

**Submission to the Senate  
Economics References Committee**

**Inquiry into the impacts of supermarkets'  
price decisions on the  
Australian Dairy Industry -  
two additional matters.**

**Submission by  
NSW Dairy Industry Conference**

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## **Table of Contents**

1. Executive summary
2. The NSW Dairy Industry Conference – a brief description of our role
3. The Australian Retail Grocery Market is likely to become even more concentrated
4. The impact of prolonged discounting of fresh milk in the market place
5. The impact of prolonged discounting of fresh milk will mitigate against reinvestment of capital in both the farm and processing sectors
6. The impact of renegotiated contracts with processors & impact on farmgate prices
7. Prohibiting anti-competitive price discrimination
8. Conclusion

## 1. Executive Summary

The NSW Dairy Industry Conference welcomes the opportunity to make an additional submission to the Senate Economics Reference Committee's inquiry into the supermarkets' price decisions in the Australian Dairy Industry on two additional matters:-

The duration of the Coles' 'Down Down' campaign and if it becomes permanent; and  
The outcome of renegotiated contracts with the processors and impact on farmgate prices

Australia has one of the most concentrated grocery markets in the world with the two major grocery retailers, Woolworths and Coles, having around 72% share in 2010. We are concerned that independent experts are forecasting that the concentration levels in the retail grocery supermarket will increase over the five years to 2015-16, as players such as Coles and Woolworths continue to implement new strategies for increasing their share of the market.

It is apparent that the large Australian retailers' are using discounted private label milk as a destination product to draw consumers into the stores. Not only to attract their competitors customers, but also to draw in customers who shop in the non retail channel.

We are concerned that the share of drinking milk in the retail channel could further increase from around 51% in 2009/10. The major retailers have adopted a similar strategy in the United Kingdom – aggressive discounting of packaged drinking milk to change customers long term shopping behaviour. One of the consequences of this has been that share of milk in the retail channel has increased from around 49% in 1997 to 71% in 2009. Our experience in Australia is that the tender process used by Coles and Woolworths appears to have a dampening effect on milk price both profitability for processors and returns for farmers. If the market share for fresh milk in the retail channel rose from 51% towards the level of that in the United Kingdom the outcome would be that the large retailers would have even more dominance and influence. Many small businesses would be severely affected, consumers' choice would be reduced, re-investment of capital in the farming and processing sectors would be extremely hard to justify due to reduced profitability.

We support competitive pricing in the market place, however we believe that pricing is only one element that is important to consumers. Consumers also want product choice, quality, food security, food safety, a diversity of choice across a number of channels and environmental sustainability. We believe it is vital that that there is long term viability of our farming sector, the viability of stakeholders through the entire Milk value chain, choice to consumers, quality of the products on offer, the diversity of retailers and availability throughout a range of outlets must be weighed up against the short term benefit of lower milk pricing.

Price discrimination in the dairy industry can have an anti-competitive impact where lower wholesale prices that processors charge the large retailers for private label milk results in processors charging higher prices for branded milk. The processors require a level of return to earn a reasonable profit. The small retailers in the non-retail sector are generally only selling the higher priced branded milk and there is a cross-subsidy being paid by the smaller retailers for branded milk to fund the lower wholesale prices at which the milk processors sell private label to the large retailers. The smaller retailers are at a substantial competitive disadvantage because of the higher wholesale prices they pay for branded milk. Clearly, there is a very real danger that price discrimination in the wholesale market for milk is deterring or preventing competitive conduct in the retail market in a way that is substantially detrimental to consumers.

We believe that where anti-competitive price discrimination is present, it should be dealt with under the *Competition and Consumer Act*. Given the continued ineffectiveness of section 46 we recommend that it is appropriate to amend the *Competition and Consumer Act* to deal specifically with anti-competitive price discrimination. This would be consistent with a number of international precedents including the United States *Robinson-Patman Act of 1936* and section 18 of the United Kingdom *Competition Act 1998*:

We strongly believe it is vital to have transparency of factual information costs and margins across the dairy supply chain. This will highlight issues and trends to enable remedial plans to be prepared to address the issues before they create serious long term and irreparable damage to the industry. Given the ongoing relationship between retailers, milk processors and dairy farmers, it is important that there is full transparency between the groups in the dairy supply chain regarding the existing challenges and the future of their relationships. We recommend that a framework for full transparency could be provided by a mandatory dairy code of conduct under the *Competition and Consumer Act*. Such a code could be prepared by industry consultation as suggested by Associate Professor Frank Zumbo in March 2011 (Source: Submission to the Senate Economics Committee, Frank Zumbo, March 2011).

