



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Reference: Impacts of supermarket price decisions on the dairy industry

TUESDAY, 29 MARCH 2011

CANBERRA

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**SENATE ECONOMICS
REFERENCES COMMITTEE**

Tuesday, 29 March 2011

Members: Senator Eggleston (Chair), Senator Hurley (Deputy Chair) and Senators Bushby, McGauran, Pratt and Xenophon

Substitute members: Senator O'Brien to replace Senator Pratt for the committee's inquiry into the impacts of supermarket price decisions on the dairy industry.

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Coonan, Cormann, Crossin, Eggleston, Faulkner, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Joyce, Kroger, Ludlam, Ian Macdonald, McEwen, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams and Wortley

Senators in attendance: Senators Colbeck, Eggleston, Heffernan, Hurley, O'Brien, Ryan, Williams and Xenophon.

Terms of reference for the inquiry:

To inquire into and report on:

The impact on the Australian dairy industry supply chain of the recent decision by Coles supermarket (followed by Woolworths, Aldi and Franklins) to heavily discount the price of milk (to \$1 per litre) and other dairy products, with particular reference to:

- (a) farm gate, wholesale and retail milk prices;
- (b) the decrease in Australian production of milk from 11 billion litres in 2004 to 9 billion litres in 2011, of which only 25 per cent is drinking milk;
- (c) whether such a price reduction is anti-competitive;
- (d) the suitability of the framework contained in the Horticulture Code of Conduct to the Australian dairy industry;
- (e) 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;
- (f) the need for any legislative amendments; and
- (g) any other related matters.

WITNESSES

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Committee met at 9.35 am**McENTEE, Mr Pat, General Manager, Fresh Foods, Woolworths****SAMIA, Ms Nathalie, Group Manager, Government Relations and Industry Affairs, Woolworths**

CHAIR (Senator Eggleston)—I declare open this fourth hearing of the Senate Economics References Committee's inquiry into the impacts of supermarket price decisions on the dairy industry. On 10 February 2011 the Senate referred this inquiry to the committee for report by 15 April 2011. The reporting date has since been extended to 20 April. To date the committee has received over 140 submissions, which are available on its website. These are public proceedings, although the committee may determine or agree to a request to have evidence heard in camera. I would ask everybody to ensure that they have switched off their mobile phones—which includes me. I would also ask photographers and cameramen to follow the instructions of the committee's secretariat and ensure that senators' and witnesses' laptops and personal papers are not filmed.

I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may of course also be made at any other time.

A witness called to answer a question for the first time should state their full name and the capacity in which they appear and witnesses should speak clearly and into the microphones to assist Hansard record the proceedings. Our first witness today is Woolworths. I welcome Woolworths and invite you to make an opening statement if you would care to do so.

Mr McEntee—Thank you. Good morning. I am Pat McEntee and I am the general manager for fresh foods in Woolworths. I have been an employee for Woolies for 22 years now. I grew up on a small family property in a little village called The Oaks, which is near Picton. After I left school I trained as a butcher and I have spent my entire working life in the fresh food industry.

I fully appreciate that people like to assume that both retailers are the same. I can assure you that this is not the case here. There are three things that I believe characterise Woolworths's approach to food retailing. Firstly, we always provide the best value to our customers and private label is an important part of this, but we believe value needs to be delivered right across the store. This is why we commenced a broad based price reduction program on thousands of everyday products across the store more than three years ago and why we compete vigorously every day with a wide range of competitors.

Secondly, we recognise that our customers want choice as well as value every time they shop with us. This means stocking our shelves with trusted brands as well as private label products. It also means working closely with our suppliers to introduce new and innovative products. Private

label has a place and it has been around for more than 30 years, but we view ourselves as a house of brands with some private label products, not a house of private label with some brands.

Thirdly, we do our very best to strike the right balance between our customers' need for value and choice and our suppliers' need for a fair go. Without balance we do not have a sustainable supply chain. The reason why Woolworths abides by each of these three characteristics is because we know what our customers expect from us. Our customers do expect us to give them value, they expect to find choice and they expect us to deliver these things in a way that is fair and responsible. When it comes to milk, which is one of Australia's most important primary commodities, we believe our mandate to provide value, choice and responsibility takes even greater significance. Achieving balance is critical, as is being aware of circumstances such as flood and drought.

I thank the committee for the opportunity to be here today. As general manager of fresh foods I will do my very best to answer your questions. If there are any questions that require an answer that is commercially sensitive or relates to another part of the business, I am happy to take them on notice and respond back as quickly as possible. Thank you.

CHAIR—Thank you very much. I might just ask you a couple of opening questions. You in your submission, and in a number of other public comments by Woolworths's representatives, have stated that:

... rapid price drop is unsustainable for the Australian dairy industry.

And that this is not a price war that Woolworths would have started. Can you tell us whether or not these are genuine sentiments, or are you just annoyed that Coles has got you on the back foot?

Mr McEntee—Woolworths have a genuine concern that the rapid price drop and the potential for this price drop to flow back to processors and farmers may impact the longer term sustainability of the Australian dairy industry. Our concerns are sincere.

CHAIR—Okay, thank you.

Senator WILLIAMS—Can you expand on that and explain it to the dairy industry? Sorry, Chair.

CHAIR—Of course, I can actually adjourn.

Mr McEntee—Short term we are absorbing the impact of the price drop within Woolworths supermarkets. We do expect, however, that as there is a change of mix of white milk sales at point of retail, there is every possibility that processors may look to recoup loss of profits through their negotiation with farmers on future contract negotiations.

Senator HEFFERNAN—What would you know of discounted milk?

CHAIR—We will come to that in a minute, Bill, I think.

Senator HEFFERNAN—You can fill a water bottle somewhere between 1,000 and 3,400 times from the tap for the price of the bottle of water you buy at retail. Why don't you blokes have a crack at water? There is plenty of slack in the water market.

Mr McEntee—Thanks, Bill.

Senator HEFFERNAN—Why don't you?

Mr McEntee—I agree that when you compare the current retail price of milk to the price of water as retail, there is an imbalance. I agree with you.

Senator HEFFERNAN—It is crazy. Didn't Kate Carnell put her finger on it?

CHAIR—I think, Bill, we will—

Senator HEFFERNAN—Just one question.

CHAIR—No, you wait.

Senator HEFFERNAN—Just one question.

CHAIR—No, I want to ask a question about processors.

Senator HEFFERNAN—All right.

CHAIR—If this price cut persists long term, how will it affect your negotiating position on your contracts with processors when those contracts come up for renewal?

Mr McEntee—In Woolworths we have quite a rigorous negotiation process, tender processes which we have with our supply partners. That tender process is either annual, for 12 months, or a 24-month period at this point in time. When it comes to dealing with the price of milk, different to the other areas of fresh foods—in our fruit and vegetable, meat, deli, seafood businesses we deal directly with our farmers and our suppliers—we are dealing with the processors. Quite often we are a price taker through the tender process, rather than a price giver.

CHAIR—Is this cycle of contracts a key consideration in all of this? At the present time you have told us you have these two time frames for your contracts. Can we presume that Coles has a similar time frame for their contracts with processors, and will this mean that, when those contracts are up for renewal, the processors may find that the prices Coles is prepared to pay are different?

Mr McEntee—I do not know the intimate detail of how Coles work their contracts with their processors. What I do know is that Woolworths have a 12-month or a 24-month contract. Our contracts are renewed in September of this year. I cannot comment on what Coles do with their contracts, I am sorry.

CHAIR—Suppose we go to September this year and you negotiate a contract with a processor, how does that flow through to the farm-gate price of milk?

