Victorian Farmers Federation

7 February 2024

Senator Nick McKim
Chair
Select Committee on Supermarket Prices
PO Box 6100
Parliament House
Canberra ACT 2600

By Email: supermarketprices.sen@aph.gov.au.

Dear Senator McKim,

Re: Submission to the Senate Select Committee on Supermarket Prices

The Victorian Farmers Federation (VFF) appreciates the opportunity to provide this submission to the Senate Select Committee on Supermarket Prices.

The VFF believes that the best outcomes for suppliers and retailers are achieved when there is normal commercial bargaining and transactions between the parties.

Well-functioning, competitive markets drive the best outcomes, including prices for suppliers and consumers.

The VFF wants the inquiry to focus on the broader drivers of food and grocery price rises. The market power and behaviour of the large supermarkets may be a factor, but the VFF considers that there are other drivers of price increases that are more directly affected by government policy changes.

Focusing only on the behaviour of the large supermarket chains obscures the cause, and responsibility for, the broader drivers of costs across the food and grocery supply chain.

The VFF wants to achieve better outcomes for both suppliers and consumers, and so government needs to look at the full suite of tools available to affect prices and improve relations between the supermarkets and suppliers.

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Context

The VFF acknowledges that the largest supermarkets – Coles and Woolworths – dominate the market in Australia and hence have some degree of market power. In much of the current commentary, this market power is blamed for the perceived high profitability of the large supermarket chains and their ability to push down prices paid to suppliers – especially the suppliers of fresh produce.

The VFF challenges this view of the market and observes that:

- Some argue that the major supermarkets are earning excessive profits. However, higher profits themselves are not necessarily evidence of abuse of market power. The major supermarket chains are large enterprises with a significant turnover, and hence a large dollar profit may not reflect an excessive rate of return. Recent analysis reported in the Australian Financial review found that Australian supermarkets were '… slightly more profitable than UK and US players (2.6 per cent to 5.6 per cent), but that is consistent with the sector more broadly. Nearly all Australian retailers make higher margins than peer businesses overseas owing to cosy market structures, geographic isolation, high population and income growth,"[1]
- People point to the difference between farm gate prices and those paid in the supermarket and argue that the difference between the two is evidence of abuse of market power and 'price gouging'. In some cases, this may be the case with large supermarkets using their market power to hold down prices paid to suppliers. However, it may also be due to the supermarkets ability to buy at scale and diversify its sources of supply. There are intricate and complicated determinants of market prices which include factors such as logistics, product specifications, volumes and timing as well as the interplay between major fresh markets and the supermarkets. Disentangling the impact of abuse of market power and superior commercial negotiations can be difficult and not straightforward.
- People have other choices - they are not forced to buy from one of the large supermarket stores. Consumers can buy fresh produce from smaller, independent stores such as local butcher shops or fruit and vegetable stores. Other options include farm gates and farmers' markets.
- Lower prices themselves are not bad – but they must be based on fair market outcomes.
- Artificially forcing prices lower can impact investment and consumer choice. Policies that seek to do this and eliminate 'price gouging' are problematic as the terms undefined and contestable and has no legal basis.

Given this context it is useful to examine what is driving supermarket prices and their relationship with suppliers.

[1] *Australian Financial Review*, 12 January 2024, p.32.

Drivers of higher food and grocery costs

The VFF believes that there are many drivers that contribute to the increased cost of production for fresh produce, as well as for wholesalers and retailers (including the large supermarket chains).

Government policy decisions

The VFF believes many of the cost drivers in the food supply chain are directly influenced by government policy decisions. These cost drivers include:

- Energy, water and other input costs.
- Government regulation and red tape.
- Policies increasing labour costs and reducing labour flexibility.
- Lack of investment in key infrastructure leading to lower productivity and blockages in the supply chain.