## 2. The NSW Dairy Industry Conference – a brief description of our role

The role of the NSW Dairy Industry Conference is to discuss, clarify and implement common desirable policies to better manage the NSW dairy industry. Ongoing policy development will enable it to be innovative, sustainable, profitable and growing, while meeting consumer expectations. The NSW Dairy Industry Conference:-

- is a forum of industry members;
- operates under the *Dairy Industry Act 2000* & Dairy Industry Conference Regulation 2010.
- it is the consultative body communicating between industry and the NSW Government;
- can conduct investigations or inquiries into general policies of the NSW food industry and any other aspects of the dairy industry as required;
- reports to and advises the NSW Minister for Primary Industries on dairy industry matters.

Our vision is to contribute to an innovative, sustainable, profitable and growing NSW dairy industry that delivers on consumer expectations.

Our members are independent and have full representation of all industry sectors - farmers, processors, vendors, retailers, workers and consumers. The members through their Chairperson report to and advise the NSW Minister for Primary Industries.

## 3. The Australian Retail Grocery Market is likely to become even more concentrated

Australia has one of the most concentrated grocery markets in the world with the two major grocery retailers, Woolworths and Coles, having around 72% share in 2010 (Source: IBIS World, February 2011).

**Figure 1**

| Market Participants   | % Market Share |
|---|----------------|
| Woolworths  | 40.0%          |
| Coles   | 32.0%          |
| Other (IGA 7.0%; ALDI 4.0%; Australian United Retailers 2.3%; Franklins < 1.0%; SPAR <1.0%; Other 12.7% ) | 28.0%          |
| <b>Total</b>  | <b>100%</b>    |

Source: IBIS World, February 2011

Woolworths and Coles not only dominate the Australian supermarket sector, they are also large by global standards (Figure 2.) The two Australian retailers occupy positions in the top 30 retailers globally by turnover that given the Australian population demonstrates their dominance in the domestic market.

**Figure 2.**

| Company                           | Country of Origin | Rank 2009 | 2009 Retail Sales (US \$Mil) |
|-----------------------------------|-------------------|-----------|------------------------------|
| Wal-Mart Stores Inc               | USA               | 1.        | 405,046                      |
| Carrefour S.A.                    | France            | 2.        | 121,861                      |
| Metro AG                          | Germany           | 3.        | 91,389                       |
| Tesco plc                         | United Kingdom    | 4.        | 90,435                       |
| Schwartz Unternehmens Treuhand KG | Germany           | 5.        | 77,221                       |
| The Kroger Co.                    | USA               | 6.        | 76,733                       |
| Costco Wholesale Corp.            | USA               | 7.        | 69,889                       |
| Aldi Einkauf GmbH & Co. oHG       | Germany           | 8.        | 67,709                       |
| The Home Depot Inc.               | USA               | 9.        | 66,176                       |
| Target Corp.                      | USA               | 10.       | 63,435                       |
| Woolworths Ltd.                   | Australia         | 20.       | 44,410                       |
| Wesfarmers Ltd.                   | Australia         | 23.       | 40,288                       |

Source: "Global Powers of Retailing 2011", Deloitte

Between 2008 and 2009 Woolworths and Coles both improved their rank relative to all the global retailers. Woolworths rank rose from 26 in 2008 to 20 in 2009, whilst Wesfarmers rank rose from 28 in 2008 to 23 in 2009. IBIS World forecasts that concentration levels for the grocery supermarket sector in Australia will increase over the five years to 2015-16, as players such as Coles and Woolworths continue to implement new strategies for increasing their share of the market. (Source: IBIS World Industry Report "Supermarkets and other Grocery Stores in Australia" February 2011 page 11.).

#### **4. The impact of prolonged discounting of fresh milk in the market place**

The retailers use certain product categories and key product lines to play important roles in their strategy to attract more customers and further grow their business. For example:-

- Destination products - a must buy product that, due to its essential or staple nature, draws consumers to shop at a store;
- Support products - carried to support a category or to provide a complete range within a category or within the wider store, provided they justify their shelf space; and
- Convenience products - typically less frequent purchases ranged to support the one-stop location.