Mr McEntee—The way that our tender process works with suppliers is that we ask for an expression of interest right across the country. We get interested parties, on a national basis, a state basis and on a regional basis, to express interest in our milk tender and volumes. That is when the prices are submitted by the processor to Woolworths.

CHAIR—But if you were, for example, selling milk at a lower price—say even \$1 a litre—and you had an existing contract with a processor, would you be seeking to get a price variation when your contract next came up and would that then flow through to farmgate prices?

Mr McEntee—The prices that are submitted to Woolworths by our processors obviously take into consideration many factors: farmgate pricing, cost of production, the processors' costs, as well as our distribution costs to get product to Woolworths. I would assume the processors will reflect the same basis in their costings this year as they have in the past years.

CHAIR—But in your case, because you buy such a huge volume of milk, you have got a very strong relative bargaining position with the processors, I would suggest to you. If you wanted a cheaper price from the processors, you could almost say, 'We want a cheaper price,' and they would have to comply, would they not?

Mr McEntee—No. Through the tender process, the processors are actually submitting proposed cost prices to Woolworths for the period of the contract, as opposed to Woolworths sending indicative prices to our processing partners.

Senator HEFFERNAN—So you do not think they would do what Carlton did and just withdraw the beer? They would not withdraw the milk?

Mr McEntee—I cannot pre-empt, Bill, what the processing sector will or will not do.

Senator HEFFERNAN—Didn't Kate Carnell put her finger on it?

CHAIR—Senator, if you do not mind, we will come back to you. If you have advertised an interest and are known to want to sell your product at a cheaper price, you with your market share are in a very powerful bargaining position with the processors: if they do not sell to you, they are not going to sell a lot of their milk, are they? So surely that will influence the price that they offer to you?

Mr McEntee—The information that we provide to the processors when we are establishing the tender for milk is the volume of milk that we sell. We provide that information on a national basis, on a state basis and on a regional basis, to all of those suppliers. So we are actually providing the volume of white milk that we sell for a private label product. We are not communicating to the processing partners the price of what we sell product for. It is a volume based tender process.

CHAIR—Fair enough. But you are selling it for a price per litre in your shops and you have to show a profit on that, I presume?

Mr McEntee—Our profits on milk are very skinny, and obviously since 26 January they are even less, but once again our—

Senator HEFFERNAN—Now you know how the dairy farmers feel.

CHAIR—That is true, I am sure. So, in other words, you are saying that, if the prices were dropped lower—if your prices are so skinny—you would have to be carrying a loss.

Mr McEntee—We are certainly not selling milk below our cost price and we are certainly not selling milk at a loss, but we are selling milk at a very low margin at this point in time.

CHAIR—Do you think that Coles are selling below the cost price?

Mr McEntee—I have no knowledge of what Coles's cost price is from their contractual arrangements with their processors.

Senator HEFFERNAN—We had a Professor King in—I think it was Professor King—who said, 'The logic was if you sold the milk cheaper, you'd sell more milk.' Have you sold more milk since it got cheaper?

Mr McEntee—Total milk volume has increased since 26 January. When you look at the units of milk sold, yes, there is a slight increase.

Senator HEFFERNAN—Do you put that down to the fact that it is cheaper?

Mr McEntee—For many people, the opportunity to buy milk cheaper than it was has obviously led to some increase in consumption.

CHAIR—Senator Heffernan, we will stop there because we have to go around the table.

Senator HEFFERNAN—All right.

CHAIR—But my last question is: if it is about farm-gate prices and the impact on the dairy industry of long-term low prices in supermarkets, what is your opinion about what might be the ultimate impact on farm-gate prices if this low-cost, \$1 a litre, promotion of milk is maintained?

Mr McEntee—I cannot forecast what the negotiation between the processor and the farmer on the farm-gate price will be. As I previously stated, we do have concerns that, as the mix of business changes in white milk sales, processors may look to recover loss of profit back to the farm gate. Woolies believe there has to be a balance. Our point is that, without a balance right through the end-to-end supply chain, there is difficulty. The important part is there has to be a balance for product to be affordable for the customer but also to give returns back to the farmer. It is the balance that we think is really important. Dropping the prices overnight on such a product does not give anyone in the supply chain a chance to work the balance.

Senator HEFFERNAN—But it would highlight market share.

Senator COLBECK—You said that you are not selling your milk below cost but you are on a very thin margin. Does that margin include all of your in-store costs?

Mr McEntee—We measure margin two ways within our business. There is obviously the profit margin, which is applied from a cost-to-sell of the product as a first margin, and then we calculate all of the other costs associated. Some of those costs would be our supply chain and distribution; our product handling within our stores; then light, power—energy running the stores. So, yes, we do take those into consideration from a total profitability point of view.

Senator COLBECK—I can accept that you are selling it for more than you are buying it for. That I take out of what you said. So you are selling it for more than you are buying it for. You are obviously not making a profit out of it, but are you covering all of your costs?

Mr McEntee—From an end-to-end costing, where we sit today, we are making a slight profit margin on our milk.

Senator COLBECK—Is that across all milk lines or just on the generic?

Mr McEntee—Milk is very complex when you start to look at your total costs and the range of products we sell.

Senator COLBECK—I am not surprised. Someone told me it was going to be complex.

Mr McEntee—There is our private label cost versus sell and then there is the branded cost. We and the processors make more margin on branded milk product than we do on private label product, from a percentage profit point of view.

Senator COLBECK—But what I am trying to get at is the issue that we are talking about, which is the private label product, and I am wanting to know are you covering all your costs on the private label product? Are you telling me that you are making a slight profit on your private branded product?

Mr McEntee—Yes. I respect your question. From a cost of product to a sell, at our first margin we are making a profit. When we take into consideration the costs associated with our supply chain and distribution, our handling costs and the other costs associated within the store, we are still not selling milk below cost.

Senator HEFFERNAN—Could you provide the figures, whether in camera or not, to prove that?

Mr McEntee—I will take that as commercial-in-confidence today. If the committee would like—

Senator COLBECK—You have said publicly and in your submission to us that this is not sustainable. How does all that line up? That does not even line up with other evidence and information that we have received. If you are actually making a profit out of this, it does not matter how big it is if you are not covering all your costs. You have said publicly that you are bearing the cost of this. What cost are you actually bearing?

Mr McEntee—I think there are two questions you asked me. The cost that we are bearing is where the benchmark of milk cost-to-sell was to the reduction. We have absorbed that loss of

profit or that cost. Our comments around whether this is sustainable or not are directly related back to the cost of production of milk and the returns back to the farm gate. Woolworths are very conscious of the effects of drought, the effects of the flood, rising input costs—be it energy, be it the cost of feed, be it the annual round of labour increases. We acknowledge and we publicly say that we are concerned about the end-to-end impact on the supply chain and through the agricultural sector.

Senator COLBECK—Effectively what you are saying to me is that you expect to return a certain profit margin out of that product line. At the moment you are not achieving that profit margin, so if that becomes the resultant price of milk, the only way that you can achieve that profit margin is to push those costs back down the supply chain?

Mr McEntee—We do not deal directly with the farmer when it comes to the price of milk.

Senator COLBECK—No, I am not saying that. There is more than one way to push a cost back down the supply chain. You can do that by doing what Coles are effectively saying they are looking to do, which is to take margin out of the supply chain. There is more than one way to skin a cat. It is not necessarily directly to the farmer.

Mr McEntee—No. In this case Woolworths would not have been first to reduce the price of private label milk. As I continue to say, it is all about balance. When we look at customer value and affordability, we believe that there was a balance, product was affordable for the customer and the overnight reduction has no doubt put pressure right throughout the supply chain. We are currently working really hard with the processors to look at how we put some value back into that supply chain.