The impact of these cost drivers is substantial. For example, recent analysis reported in the *Australian Financial Review* noted that '… the supermarkets' wages costs are up 19 per cent, rent is up 16 per cent, electricity is 10 per cent more expensive and insurance has jumped 26 per cent – nearly all tracking well above food price increases.' [2]

The impact of complying with various regulations and red tape is more difficult to measure but feeds directly into higher business costs that are passed down the chain to consumers.

The VFF notes that these cost drivers affect not only the large supermarkets but also feed into higher costs through the supply chain from producers, transport, wholesaling and to other smaller retail outlets.

Market power exerted by major supermarkets

The VFF acknowledges that the market power exerted by the large supermarket chains is likely to have some impact on the prices paid to suppliers and then charged to consumers. However, the VFF considers that there are limited tools available to address market power issues, and that taking heavy handed legislative action may lead to unintended and perverse outcomes, for example:

- Breaking up the larger supermarket businesses into smaller units or require them to divest themselves of some outlets to reduce market concentration is not a reasonable policy response.
- Requiring price transparency – does not reduce market power in itself – and may not be wanted by suppliers who want to negotiate in a commercial-in-confidence environment. There is also complexity over the possible adverse consequences of transparency including the risk of collusion.

[2] *Australian Financial Review*, 12 January 2024, p.32.

- Direct regulation of food prices is also not a viable policy option, and the VFF would not support such an approach.

Treatment of suppliers

Of more concern to the VFF is how the supermarket's market power might be used to impact unfairly on suppliers (especially those supplying fresh produce who cannot delay supply). Issues identified by VFF members include:

- Supermarkets implementing ethical sourcing policies for products they sell, but the cost of these policies is pushed back onto suppliers who have no option but to accept lower margins. In addition, there is no guarantee that the supermarkets will follow their own policies. For example, if there is a shortage of a particular product, the supermarkets will fill the gap in supply from the market from whatever suppliers are available (even if they are not consistent with the ethical sourcing standards).
- Similarly, supermarkets may specify quality standards in supply agreements, which suppliers are required to meet. However, supermarkets will arbitrarily vary the standards if it suits them even though suppliers have invested to meet the conditions set.
- Supermarkets set requirements for product packaging, for example, in terms of sustainability or ability to be recycled. Suppliers are not consulted in the setting of these standards and the cost of complying with them is pushed back onto the supplier.
- Concerns around transparency when a product is rejected. A consignment of product may be rejected by a retailer, but the reason is not always clear – it may be because of concerns around the product, though anecdotally we have been told that 'rejections' often occur when the market price has dropped on a line of produce and the retailer wants to avoid paying a previously agreed higher price. The lack of transparency is a problem because the supplier may not know what needs to be done to avoid a repeat of the rejection and has no assurance that the evidence of the quality problem is legitimate. There is no means for independent third-party inspection of the produce. In the meantime, the supplier of the rejected product incurs the cost of losing the initial sale, taking the product back and then trying to find a new market- often into the same retailer distribution centre that initially rejected the stock.
- The process of expediated payments or increased purchasing volumes can lead to suppliers being required to make substantial rebate payments to the supermarkets.
- The lack of the ability of suppliers to be able to differentiate by utilising private branding also enhances the already significant market power exerted by supermarkets. Supermarkets can stop stocking product from a particular supplier and customers are unable to have visibility of this- they have not been able to build any brand loyalty. This problem is further exacerbated by the major supermarkets moving to stock more 'home' brand products, which further obscure knowledge of the individual suppliers.

Finally, VFF members suggest that the ability to secure 'Supply contracts' (as opposed to 'supply agreements) could provide suppliers with more certainty over the price paid for and volume of their products taken by the supermarket. Supply agreements are less prescriptive and do not lock in price and volumes to the same extent.