Source: Department of Agriculture, Fisheries and Forestry. "Price Determination in the Australian in Food Industry: A Report", 2004.

Whilst we are not privy to the retailers' strategies, it appears that the large Australian retailers' are using discounted private label milk as a destination product to draw consumers into the stores. Not only to attract their competitors customers, but also to draw in customers who shop in the non retail channel.

The NSW Dairy Industry Conference believes that if private label Milk continues to be discounted indefinitely, it will have long term consequences for a number of stakeholders in the Dairy supply chain, as well as for consumers. The competition for market share and growth is being fought out by the large retailers, however there is collateral damage across the supply chain – farmers, processors, distributors, small business in the non-retail channel. The share of drinking milk in the retail channel has steadily risen from around 47% in 2005/6 to almost 51% in 2009/10 (Source: Aztec Synovate and Dairy Australia - accessed 4<sup>th</sup> March 2011).

The major retailers have adopted a similar strategy in the United Kingdom – aggressive discounting of packaged drinking milk to change customers long term shopping behaviour. One of the consequences of this has been that share of milk in the retail channel has increased from around 49% in 1997 to 71% in 2009 (Source: Dairy UK “The White Paper – a Report on the UK Dairy Industry”, June 2010 page 32.).

If this trend continues in Australia, it will have an enormous impact on small businesses and will reduce consumer choice. There are around 50,000 registered business outlets in NSW (Source: NSW Food Authority website 27<sup>th</sup> August 2011). These business use and/or sell Milk and include milk bars, bakeries, small corner shops, butchers, canteens, delicatessens, health food shops, hotel/motel operations, kiosks, licensed clubs, pubs, restaurants, service stations, street vendors, takeaways, businesses and wineries. Extrapolating the number of outlets in NSW on a population basis equates to around 150,000 small business outlets using or selling milk throughout Australia.

The NSW Dairy Industry Conference is concerned that if drinking milk share continues to move towards retail as it has in the UK, many of the small businesses in the Route, Convenience & non retail channel will be severely impacted. In their submission to the Senate Economics References Committee in March 2011, National Foods stated that Processors may find that the viability of their cold chains could become questionable if the shift to supermarkets, away from the non-grocery channel continues. “Distribution of chilled products to over 75,000 outlets is likely to become uneconomic without the inclusion of fresh white milk”. (Source: National Foods submission to the Senate Economics References Committee 7<sup>th</sup> March 2011).

Further, “CHOICE” states that if heavy discounting in the short term has the effect of reducing product choice beyond what consumers want or undermining food security in the medium or long term, is not a win for consumers (Source: CHOICE submission to the Senate Economics References Committee, March 2011).

Dr. David McKinna, an Australian agrifood consultant, says consumers will be the losers in the checkout wars currently being played out. McKinna believes that the milk discount war is an example of the supermarkets re-structuring entire industries because of their enormous market power. McKinna says that in the short term consumers will be better-off, paying lower prices in a deflationary food environment. However, in the long term, they will lose out with the re-engineering of food products being needed for suppliers to meet lower retail price points, less choice on the shelves and lower margins. The lower margins will not permit investment in innovation and to invest in new capital to upgrade plant and equipment. (Source: David McKinna: “The Australian Financial Review” 20<sup>th</sup> July 2011 page 59 and David McKinna “The Sydney Morning Herald” 16 August 2011 page 5 “Business day”).

There is evidence in the public domain that categories other than milk are experiencing major challenges with the dominance of the Australian retail market. In reporting their financial performances, both HJ Heinz and Goodman Fielder blamed erosion of their margins on the price war between supermarket rivals Woolworths and Coles. HJ Heinz publicly slammed the dominant market power of Coles and Woolworths for fostering an inhospitable environment for suppliers. A senior representative of HJ Heinz was quoted as saying that Heinz has two key customers in and there has become an inhospitable environment for grocery manufacturers. The fight flared-up in January 2011 when both supermarkets slashed the price of their home-brand milks, placing further pressure on branded suppliers. Both Coles and Woolworths also devoted a growing amount of shelf space to their own private label items. The outburst from HJ Heinz represents a rare public outburst

as suppliers typically keep their criticism of retailers to themselves rather than run the risk of having their products removed from the shelves. (Source: Ian Verrinder, "The Sydney Morning Herald" - "Business Day" 30 August 2011).