Senator COLBECK—At this point in time the actions that you have taken directly are impacting back down the supply chain on the basis of the contracts that you have with your suppliers. I refer specifically to evidence that we had in Melbourne—I think it was—from dairy farmers in Queensland. You have a contract there with Parmalat. Their contracts with farmers are based on the ratio of generic to branded milk and they have this month received reduced returns because of the change in the ratio between those two products.

You say on your website that you have an ethical sourcing guide and you just said again that you do not buy direct from the farmer, so you do not impact on prices. How do you make sure that that does not occur? You have got an ethical sourcing guide which stipulates to your suppliers how they should act. How does that apply to Woolworths?

Mr McEntee—At this point in time the price reduction which we took in reaction to a major competitor is being absorbed by us. The contract that we have in place with our processors is either for the remainder of this year, or up until September, or in some cases until September next year. Once we sign that tender agreement those prices are locked in, so we continue to pay the same price to the processor. We are very aware that in certain parts of Australia—and Queensland/northern New South Wales being one of those—the bonuses paid back to the farmer based on the units and the value sold—

Senator COLBECK—This is not about bonus. This is about a reduction in price because it is a lower valued product.

Mr McEntee—But my point is that the structure of the farmer's arrangement with the processor in some locations is very much linked to the sales of the branded milk products. We are very conscious of that and we are currently working with our supply partners to look at how we can put some value back into the branded milk category. So we are aware of that.

Senator COLBECK—I might give someone else a chance.

CHAIR—Senator Hurley.

Senator HEFFERNAN—Was Kate Carnell right when she said that the—

Senator COLBECK—You do not look anything like Senator Hurley.

CHAIR—I thought the name was Hurley, Senator.

Senator HEFFERNAN—I have got a question.

CHAIR—Senator Hurley.

Senator HEFFERNAN—If you only had 14 per cent of the market share, Coles would not have made any difference.

Senator HURLEY—I will just ask a couple of questions and then I will pass over to Senator O'Brien. Is the price of your milk the same nationwide in all your stores?

Mr McEntee—Our private label milk is the same nationally. There might be some exception to somewhere as remote as Weipa, where there may be some extra cost of transport applied to the product. As far as branded milk goes, we generally try to have consistent pricing right across all of our stores. Because we deal locally with a lot of dairy products, some dairy products do change from region to region as opposed to store by store, but our private label products are the same.

Senator HURLEY—Have you had any discussions with the ACCC since the price cuts commenced?

Mr McEntee—Personally I have not had any discussions with the ACCC.

Senator HURLEY—Has Woolworths?

Mr McEntee—Woolworths have previously provided information around cost price and other points of interest from the ACCC.

Senator HURLEY—So you have provided information but not had discussion?

Mr McEntee—I personally have not had discussion with the ACCC.

Senator HURLEY—You do not know of any other people in Woolworths who have?

Mr McEntee—I am not aware of that but can I take that on notice? I am quite happy to give you a written response back to that.

Senator HURLEY—I just want to go back into that price issue. You said that you are absorbing the cost of the price cuts in terms of your profit margin. You have said that you are a price taker in your deal with the milk processors. Given that is the case, if you are a price taker with milk processors, how do you see it is possible for there to be downward pressure on the price back through from you to the dairy farmers?

Mr McEntee—From us to the dairy farm or through the end-to-end supply chain, meaning the processor back to the dairy farmer, the obvious long-term concern that we have is around the mix of sales of the milk and what happens with the sales of the branded product, which a lot of farmers' price negotiations with the processors are linked to. That is our concern when we say long-term sustainability on pricing is to do with the branded product.

Senator HURLEY—So your concerns are around the increase in the percentage of private brand milk sold as opposed to branded milk?

Mr McEntee—That is where we see, as private label brand milk increases, that pressure could come back right through the supply chain from the processor.

Senator HURLEY—So why is it not possible—if dairy farmers and processors see that this may be a long-term trend to go to private brand milk, to Home Brand milk—that they would not say, 'Well, our industry is now unsustainable. We'll have to put up the price of milk, even for Home Brand milk, to a higher level'?

Mr McEntee—From a Woolies point of view we think we need to have choice, so offering our customers value—and there are a lot of customers in Australia—

Senator HURLEY—What difference does it make to you as a company whether you sell branded or private label milk?

Mr McEntee—What is important to us is that our customers want to and expect to have choice.

Senator HURLEY—Their choice at the moment is to buy cheaper milk.

Mr McEntee—Their choice still is, in all of our stores, to buy the branded product that they have grown up with and they are loyal to. What is important to Woolworths at the point of retail is to offer the customer that choice. Woolworths do not have a long-term plan to replace all of our milk with a Woolworths private label product. Brands are very important to many of our customers and we need to offer choice.

Senator HURLEY—Are you saying that Coles do have that long-term plan?

Mr McEntee—I am stating what Woolworths's plans are. I am not privy to what Coles's strategic plans are within their business.

Senator HURLEY—On this committee and on the Rural and Regional Affairs Committee we have heard criticism of Woolworths and their direct relationship with their suppliers, saying that it has forced down prices and conditions for farmers. You are saying—as you would, I suspect—that you are concerned about dairy farmers, but does that concern extend to other farmers? Are other farmers' criticisms right in that Woolworths have forced down their price and conditions?

Mr McEntee—As general manager, fresh foods, I get to deal with over 4,000 suppliers that provide Woolworths fruit and veg, meat, deli products and seafood right across the board each and every week. I have not had that criticism from the people that supply Woolies product. We work really closely with our farmers to make sure that they get a good deal, a good go, and we have done that for lots and lots of years.

Senator HEFFERNAN—The difference being, of course, that with fresh food there is an auction system to put tension in the market, which guides you in direct selling. In the milk market there is no auction.

CHAIR—Senator Heffernan, we have a fairly tight time frame.

Senator HEFFERNAN—Yes, all right.

Senator O'BRIEN—Ms Samia, are you the author of your company's submission?

Ms Samia—Yes, I am.

Senator O'BRIEN—Presumably it was authorised at a higher level.

Ms Samia—Yes, indeed. I worked with Pat, my colleague here.

Senator O'BRIEN—Can we be absolutely confident that it represents the views of the highest level of the company?

Ms Samia—Yes, I think you can.

Senator O'BRIEN—In terms of the submission itself, you say, talking about the dairy prices as they are now, following the 27 January price reductions:

Ultimately, these prices set a new benchmark, and can be expected to flow back to processors and farmers as new supply and pricing agreements are negotiated over the coming months and years.

I take it that means that in those coming negotiations Woolworths, in this price paradigm, will be seeking lower prices from its processors.

Mr McEntee—As I explained previously, the process that we have with our tender is that we are providing to the milk processors the volume of product available or what we sell within private label. The processor will make submission to Woolworths on what their contracted prices are.

Senator O'BRIEN—A tender is a tender. We know what a tender is. The process between the major supermarkets and milk processors has been going on basically since dairy deregulation, if not before, but I am concerned to get a clear position in relation to this submission because it seems to be saying that you will be seeking lower prices from your processor. That is, the reduction in prices in your terms 'can be expected to flow back to processors and farmers as new supply and pricing agreements are negotiated over the coming months and years'. Is it not fair that I take that to mean that Woolworths—and your competition as well, I expect—will be forced to seek lower prices to retain a reasonable margin on the product that you sell in your supermarket?

Mr McEntee—I think the context in which our submission was written was in relation to the concerns we have with the changing mix of private label milk at retail and the flow-on effects back through the supply chain. Woolworths will always negotiate vigorously on behalf of our customer to offer best value, but our concerns within—

Senator O'BRIEN—Is your submission right or not? Do I understand wrongly? Can you explain it to me in any different way? It seems to be saying very clearly that you are going to have to negotiate a lower price. I just want you to be clear with us. Is that what you are saying or not?