These types of concerns are not unique to Australia. A recent New Zealand Commerce Commission inquiry into the grocery sector heard examples of the supermarket sector in that country (which has only two major supermarket and so is more concentrated that Australia) using their strong negotiating position to:

- Transfer retail costs and risks onto suppliers.
- Reduce transparency and certainty over terms of supply.
- Limit supplier’s ability or incentive to provide favourable supply terms to other retailers.[3]

Solutions to the issues

The VFF considers that the behaviour of the major supermarkets needs to be monitored, and especially their interaction with smaller suppliers. However, the VFF believes that focusing solely on the market power of the large supermarket chains is not the answer to lower consumer prices and better outcomes for suppliers.

There are limited tools that could be used to address market power issues. No one would suggest breaking up the large supermarket chains nor would the VFF support direct regulation of food and grocery prices.

The Senate inquiry could usefully examine whether there are opportunities to remove unnecessary barriers to competition, which could encourage greater competition.

Improving price transparency is another policy option worthy of further investigation. The VFF would not support ‘real time’ price information being available to market participants but sees merits in information being provided periodically, to an independent body such as the Australian Competition and Consumer Commission to better understand differences in prices paid to suppliers and those charged to consumers.

The costs and benefits of different price transparency mechanisms need to be weighed carefully. On the one hand price transparency may help promote more informed negotiations and highlight instances of abuse of market power. On the other, transparency may not be wanted by suppliers who want to negotiate in a commercial-in-confidence environment. It may also aid in collusion and other anti-competitive behaviour.

The VFF considers that the Senate inquiry could examine these costs and benefits and, if found suitable, recommend a possible price transparency mechanism.

[3] Commerce Commission (2022) *Market study into the retail grocery sector*, Final Report, p.351

Focus on the direct drivers of cost increases

The VFF believes that the focus of government policy should be on addressing the drivers of cost increases in the food and grocery supply chain. These are government policies that directly increase the costs of doing business for farmers, wholesalers, and retailers.

Treatment of suppliers must be improved

The VFF argues that the treatment of suppliers by the major supermarkets must be improved. The VFF is particularly concerned that fresh produce suppliers are particularly vulnerable to unfair practices by large supermarkets. Perishability of the product means that suppliers are forced to accept conditions offered by the large supermarket because there is not time to find and negotiate supply agreements with other retailers before the quality of the produce degrades.

The Senate inquiry could usefully investigate the treatment of suppliers and consider ways of addressing the imbalance of market power faced by suppliers which lead to this treatment.

In addition, the recently announced review of the Food and Grocery Code of Conduct by Dr Emerson will provide an opportunity to consider the best way to support suppliers achieve fair and reasonable supply conditions.

However, the VFF notes that there are gaps in the existing regulatory mechanisms available for growers with a dispute. For example, section 11 of the code exempts wholesalers supplying supermarkets from all of part three of the code which deals with general conduct, such as paying suppliers. Alternatively, under the Horticulture Code of Conduct, Horticultural Produce Agreements a written contract which includes information on how prices are calculated, product quality etc, apply to wholesalers but not supermarkets. Section 27A of the Food and Grocery Code regarding price increases is largely redundant in practice as it only comes into effect when negotiations on price have not concluded within five days. This requirement does not reflect the timing imperatives for suppliers of fresh fruit and vegetable products which are required to be on shelves immediately, and as a consequence, growers have little ability to negotiate price.

The way forward

The recently announced ACCC inquiry into the Australian supermarket sector provides an opportunity to examine further the power of the large supermarket chains, the extent of competition and the treatment of suppliers.

However, the inquiry will last 12 months and there will then be a period before the government announces its response to any recommendations and then for those recommendations to be acted upon. The VFF believes this is too long to wait when there are actions the government can start taking now to reduce costs across the food and grocery supply chain.

The bottom line is that the government needs to act now to support producers and consumers and not wait for the outcome of another inquiry.

The VFF thanks you for the opportunity to provide input to the Senate Select Committee on Supermarket Prices. We are more than happy to meet with the Committee to explain our position or present at any public hearings. The policy contact for this matter is

Yours sincerely

Emma Germano
President
Victorian Farmers Federation