $1 per litre through out the year for 2011/12 is $1.04 per litre. The difference in pricing between the two years is a decline of 15 cents per litre.

Across the volume of sales of supermarket branded milk in this forecast of 634 million litres with a reduction is price of 15 cents compared to 2009/10, there has been an additional loss of $95 million in value on those retail milk sales.

In addition the accumulated retail value difference would increase from 71 cents to per litre in 2009/10 to 86 cents to per litre in 2011/12 between the two categories of milk, being supermarket 'store brand' and processor proprietary brands.

This increasing price difference between the categories provides the supermarkets with a larger price marketing advantage over processor proprietary brands and increasing market share gives the supermarkets greater market power.

Forecast 2: The second forecast is based on the assumptions that;

- supermarket $1 per litre discounting continues throughout the year and results in an average retail price for supermarket brand whole and reduced fat milk of a $1.02 and $1.01 per litre,
- Processor branded milk prices remain static,
- Processor branded milk sales fall by 10 percent and supermarket 'store brand' sales increase by 10 percent,
- consumption growth of 1.5 percent reflecting population growth.

The resultant forecast impacts for 2011/12 compared to 2010/11 include;

- a loss of processor proprietary brand sales of 50 million litres and $106 million,
- an increase in supermarket 'store brand' sales of 72 million litres and $29 million,
- an additional loss of retail value from overall national domestic fresh milk sales of $111 million,
- increasing the retail price differential between supermarket 'store band' and processor proprietary brands from;
    - 18 cents per litre in 1999/00, to
    - 71 cents per litre in 2009/10, to
    - 78 cents per litre in 2010/11, to

    - a forecast 86 cents per litre in 2011/12, to
- increasing the retail value differential between supermarket 'store band' and processor proprietary brands from;
    - $44 million in 1999/00, to
    - $414 million in 2009/10, to
    - $490 million in 2010/11
    - a forecast $597 million in 2011/12, to

This data clearly presents that the large discounting of milk by Coles and subsequently other major supermarkets, is devaluing the value of milk sold through supermarkets nationally and is causing a significant loss in returns to the dairy industry value chain which is not sustainable.

Table 1 Comparison of National Milk Retail Sales through Supermarkets

	1999/2000			2009/10			2010/11 (p)			2011/12 (f) Forecast 1 *			2011/12 (f) Forecast 2 *		
										Discounting, 1.5% mkt growth & static mkt shares			Ongoing discounting & 10% branded sales loss		
	Branded Milk Sales			**Branded Milk Sales**			**Branded Milk Sales**			**Branded Milk Sales**			**Branded Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	325,000,000	$ 1.33	$ 432,250,000	148,000,000	$ 1.83	$ 270,840,000	151,922,000	$ 1.82	$ 276,498,040	154,200,830	$ 1.82	$ 280,645,511	139,008,630	$ 1.82	$ 252,995,707
Reduced Fat	168,000,000	$ 1.47	$ 246,960,000	185,000,000	$ 2.03	$ 375,550,000	182,645,000	$ 2.04	$ 372,595,800	185,384,675	$ 2.04	$ 378,184,737	167,120,175	$ 2.04	$ 340,925,157
Low Fat	88,000,000	$ 1.53	$ 134,640,000	59,000,000	$ 2.07	$ 122,130,000	53,956,000	$ 2.05	$ 110,609,800	54,765,340	$ 2.05	$ 112,268,947	49,369,740	$ 2.05	$ 101,207,967
Flavoured	36,000,000	$ 2.36	$ 84,960,000	74,000,000	$ 3.72	$ 275,280,000	83,332,000	$ 3.64	$ 303,328,480	84,581,980	$ 3.64	$ 307,878,407	76,248,780	$ 3.64	$ 277,545,559
UHT	70,000,000	$ 1.33	$ 93,100,000	110,000,000	$ 1.63	$ 179,300,000	119,640,000	$ 1.56	$ 186,638,400	121,434,600	$ 1.56	$ 189,437,976	109,470,600	$ 1.56	$ 170,774,136
Other	17,000,000	$ 1.57	$ 26,690,000												
	704,000,000	$ 1.45	$ 1,018,600,000	576,000,000	$ 2.12	$ 1,223,100,000	591,495,000	$ 2.11	$ 1,249,670,520	600,367,425	$ 2.11	$ 1,268,415,578	541,217,925	$ 2.11	$ 1,143,448,526