Mr McEntee—What I am saying is that I believe the context in which the submission was written is agreeing with our concerns about the flow-on effect back through the supply chain in milk.

Senator O'BRIEN—The flow-on will go back through the supply chain, so prices will go down in the supply chain.

Mr McEntee—Will flow right through the supply chain.

Senator O'BRIEN—So prices will go down in the supply chain. That is what you are saying, isn't it?

Mr McEntee—Potentially it will.

Senator O'BRIEN—Potentially? So the alternative is that they will stay the same, is it, or will they go up? Is there potential for them to rise?

Mr McEntee—As previously discussed, the way in which the processor will submit pricing to Woolworths will be based on their costs and the cost of production back to us.

Senator O'BRIEN—So if the prices to the processors were to go up and the processors' price to you, by that necessity, had to go up, does that mean that the price of milk in the supermarket would have to rise?

Mr McEntee—The price at the supermarket is dictated by the market price. So, clearly, there are two differences here: there is the cost of product and there is the sell price of the product. Sell prices are dictated by the market. We have a central manner in which we check competition prices on a regular basis. Our commitment to our customers is to provide the best value.

Therefore, where the market price is on key value items is where the retail sales will be. It is a separate discussion from negotiating the cost price of goods.

Senator O'BRIEN—So you could be selling at a loss?

Mr McEntee—We would not sell at a loss.

Senator O'BRIEN—So if the price goes up, you will have to put your price up at some point? They are contradictory positions that you are putting to us, in a sense, and I am trying to tie you down to a response. Clearly, you have to have flexibility in the market, but if your position is that you have to make a profit on the product and the price has to go up, at some stage the price has to go up, doesn't it?

Mr McEntee—As you would appreciate, I do not think I can predict pricing in a public forum. There are laws that stop me from doing that.

Senator O'BRIEN—Your submission says something to us, you invite us to draw a conclusion, yet when I am asking you questions which are the natural consequence of that submission you are dancing around with your answers. I would just like a clear position put by Woolworths and I do not know why you are having a problem answering.

Mr McEntee—I am certainly not trying to confuse the issue or mislead you in my response.

Senator O'BRIEN—You probably are not trying to mislead me, but you are not trying to lead me to—

Mr McEntee—As I said, I think the context in which our submission was written was on the basis of what our concerns are; we have those concerns. We are saying that we are working really hard at the moment with our processing partners to put value back into the milk category. I think the contract negotiations and the tender processes that will take place will reflect cost of goods and the market will be the market.

Senator O'BRIEN—Can you explain what the milk category is? What is the milk category that you just referred to?

Mr McEntee—In our terminology?

Senator O'BRIEN—Yes.

Mr McEntee—The milk category in conversation today is the white milk category, the combination of Home Brand products and branded milk products.

Senator O'BRIEN—So it does not include other dairy products?

Mr McEntee—Other dairy products are negotiated separately from our private label milk tender and are done within the normal process of business.

Senator O'BRIEN—So when you talk about putting value back into the milk category, you are talking about value to whom: a processor or to your company?

Mr McEntee—The processor and back to the farmer. So we are talking about the white drinking milk category and exploring ways that we put value back into that category.

Senator O'BRIEN—Would those ways include increasing the margin on branded product instead of on your company branded product?

Mr McEntee—Specifically, with what we are working on with the processors at the moment, no, we are not talking about putting the price of branded milk up.

Senator HEFFERNAN—Can we just go to why we are here? We are here because Coles want to get back market share. Do you think that is a fair summary? That is why they put the price of milk down. It was about market share, not the wellbeing of the dairy farmers certainly.

Mr McEntee—I cannot explain why Coles dropped the price of milk on 26 January. What I can say is that Woolworths would not have dropped the price of milk.

Senator HEFFERNAN—Fair enough. So it is about market share and whatever it takes. I think Kate Carnell put her finger on it, and I want to go through you, Mr Chairman, to the elephant in the room, which is market share. The top five supermarkets in the US have 40 per cent of the market, and Walmart, the biggest supermarket, has 14 per cent of the American market. If Coles only had 14 per cent of the Australian market, it would not have mattered much, would it, if they had dropped the price of the milk? You would not have had to follow?

Mr McEntee—I think it is well documented by many people other than myself as to what Coles might be doing—

Senator HEFFERNAN—It is a sort of a drop-dead question.

Mr McEntee—and the reasons behind it.

Senator HEFFERNAN—So if it had not been for the global spike in milk prices—and I chaired an inquiry in Tasmania that Senator Colbeck was at, when they were asking the dairy farmers in Tasmania to supply milk to the processor down there for 16c a litre based on the world price, and Coles tells me everything is good, because this is all about the global price which presently is spiking—wouldn't this be a complete disaster for dairy farmers? It is going to be a disaster anyway. You blokes have got 80 per cent of the prepackaged market between you. You get a contract and you go home and get drunk and then two years later, after you have been screwed properly, you feel like suicide. Isn't it about market share? This is not about the wellbeing of consumers. This is about two people that have too much market share—and you will not agree with that—fighting over market share. Surely the dairy farmers have the least consideration.

Mr McEntee—On this occasion our reaction was to the drop in the market. Our customers expect us to be competitive.

Senator HEFFERNAN—We are not in a position to be like Carlton and just pull the grog off the market. We cannot stop milking the cows. If you were serious about the wellbeing of consumers and this was not about market share and Mr McLeod's bloody bonus, wouldn't you simply say when you got to the checkout, 'For the wellbeing of consumers, here's a five per cent discount on everything you've bought in the store,' and just do that across the board, instead of screwing the various suppliers to the market?

Mr McEntee—I believe Coles are speaking at this forum today after me. Perhaps those questions are better—

Senator HEFFERNAN—Wouldn't that be a way for you to get back market share though: to say to everyone that gets the discount, 'Here's five per cent off your bill'?

Mr McEntee—I think that within our stores there are many customers that shop with Woolworths who have an expectation that we will be competitive in the market. We have a commitment to those people.

Senator HEFFERNAN—But the difficulty is—and you have a great meat product and you can buy meat confidently, and I have to declare an interest; I sell meat to Cargills and I sell meat to you—there is no auction system to sort of put a floor in the milk market. This is exactly the same as the wine inquiry which I chaired, which took 10 minutes to work out what the problem was and six months to have a long-winded inquiry, dealing with consolidated retailers and grape growers who were seriously unable to compete and do anything about it. They could not stop picking the grapes, although they have had to pull the vines out eventually. This will be about cows going to the abattoir in due course.

Mr McEntee—Part of the solution here, we believe, is for all stakeholders within the supply chain to have responsibility for viable farming and agricultural practice. We agree.

Senator HEFFERNAN—You have my full sympathy, but if there is a collapse again—we cannot compete with the US and European subsidies that they put on, and bear in mind the bulk of our milk is non-market milk—the dairy industry will just collapse. The market milk is the little ray of hope in a dairy farmer's life that sort of makes it all worth getting out of bed and going and milking the cows. So, if you are going to screw them on market milk and they have no control, like the weather, over the export milk market, it is a pretty gloomy outlook, isn't it? It is all because there is too much market share, I think. If you blokes only had 15 per cent of the market—good on you, you have a got a lot more than that. The ACCC does not think that that is a problem, but I agree with Kate Carnell. Thanks.

Mr McEntee—Thank you.

Senator WILLIAMS—Just a couple of questions to you. Do you price check your competitors?

Mr McEntee—Yes, Woolworths price check our competitors, so we have a central—

Senator WILLIAMS—Yes, thank you kindly.

Mr McEntee—pricing mechanism where we check our competitors in the market.