Recent research has been conducted to support the premise that consumers are paying heavily for discounted supermarket staples such as milk and bread in higher process for other items. Morgan Stanley Research looked at prices offered online for shoppers within the 2000 Sydney postcode across twenty eight common household items like milk, bread, mince meat, cream, tea and chocolate biscuits. The study found that while Coles emerged about six percent cheaper than Woolworths, both companies had started jacking up non-staple items at the same time their "prices are down and staying down" campaigns began (Source: Neil Keene "The Daily Telegraph", 27 July 2011).

We believe a key question to be answered is "who is going to fund the reduced price of the private label milk over a prolonged period of time? It is possible that the large retailers can offset the lower prices on their discounted milk by raising process on other grocery products. However this will adversely affect consumers and also a dramatic and threatening impact on dairy farmers. There is anecdotal evidence that the large retailers could refuse to accept legitimate cost increases from processors or even request processors supply the retailers at a lower price. If scenario was to take place, it is possible that the processors could simply reduce the farm gate price that they pay to the dairy farmers. Our serious concern is that a reduction in the farm gate price would result in the financial viability would be further reduced with the inevitable result that more dairy farmers will leave the industry which ultimately will result in the reduction in fresh milk supply and potentially an increase in the price for fresh milk.

## **5. The impact of prolonged discounting of fresh milk will mitigate against reinvestment of capital in both the farm and processing sectors**

It is clear that the current return on capital for the major Milk processors in Australia is low and commercially unacceptable and will likely discourage re-investment in new plant and equipment. A long term price discounting of milk will only exacerbate this and this will have a major impact on all stakeholders in the dairy supply chain.

In their submission to the Senate Economics References Committee in March 2011, National Foods stated that capital investment in Australian dairy farms as a general rule is typically four times more capital intensive than is investment in Australian dairy processing. In turn, Australian dairy processing is typically ten times more intensive than the investment at the retail end. Dairy farms are very capital intensive enterprises. National Foods submitted an example of a farm in Tasmania – "On mainland Tasmania the average investment on farm is about \$4 million in order to produce 1.3 million litres of milk on a 200 hectare property. This investment has a return of 2.2%. Plant machinery and equipment typically cost \$400,000. Total livestock cost are approximately \$600,000 and land and improvements about \$3 million". (Source: National Foods submission to the Senate Economics References Committee, 7 March 2011).

National Foods stated that they expected an EBIT of approximately \$100 million in 2011 and that provides a return on invested capital of approximately 2.5%, whereas the accepted cost of capital in Australian is around 10%. (Source: National Foods submission to the Senate Economics References Committee, 7 March 2011).

Further, National Foods elaborated before the Senate Economics Committee, advising the committee that their margin on Coles and Woolworths' private label milk was close to zero, with their overall profitability on milk sales (generic milk plus National Foods' branded milk) being approximately two per cent. National Foods also advised that they were making a loss on their private label contract with Coles prior to the wholesale

price increase recently paid by Coles. (Source: Economics References Committee. The impacts of supermarket price decisions on the dairy industry. Second Interim Report. May 2011).

Clearly in this environment where satisfactory returns on capital invested, at both the farm sector and with the major processors, there is a real concern that capital will not be re-invested in both.

Australian Bureau of Agricultural and Resource Economics (ABARE) reported that a survey of the financial performance of Australian dairy farms found that average farm cash income for dairy industry farms fell from \$129,300 per farm in 2007/08 to \$88,000 per farm in 2008/9. ABARE estimated that farm income would fall to around \$50,000 per farm for 2009/10. ABARE stated that on a national level, this trend was a result of lower farm gate process, higher purchases of fodder due to dry conditions and low availability of irrigation water and increased interest payments due to increased average debt. (Source: ABARE, *Australian dairy: financial performance of Australian dairy farms, 2007–08 to 2009–10*, page 3, June 2010).

Our goal as an entire industry ought to be to strive to achieve a world class dairy supply chain that provides benefits to consumers and where all stakeholders can make a fair return and can profit from a sustainable future.