	Private Label Milk Sales			**Private Label Milk Sales**			**Private Label Milk Sales**			**Private Label Milk Sales**			**Private Label Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 1.26	$ 185,220,000	359,000,000	$ 1.12	$ 402,080,000	368,694,000	$ 1.07	$ 394,502,580	374,224,410	$ 1.02	$ 381,708,898	411,093,810	$ 1.02	$ 419,315,686
Reduced Fat	22,000,000	$ 1.37	$ 30,140,000	177,000,000	$ 1.30	$ 230,100,000	205,101,000	$ 1.14	$ 233,815,140	208,177,515	$ 1.01	$ 210,259,290	228,687,615	$ 1.01	$ 230,974,491
No Fat	3,000,000	$ 1.47	$ 4,410,000	4,000,000	$ 1.63	$ 6,520,000	5,025,000	$ 1.42	$ 7,135,500	5,100,375	$ 1.42	$ 7,242,533	5,602,875	$ 1.42	$ 7,956,083
Flavoured	-	$ 2.74	$ -	5,000,000	$ 2.01	$ 10,050,000	5,157,000	$ 1.98	$ 10,210,860	5,234,355	$ 1.98	$ 10,364,023	5,750,055	$ 1.98	$ 11,385,109
UHT	74,000,000	$ 0.90	$ 66,600,000	40,000,000	$ 1.15	$ 46,000,000	40,883,000	$ 1.13	$ 46,197,790	41,496,245	$ 1.13	$ 46,890,757	45,584,545	$ 1.13	$ 51,510,536
Other	-	$ -	$ -												
	246,000,000	$ 1.16	$ 286,370,000	585,000,000	$ 1.19	$ 694,750,000	624,860,000	$ 1.11	$ 691,861,870	634,232,900	$ 1.04	$ 656,465,501	696,718,900	$ 1.04	$ 721,141,905
	950,000,000	$ 1.37	$ 1,304,970,000	1,161,000,000	$ 1.65	$ 1,917,850,000	1,216,355,000	$ 1.60	$ 1,941,532,390	1,234,600,325	$ 1.56	$ 1,924,881,078	1,237,936,825	$ 1.51	$ 1,864,590,430

	Difference in Branded & Private Label Sales			**Difference in Branded & Private Label Sales**			**Difference in Branded & Private Label Sales**			**Difference in Branded & Private Label Sales**			**Difference in Branded & Private Label Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 0.07	$ 10,290,000	359,000,000	$ 0.71	$ 254,890,000	368,694,000	$ 0.75	$ 276,520,500	374,224,410	$ 0.80	$ 299,379,528	411,093,810	$ 0.80	$ 328,875,048
Reduced Fat	22,000,000	$ 0.10	$ 2,200,000	177,000,000	$ 0.73	$ 129,210,000	205,101,000	$ 0.90	$ 184,590,900	208,177,515	$ 1.03	$ 214,422,840	228,687,615	$ 1.03	$ 235,548,243
No Fat	3,000,000	$ 0.06	$ 180,000	4,000,000	$ 0.44	$ 1,760,000	5,025,000	$ 0.63	$ 3,165,750	5,100,375	$ 0.63	$ 3,213,236	5,602,875	$ 0.63	$ 3,529,811
Flavoured	-	-$ 0.38	$ -	5,000,000	$ 1.71	$ 8,550,000	5,157,000	$ 1.66	$ 8,560,620	5,234,355	$ 1.66	$ 8,689,029	5,750,055	$ 1.66	$ 9,545,091
UHT	74,000,000	$ 0.43	$ 31,820,000	40,000,000	$ 0.48	$ 19,200,000	40,883,000	$ 0.43	$ 17,579,690	41,496,245	$ 0.43	$ 17,843,385	45,584,545	$ 0.43	$ 19,601,354
Other	-	$ 1.57	$ -												
	246,000,000	$ 0.18	$ 44,490,000	585,000,000	$ 0.71	$ 413,610,000	624,860,000	$ 0.78	$ 490,417,460	634,232,900	$ 0.86	$ 543,548,019	696,718,900	$ 0.86	$ 597,099,548