Senator WILLIAMS—And you have this program, the knockdown campaign. Someone gave me this information. I have been told that price checks of the dry grocery items in Woolworths stores indicate that in the current quarter of this year Woolworths has a price increase to decrease ratio of about 65 per cent to 35 per cent. In other words, you have raised the price on 65 per cent of your items and reduced it on 35 per cent. Would that be correct?

Mr McEntee—I am not aware of the information you have provided and it is certainly contrary to the price reductions that we have been implementing in our business for the last three years.

Senator WILLIAMS—A few minutes ago when you were talking you were sounding very sympathetic to the farmers and you are from the bush yourself. How long has Woolworths been concerned about the livelihood of farmers?

Mr McEntee—Woolworths has worked really closely with our suppliers and many of those are farming families, be it in our meat operation or our fruit and veg. We have been concerned for more than 20 years. As long as we have been dealing with farmers we have been concerned about farmers. Our track record is pretty good.

Senator WILLIAMS—You have been concerned about farmers for more than 20 years? Do not worry about the note from your neighbour. You have been concerned about farmers for more than 20 years, you are saying?

Mr McEntee—For as long as we have been dealing directly with farmers in our fresh food business, Woolworths are concerned about farmers.

Senator WILLIAMS—Are you concerned about the livelihood of farmers surviving financially on their land?

Mr McEntee—Yes, we are, and we work closely with our producers.

Senator WILLIAMS—For 20 years? I find that amazing, because my brother and I were pig farmers. We built a large piggery and we shovelled 120 tonnes of gravel and cement into cement mixers and did it the hard way. We were selling pigs to Woolworths and Woolworths said, 'We will not buy imported pig meat from Canada.' That is what they told us and we kept supplying Woolworths. Six months later, what were Woolworths doing? Buying imported pig meat.

So I find it hard to fathom, when you say for 20 years you have been more concerned about the livelihood of farmers, and I say it on the grounds that I think you are concerned about profit. I think that is the biggest concern of Woolworths: profit, more share of the market. The reason here is that Coles are doing the same thing—share of profits. Can you see where I could be cynical about your concern for farmers, on my personal experience?

Mr McEntee—In relation to pig meat, 100 per cent of Woolworths fresh pork sold in our supermarkets is from Australian farmers.

Senator WILLIAMS—Of course it is. You are not allowed to import fresh pork. It has to be processed to a certain degree. You are not allowed to bring fresh pork into Australia. That is AQIS regulations. All fresh pork in Australia is Australian grown, but you turned over to ham and bacon, processed, when you dumped us. That is why I found it hard to fathom that you are sympathetic to farmers, going on my personal experience. There are not many pig farmers in this parliament, you know. I am perhaps honoured.

Mr McEntee—I respect your position. Woolworths do not import any pig meat.

Senator WILLIAMS—I am going to pose this: if you are genuine about the survival of family farms and keeping people in business without screwing them down to a price where they cannot survive, I expect you from now on to honour that commitment.

Senator XENOPHON—Mr McEntee, in your opening statement you said that Woolworths was a house of brands with some private labels, not a house of private labels with some brands. That sounds nice, but the fact is you have increased private labels, generic brands, over the years, haven't you?

Mr McEntee—The number of SKUs that we sell in private label product has not increased dramatically over the years. Private label sits at about 13 per cent of our total supermarket sales.

Senator XENOPHON—But with milk it has increased significantly in the last 10 years, hasn't it?

Mr McEntee—The mixture of milk has increased.

Senator XENOPHON—So that contradicts your opening statement, doesn't it?

Mr McEntee—My opening statement was referring to the offer that we give our supermarkets across the whole supermarket. If you look at the milk category, private label milk is about 50 per cent of the milk sold within our supermarkets, so in each and every store right across the country we still offer our customers a wide range of brands from which they can choose.

Senator XENOPHON—But private label milk, your Woolies brand milk, has increased since this price war. Correct?

Mr McEntee—The units sold of private label milk has increased since the price drop on 26 January.

Senator XENOPHON—Which goes against the grain of your opening statement about private labels and branded products.

Mr McEntee—On the basis that our action on 26 January was to meet a major competitor and that we would not have been the person to reduce the price of milk, that is the circumstance which we are in.

Senator XENOPHON—I have a number of questions to ask you and time is very limited. Ms Samia, in terms of policies, you are authorised to speak at the highest levels for Woolworths. Is that correct?

Ms Samia—Yes.

Senator XENOPHON—Is selling below cost an abuse of a strong market position, as a general principle? If you sell a product below cost is that an abuse of market position?

Ms Samia—Woolworths has a general view of being competitive across our entire supermarket. Each product that we sell should stand on its own two feet and it should be profitable. We do not have a policy of selling below cost. We expect each and every product across the supermarkets to stand on its own two feet.

Senator XENOPHON—But selling below cost is a policy you would normally do?

Ms Samia—No.

Senator XENOPHON—But you might do it in some circumstances—for example, if you have been forced into it as a result of this price war with Coles?

Ms Samia—I am not aware of anything in particular. If there is something that you know, I am happy—

Senator XENOPHON—Let's follow that through, because Senator O'Brien asked you a very interesting line of questions in relation to the whole issue of margins. I appreciate you guys did not start this price war, but you have joined in it because you have no choice. Is that what your position is?

Mr McEntee—That is correct.

Senator XENOPHON—Further to Senator O'Brien's line of questioning, you have said that this rapid price drop is unsustainable for the Australian dairy industry. Doesn't that mean, Mr McEntee and Ms Samia, that you will have to drop the price? Ultimately the price that dairy farmers will get will drop because of this price war.

Mr McEntee—The way that—

Senator XENOPHON—No. Why can't you be up-front with the committee about this?

Mr McEntee—I have been up-front. The way that this normally pans out is at the moment the drop in price has been absorbed by the supermarket across the supermarket. As time goes on, obviously that then reflects closer to the department. When those things happen then you find that things return to some balance and that is what the next nine months is about.

Senator XENOPHON—Are you selling milk below cost? Is Woolworths milk being sold below cost?

Mr McEntee—No, Woolworths is not selling milk below cost.

Senator XENOPHON—No, let me rephrase the question for you. Is Woolworths's own private label milk, at \$1 a litre, being sold below cost in places like Darwin and Kununurra?

Mr McEntee—The price of private label milk is not being sold below cost. I am happy to take your comment on notice and Woolworths will be happy to provide information back to you in confidence.

Ms Samia—To show that we are not doing so.

Senator XENOPHON—And that includes the costs of transport, refrigeration, the handling of the product?

Ms Samia—As best as we can determine what all those things are, yes.

Senator XENOPHON—Hang on. Can't you determine the cost of transport? We have heard evidence from Dairy Farmers that it is about 20c a litre, 23c a litre, to go from Victoria to northern New South Wales. That is evidence on the record. What is the cost of getting milk from North Queensland to Darwin or from the Perth market to Kununurra?

Mr McEntee—When you look at the price of milk and the distribution of milk, it is different by state, by area, by region. So that I do not misinform you on your question today—

Senator XENOPHON—It is a question of misinforming the committee.

Mr McEntee—The committee. I would like to take that on notice and we will provide you information back.

Senator XENOPHON—So you are telling me that you are not sure? Again, you did not start this price war, but can you categorically say that milk sold in Darwin or Kununurra is not being sold below cost when it is \$1 a litre?

Mr McEntee—On the information that I have and the knowledge that I have, without being absolutely specific, I know that from a cost-to-sell point of view Woolworths are not selling milk below cost.

Senator XENOPHON—Is that all brands of milk? Yes, that is what you are saying?

Mr McEntee—No. Sorry, I am talking about private label milk. We are not selling private label milk below cost.