## **6. The impact of renegotiated contracts with processors & impact on farmgate prices**

We are not privy to the confidential nature of negotiated contracts between processors and retailers. Two recent significant changes have been announced and are in the public domain. Coles announced in July 2011 that it had awarded their private label milk contract to Harvey Fresh in Western Australia for the next three years. Harvey Fresh will begin supplying Coles brand milk in WA from October 2011. At this stage it is unclear what impact this will have on the current supplier, Brownes Dairy. (Source: Coles Media Release, 28 Thursday July 2011).

Woolworths advised in June 2011 that Parmalat would replace National Foods as their supplier of private label Milk (Source: "Weekly Times", 15 June 2011).

It is still unclear what the ramifications of these changes will be, however the drift of consumers buying private label milk away from buying processor branded milk products is impacting farmers and processors. It was reported that milk payments for most of Parmalat's Queensland farmers during May 2011 were an average \$850 less than for the corresponding month in 2010. This is believed to be a direct result of consumers moving from branded to private-label milk, with a portions of the supplier's milk cheque directly linked to the sale of the processor's branded milk. (Source: "Weekly Times", 15 June 2011).

One of our recommendations in our March 2011 submission to the Senate economics Committee was to establish an Ombudsman position be created to cover all Retail Food Channels – not only covering the Supermarket channel. The Ombudsman would work closely with the relevant Government bodies, the ACCC and other stakeholders. The position of this Ombudsman is envisaged to be dedicated to task of promoting and protecting competition in the retail and non-retail channels. As well as providing leadership, we believe the two following areas are crucial:-

- That all players and regulators comply with and enforce the existing rules. The Ombudsman could also make recommendations if it was felt that the existing regulatory regime was not sufficient to deal with issues.
- Proactive instigation and research. Conducting research and making recommendations where things are not working. If there are changes in the regulatory structure that are not sufficient. Also provide



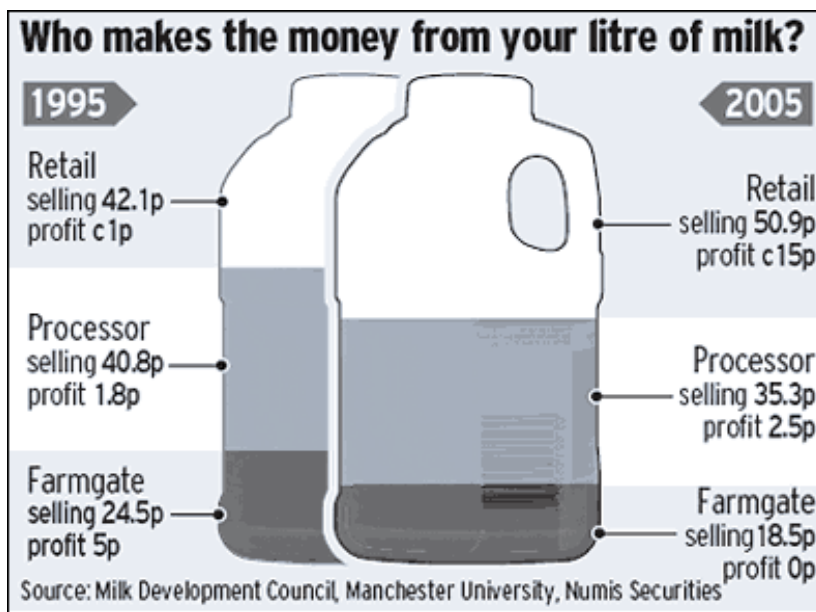
transparency in key areas of revenue, costs and margins to improve the understanding of key issues and improve the quality of decision-making.

- Liaise with all existing functions. Liaise with existing bodies to avoid duplication and make recommendations that lead to a streamlining towards one national policy making body.

We believe that full transparency of factual information costs and margins by key stakeholders in the dairy supply chain can highlight issues and trends to enable remedial plans to be prepared to address the issues before they create serious long term and irreparable damage to the industry.

Given the ongoing relationship between retailers, milk processors and dairy farmers, it is important that there is full transparency between the groups in the dairy supply chain regarding the existing challenges and the future of their relationships. We recommend that a framework for full transparency could be provided by a mandatory dairy code of conduct under the *Competition and Consumer Act*. Such a code could be prepared by industry consultation as suggested by Associate Professor Frank Zumbo in March 2011 (Source: Submission to the Senate Economics Committee, Frank Zumbo, March 2011).