CHAIR—When you speak about costs are you talking about a global national cost or in fact do costs vary from location to location?

Mr McEntee—Costs do vary from location to location across the country.

Senator XENOPHON—Mr McEntee, Woolworths's submission said—and, Ms Samia, you may want to join in on this:

We have publicly expressed our concern that this rapid price drop is unsustainable for the Australian dairy industry.

Isn't the logical corollary of that that dairy farmers will end up getting less for their produce and aren't you—and Ms Samia, you might want to weigh-in on this—aren't you actually devaluing the product? As Senator Heffernan says, you are flogging off milk less than bottled water. How is that not devaluing a consumer product?

Mr McEntee—There is no doubt that, when you take the sell price of private label milk from where it was to where it is today, the value at sell point has been devalued. At this point in time, that has not reflected back to the cost price because our cost prices are locked in.

Senator XENOPHON—At this point in time. But inevitably it will, won't it?

Mr McEntee—We agree, and we have been open on our concerns of that.

Senator XENOPHON—Yes. Can you just say 'yes' or 'no': the consequence of this price war will be that farmers will end up getting less for their milk that they produce.

Mr McEntee—We have concerns that that may be an impact. We do not deal directly with the farmer and it is one month or thereabouts since the price reduction.

Senator XENOPHON—Two months.

Mr McEntee—But we all have—

Senator XENOPHON—It has been two months now.

Mr McEntee—We have genuine concern.

Senator XENOPHON—'Genuine concern' means that inevitably farmers will end up getting less, if this keeps going on. That is a fair summary of your submission, isn't it?

Mr McEntee—Potentially, yes.

Senator XENOPHON—You cannot say 'yes'. So, Ms Samia, can you help us on that? I mean, your submission is clear:

... rapid price drop is unsustainable for the Australian dairy industry.

Will it mean farmers will get less? Eventually they will end up getting less, won't they?

Mr McEntee—The biggest difficulty that we have with this is that we do not deal directly with the farmer. I am not sitting down talking directly to farmers. There is a processor that is part of the supply chain.

Senator XENOPHON—All right. We cannot take it any further. Thank you, Chair.

Senator RYAN—You mentioned earlier, Mr Entee, that you make more money selling branded milk than you do your private label or generic milk, don't you?

Mr McEntee—The margin?

Senator RYAN—In margin. You make a higher margin.

Mr McEntee—There is a higher margin on branded.

Senator RYAN—That is a higher margin at the Woolworths end as well as—we know from previous evidence—the processor end.

Mr McEntee—I do not have intimate knowledge of the processors dealing with farmers.

Senator RYAN—No, sure. We have had that evidence previously. If you are concerned about brand switch and brand shift, you could have cut your margin on the branded milk to the same as the private label milk, couldn't you? That would have meant there was more value in the supply chain for the processors, if you were concerned about protecting their brands, and you would not have had this brand shift that you have outlined and that you are so worried about. That could have happened, couldn't it, but Woolworths chose not to?

Mr McEntee—We do not control the price of the brand.

Senator RYAN—No. You control the price—

Mr McEntee—The brand sits with the processor.

Senator RYAN—on the register, on the shelf in the fridge, when I go to see Pura or Dairy Farmers as opposed to Woolworths, don't you?

Mr McEntee—Those prices are set by the processor.

Senator RYAN—The price you sell that milk for is set by the processor?

Mr McEntee—We work with the processor on what the processor determines the price of their brands are.

Senator RYAN—In your shop?

Mr McEntee—In our shop.

Senator RYAN—So you do not control what the price of Pura milk is on a Woolworths shelf?

Mr McEntee—Those prices are submitted to us, in a normal trading relationship, by the processor and the person who controls those brands.

Senator RYAN—And that is true of all the brands that you sell: that you do not control the price in the fridge of those fresh milk branded products?

Mr McEntee—That is right. We have a relationship with our suppliers where there is a standard price or a shelf price and there are promotional prices which we work with the suppliers on.

Senator RYAN—I understand there are promotionals. I am just talking about the standard price. You do not set that price on the shelf? I need a ‘yes’ or ‘no’ answer.

Mr McEntee—We do not set the shelf price of the branded product on our shelf.

Senator RYAN—When you deal with suppliers in fruit and veg—

Mr McEntee—Yes.

Senator RYAN—horticulture, for example—apart from the code, you do not seek to get hold of product at below the cost of production, do you?

Mr McEntee—No, we do not.

Senator RYAN—You do not. If you do not behave that way and the processors are the middle man between you and the dairy farmer—they effectively serve that role for the dairy farmers—why are you alleging, by implication or otherwise, that the processors will seek to get milk production at below cost? It is not sustainable economically over the longer term, is it?

Mr McEntee—Our concerns have been, right from the start, about the balance of things in the end-to-end supply chain.

Senator RYAN—Woolworths have made, through your current managing director and previous one—I could go through annual report after annual report where Woolworths has actually, as a badge of honour, advertised its ability to screw down supply chain costs and deliver benefits to consumers through lower prices and some of those benefits to go to shareholders. Why all of a sudden this concern about one particular sector?

Mr McEntee—I think Woolworths’s management being able to gain efficiency and productivity through our own infrastructure is very different to the infrastructure of farmers and other people that we cannot control.

Senator RYAN—True. But you have screwed down supply chain costs off manufacturers, not just people from whom you directly acquire—for lack of a better word—primary or raw produce; whether it is the makers of Vegemite or cheese manufacturers. You have, over the last 10 years, screwed down those supply costs, too, have you not?

Mr McEntee—The reference that Woolworths has made over many years to our ability to reduce our costs has been through our efficiencies in investment in new warehouses and technologies.

Senator RYAN—You are saying that none of them have come from suppliers?

Mr McEntee—We negotiate with suppliers on a day-to-day, weekly basis to deliver the best value to our customers. We do not deny that.

Senator RYAN—But some of those savings have come from acquiring at lower costs, have they not?

Mr McEntee—Cost of goods is one component of what makes up the cost of a product.

Senator RYAN—When I see ads on television for lettuce or tomatoes, or meat, or soft drinks, but particularly with fresh produce, they do not all cost an equal amount to acquire. A lettuce acquired in Melbourne, from market gardens outside of Melbourne, could be acquired from Woolworths at a different price to what you might supply a store in Wodonga, for example. Is that possible?

Mr McEntee—In the case of fruit and vegetables, prices are different by region, yes.

Senator RYAN—And you have a pricing policy whereby you try and have some consistent level of pricing within regions?

Mr McEntee—Within regions, yes, especially in fruit and vegetables.

Senator RYAN—So you do not have an equal margin on all the fresh produce you acquire. You try and average the cost out and then have make-up margins with an average price?

Mr McEntee—Yes, we do not have the same cost of fruit and veg products that go into our stores. Yes.

Senator RYAN—So that is the same here with milk. To refer to the question that Senator Xenophon asked, you have a national pricing policy in this case and presumably you average out the cost of milk—acquiring milk and supplying it, transporting it, refrigerating it—across the Woolworths chain of stores. Is that the way you price it and say, ‘We are making money on milk through this?’

Mr McEntee—Depending on the contract for milk. We have more than one supplier of product for milk and prices differ by supplier and region.

Senator RYAN—I am not challenging your statement that you are making money on this, but you would be making different amounts of money in different parts of Australia, would you not, presumably because the cost of acquiring milk in different parts of Australia is different?

Mr McEntee—There might be a slight difference in the cost price of private label milk in different regions.

Senator RYAN—If I could ask you to take this on notice: you mentioned earlier that since the price cut there had been an increase in the units of milk sold.

Mr McEntee—Yes.

Senator RYAN—If it is in confidence, I am happy for you to do so, but I would be interested in knowing what sort of increase the price cut has led to. There has been some debate around the elasticity or otherwise.

Mr McEntee—Yes. We are more than happy to provide you with that information in confidence, but there is some public knowledge with that, with the Aztec data that is provided by the dairy companies as well. But we will provide you with our information.

Senator RYAN—When you mentioned earlier your house brands versus other products and you talked about there being a change of mix in the milk market, it is no secret to any reader of the business pages or whatever that Coles and Woolworths have a slightly different marketing strategy at the moment around the role of private label generic products versus the role of branded products for which prices are cut or specials are made or whatever.

Isn't this simply a commercial disagreement between you and Coles in this regard? The reason I put that to you is that if you were so concerned about dairy farmers, didn't Woolworths cut a contract with dairy farmers in Far North Queensland last year which actually put that particular region of Australia and the dairy farmers there in a significantly difficult situation?

Mr McEntee—Woolworths did change our supplier in North Queensland.

Senator RYAN—Was that done on cost? Presumably it was a tender.

Mr McEntee—It was done on the basis that in retail we have an obligation to be competitive, and we believe for the industry it is important that the supply base needs to be competitive as well. The fact is that over the past number of years there was one major supplier that was providing pretty much 100 per cent of our product. Again, we see for the long-term sustainability of the industry that we need more than one supplier.

Senator RYAN—I understand all the reasons. The reason I ask this, Mr McEntee, is that I am a little bit cynical of one big company trying to position itself as friendly against another big company, when it could have chosen to do things other than what it is now complaining about. When you changed from that contract in Far North Queensland, was cost the significant factor in you making that decision in that tender?

Mr McEntee—No, that decision was more than just price.

Senator RYAN—But price plays a role.

Mr McEntee—That was looking at more than just a price. Price was not the only factor in the decision we made.

Senator RYAN—How significant is price when you come to choosing between tenders?

Mr McEntee—Price plays a part, but long-term availability of supply, day-to-day shelf life of supply, having product available for our customers, and increasing volume are also very important.

Senator HEFFERNAN—But if it is long-term availability of supply, the reality of what happened in Queensland—

Senator RYAN—Bill, can I finish my last question?

CHAIR—Senator Heffernan, let Senator Ryan finish, please.

Senator RYAN—Last year in Western Australia, before this price cut, did Woolworths lead with a price-cutting campaign that reduced the price of fresh milk?

Mr McEntee—We introduced Home Brand milk into Western Australia last year, which was before what happened on 26 January.

Senator RYAN—What was the price of the Home Brand milk you introduced?

Mr McEntee—The price of Home Brand milk introduced in Western Australia was \$2.09 at that point in time.

Senator RYAN—What was your lowest priced milk before that?

Mr McEntee—We did not sell Home Brand milk in Western Australia before.

Senator RYAN—What was your lowest priced private label milk before that?

Mr McEntee—Woolworths \$2.47.

Senator RYAN—Do you think maybe that price cut was more significant than the last 9c?

Mr McEntee—No. In Western Australia the market is quite different. In Western Australia, for a long period of time, the market actually high/low's and promotes milk on a regular basis, even weekly. It is quite common in Western Australia, even today, that milk is sold outside of Woolworths at \$1 a litre or thereabouts. We worked really closely with supply partners in Western Australia to introduce the price, because we do not special milk on a week-to-week high/low basis.

Senator RYAN—You have no evidence that this price cut, led by Coles and followed by you and ALDI and others, is going to be passed on to farmers, do you? You have no knowledge of that? We know about the issues of tier 1 and tier 2 milk pricing, but in terms of contracts being rolled over—you imply it. I do not know what 'sustainability' means in this context. I have not, through this inquiry, had anyone who has been able to provide me with a definition that I can measure. But do you have any evidence that prices will be cut at the farm gate as opposed to margins for yourselves or the processors?

Senator HEFFERNAN—Bear in mind this bloke has never milked a cow.

Mr McEntee—I do not have evidence of that today.

Senator RYAN—Thank you.

Senator COLBECK—I want to go back to the discussion you have just had with Senator Ryan in relation to your decision in Queensland, and you mentioned a number of factors that you took into consideration, price being one, and providing a fresh product to your local supplier. Again, it appears to me that you are giving contradictory evidence, because to take out a supplier that provides and manufactures milk in Far North Queensland and to give it to a supplier that comes from South East Queensland is not providing a fresh local product into a local market. In fact, that milk, as I understand it, is now going into Darwin, which again is not a local market. So how does that align with the values that you talk about? If it is price, then it is price and just tell us it is price. I am not fussed about that. That is the competitive market that we are talking about. But to try and pad it in a whole heap of other stuff that does not stack up quite frankly drives me nuts, because that has been what half of this whole thing has been about.

Senator HEFFERNAN—Because it is bloody stupid—

Senator COLBECK—We have had so much stuff spun at us by various parties—particularly Coles to start with, but by everybody else—to make it look as though they are warm and fuzzy and cuddly and love farmers, when we know that this whole thing is about trying to gain market share, as Senator Heffernan says. So you tell us that you have got a series of considerations, including supplying a fresh product in a local market, yet that is exactly the opposite to what you have done in Far North Queensland, because you are not supplying a fresh local product there any more. In fact, that is potentially one of the impacts that we could see out of this whole process; that those farmers in Far North Queensland, because they have got a higher cost of production, are not viable in the overall market any more. The only thing that protects them is going to be the cost of getting it there and, if you or your suppliers can come up with a cheap cost of getting it there, they are finished. That is the potential impact. So how do you say providing a fresh local product is part of your ideals when it is exactly the opposite to what you have done?

Mr McEntee—My comments were that the decision in Queensland was not just about cost; we were taking a longer term view of what the supply of product was across the board. Sometimes it is difficult, when you are making decisions across the whole of this country, to get every one of them in balance at a point in time.

Senator COLBECK—So what are the issues in regard to long-term supply into Far North Queensland?

Mr McEntee—The issue was more to do with the nature of our total supply of private label product where, over recent years, that supply was being dominated by one supplier. We do not believe having only one supplier of fresh milk product is beneficial to all parties in the industry.

Senator HEFFERNAN—In North Queensland, that is the supplier.

Senator COLBECK—Effectively, what you are doing is trying to spread your load to provide some competitive tension into your supply chain?

Mr McEntee—Not only into our supply chain, but into the end-to-end supply chain.

Senator COLBECK—This is the McDonald's argument from 2005, when they gave half of their supply contract to McCain's which went to New Zealand and left Tasmania, which is why all the tractors turned up here. That is the argument. I am not saying it is not a legitimate argument. I just want to know what the reasons are and I do not want the fluff put around it—'We want local supply.' How many suppliers do you have now in Queensland?

Mr McEntee—We have three suppliers of private label milk across the country. So we have one in Queensland—

Senator COLBECK—No, that is not the question I asked you. I want to know how many suppliers of private label milk you have in Queensland?

Mr McEntee—We have one in Queensland.

Senator COLBECK—Does this change in supply provide you with an increase in the number of private label suppliers in the country, or are you just transferring a portion of it to a different supplier?

Mr McEntee—No. In the last contract that we did, which was in September last year, we introduced more suppliers to our private label contract than what we had had in the past. Parmalat is one of those; Murray Goulburn is another.

Senator COLBECK—Yes. So Murray Goulburn took the Canberra supply—

Mr McEntee—They have got regional supply in northern Victoria and into southern New South Wales through our distribution channel.

Senator COLBECK—But in terms of Queensland, it has effectively just gone from one to another?

Mr McEntee—That is correct.

Senator COLBECK—In that state.

Mr McEntee—In that state.