**Figure 3 - Example 1 from the UK Market**



Source: Milk Development Council Manchester University 2006

A study in the UK showed that the retailers profit had increased from 1pence/litre in 1995 to around 15 cents/litre in 2005. At the same time farmers profit margins had dropped from around 5 cents/litre to zero. For the UK this was a huge issue and some experts said that if trend continued, the UK Milk Industry could come close to collapse within a matter of years, forcing the UK to import liquid milk from Europe. The prediction was that the crunch could come within five years. The official farm figures for 2005 had been released and shown that the number of dairy farms had halved since 1990 with 12,918 remaining. The study revealed that in 1995 the retailers, processors and farmers were all making money – albeit the retailers and processors were lower than the farmers. Then a price war broke out between the supermarkets in a battle for market share. Milk and bread became two of the key battlegrounds, with supermarkets scrapping for customers by slashing prices. Supermarkets leant heavily on suppliers to help fund the price war. On the supermarket shelves, the milk retail price was virtually the same in 2005 as it was in 1995.

The University of Manchester estimated in 2002 that it cost farmers' 18.3pence/litre to produce a litre of milk, which was marginally below the price farmers received from the processors. Clearly this was not sustainable in the long term.

## 7. Prohibiting anti-competitive price discrimination

Associate Professor Frank Zumbo states that while anti-competitive price discrimination is a form of anti-competitive conduct intended to be covered by section 46 of the *Competition and Consumer Act*, it remains a problem area given the current ineffectiveness of section 46. Indeed, the repeal of section 49 of the then *Trade Practices Act* in 1995 was premised on s 46 being adequate to deal with anti-competitive price discrimination. (Source: Submission to the Senate Economics Committee, Frank Zumbo, March 2011).

We agree with Zumbo that unfortunately section 46 has completely failed to reach expectations in this area, and as a result, Australia currently does not have an effective prohibition against anti-competitive price discrimination and is out of step with international competition laws.

Price discrimination in the dairy industry can have an anti-competitive impact where lower wholesale prices that processors charge the large retailers for private label milk results in the processors charging higher prices for branded milk. The processors require a level of return to earn a reasonable profit. The small retailers in the non-retail sector are generally only selling the higher priced branded milk and there is a cross-subsidy being paid by the smaller retailers for branded milk to fund the lower wholesale prices at which the milk processors sell private label to the large retailers. The smaller retailers are at a substantial competitive disadvantage because of the higher wholesale prices they pay for branded milk. The large retailers need not compete as aggressively on the price of branded milk as they would have to if the smaller retailers were not faced with price discrimination at the wholesale level. Zumbo states that in the absence of price discrimination at the wholesale level smaller retailers would provide a stronger competitive constraint on the larger retailers at the retail level for the benefit of consumers. Clearly, there is a very real danger that price discrimination in the wholesale market for milk is deterring or preventing competitive conduct in the retail market in a way that is substantially detrimental to consumers.

We believe that where anti-competitive price discrimination is present, it should be dealt with under the *Competition and Consumer Act*. Given the continued ineffectiveness of section 46 we recommend that it is appropriate to amend the *Competition and Consumer Act* to deal specifically with anti-competitive price discrimination. This would be consistent with a number of international precedents including the United States *Robinson-Patman Act of 1936* and section 18 of the United Kingdom *Competition Act 1998*:

**18.** - (1) 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.

(2) Conduct may, in particular, constitute such an abuse if it consists in-

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;...

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; ...

(Source: Submission to the Senate Economics Committee, Frank Zumbo, March 2011).

We therefore recommend that the *Competition and Consumer Act* be amended to effectively prohibit anticompetitive price discrimination in line with overseas jurisdictions.

## **7. Conclusion**

We remain firm in our resolve that the heavy price discounting of private label milk by the large Australian retailers is not in the long term best interests of consumers and all other stakeholders across the dairy supply chain in the long term. We recommend that the Senate Economics Committee take a long term view and the broader context against the short term wins for some consumers and some retailers.

If all the stakeholders in the dairy supply chain are to earn a fair and reasonable sustainable return, then the retail price of private label milk needs to be higher than \$1/litre.