Senator COLBECK—And then all of the dislocation adjustment issues are still being managed as part of that process.

Mr McEntee—As I said, it is difficult, because sometimes you are making decisions on what is right for now and sometimes you are trying to make decisions on what is right for the future.

Senator COLBECK—How does that switch impact and improve things into the future? If it is all about your future, just tell me. That is fine. I am not asking you to give me a warm and fuzzy answer. I just want to know what the real answer is. Is it about what is best for you and your customers? That is fine. I just want to know straight down the line.

Mr McEntee—No. I sincerely believe that the decision to introduce more than one supplier is beneficial to everyone in the dairy sector.

Senator HEFFERNAN—So there is a serious problem with monopoly of milk.

Mr McEntee—I believe that.

Senator COLBECK—So what you are effectively saying is that there is no scope for one of your other suppliers to win back that contract in Queensland, regardless of price?

Mr McEntee—No, our contracts go for either a 12-month or a 24-month period. The decision we made last year was to introduce more than one supplier into our milk contracts, which you would look at from: short term, difficult decision; longer term, better decision for everyone. It gives us in the industry options into the future that we did not have prior to September last year.

Senator HEFFERNAN—It certainly does not give the dairy farmers in North Queensland on the Atherton Tablelands much choice if they have got to cart the milk to Darwin.

Senator COLBECK—What are the options that you talk of? What are the options for the dairy industry? I can tell you they would like to know.

Mr McEntee—The option for the dairy industry is that we have more than one supplier supplying private label product to Woolworths.

Senator COLBECK—But not in Queensland.

Mr McEntee—We still continue to range the local product in all of our stores in Queensland as well. We have not removed the local brand from our shelves in Far North Queensland. We still give customers a choice.

Senator COLBECK—Look, I understand that, but this current process is having a severe impact, which we discussed earlier, because of the differential in price. It has gone from 70c or 80c to close to \$1 and you can understand people making the decision to buy the cheaper product. You say that there is a benefit in the long term. Apart from telling me that there is more than one supplier you cannot tell me what the benefits are. What is your view of what will happen to the shape of the Queensland dairy industry based on the decision that you have made?

Mr McEntee—We continue to take the milk product out of Far North Queensland under a branded product into our stores. We stand by our decision for the longer term. To introduce more than one supplier has to be a benefit to everyone in the dairy sector.

Senator COLBECK—Previous conversations I have had with Woolworths talk about you make 3c in the dollar, so what are those numbers? You talk about making 3c in the dollar. What is your current EBIT?

Mr McEntee—Our total EBIT?

Senator COLBECK—Yes.

Mr McEntee—I would need to take that on commercial confidence and provide that back.

Senator COLBECK—Why is that a confidential number?

Ms Samia—Do you mean across the entire company?

Senator COLBECK—Yes.

Ms Samia—I think it has been consistently about that.

Mr McEntee—Sorry, I misunderstood. I thought you were asking me a question.

Ms Samia—Specifically about milk.

Senator COLBECK—I was going to come to that, and so you have taken that on notice. That is fine. I am looking at your company EBIT, across the company.

Mr McEntee—Earnings—

Senator COLBECK—Before income tax.

Ms Samia—Yes, it is about that.

Senator COLBECK—About 3c in the dollar?

Ms Samia—Or thereabouts.

Senator COLBECK—Three per cent.

Ms Samia—Maybe a little bit more.

Senator HEFFERNAN—The ASIC obligation of the directors of Woolies and Coles, who have got 80 per cent of the prepackaged market in Australia, is to maximise the profit for the shareholders. That is the driver. You go to jail, I think, if you act in a way that does not do that; you have breached your obligation. So in doing that, the outcome in Northern Queensland is for the dairy farmers on the Atherton Tablelands to wonder how long they can keep sending their milk to Darwin. And I agree with you; there is too much consolidation in the processing industry, but the ACCC—I do not know how they tick—will not deal with this. Doesn't it mean that the ASIC obligation to maximise your profit, therefore to have market share when you have already between you got 80 per cent of the prepackaged market, mean that we really should probably disaggregate you? You are going to kill the industry. This is like—

CHAIR—Senator Heffernan, let the witnesses answer, because we are well over time.

Senator HEFFERNAN—The impact of this on farmers—

CHAIR—There was a question there. Did you want to answer it?

Senator HEFFERNAN—is exactly the same as death duties. Until Bjelke-Petersen got rid of them, death duties were high impact, low revenue. But there was a 48 per cent in state and federal death duties on the farm and the more honest you were with your bookwork the more you were likely to cop it. Isn't this the same as death duties to farmers? This is to maximise the profit for the shareholders and destroy the bloody farmers.

CHAIR—If you would like to answer the earlier question.

Mr McEntee—Was there a question?

CHAIR—It was about aggregation.

Senator HEFFERNAN—I mean, where does it start and stop?

CHAIR—Senator Heffernan, let the witnesses answer as best they can and then we will have to conclude this session.

Mr McEntee—Sorry, I am not sure what the question was.

Senator RYAN—He simply asked whether you wanted to be disaggregated.

CHAIR—Breaking up your empire.

Senator RYAN—We can safely assume that is a no.

Senator HEFFERNAN—You have got too much market share, for God's sake.

CHAIR—It is about market share and the size of your market share.

Senator HEFFERNAN—The wine industry is—

CHAIR—Okay, Senator Heffernan, we have heard you. Thank you. Just give the witness a chance to answer.

Senator O'BRIEN—Why? We are having fun.

Mr McEntee—It is a competitive marketplace.

Senator HEFFERNAN—We are propping up the New Zealand dairy farmers through Fonterra.

CHAIR—All right, Senator Heffernan, if the witnesses are unable to provide an answer, we will conclude.

Senator HURLEY—Being 'unable to provide an answer' sounds a little bit pejorative. Senator Heffernan indulged in a bit of a rant and it is hard to say that—

Senator HEFFERNAN—The question is should we disaggregate the consolidated—

Senator HURLEY—the witnesses could have provided any kind of answer whatsoever.

CHAIR—I do not think this witness is a person who would have the policy responsibility to answer that, Senator Heffernan, so I think at this point we will conclude this segment of these hearings. Thank you, Woolworths, for appearing this morning.

Mr McEntee—Thank you.

Proceedings suspended from 10.56 am to 11.11 am

DURKAN, Mr John, Merchandise Director, Coles Supermarkets**McLEOD, Mr Ian, Managing Director, Coles Supermarkets**

CHAIR—I welcome Coles to the hearing and invite your representatives to make an opening statement.

Mr McLeod—Thank you, Mr Chairman. I would like to thank the Senate standing committee for the invitation to appear today to address the impacts of supermarket price decisions on the dairy industry. My name is Ian McLeod and I am the managing director of Coles. With me is John Durkan who is the merchandise director of Coles. As you would be aware, Coles submitted a formal submission to the inquiry on 11 March. Unless it is this committee's wish, I do not propose to read our submission as my opening statement but, rather, would make a few remarks before the committee moves to question both John and I. I have a few things to say, if that is okay, Chairman.

CHAIR—That is a perfectly acceptable way for you to go; a very good idea, in fact, because we have read your submission.

Mr McLeod—First a few words about our commercial strategy: Perth based company Wesfarmers bought Coles in 2007. At that time Coles was widely regarded as a second-rate player with run-down cluttered stores, offering poor-quality products at high prices. Customers were actively avoiding shopping at our supermarkets a few years ago and it was, frankly, hard to blame them.

In early 2008, Wesfarmers approached me to move to Australia and lead the turnaround of Coles. My job description was fairly simple: to attempt to transform Coles from a run-down, second-rate supermarket chain to a high-performing company which both attracted customers back into our stores and made our company sustainable for the long term for Wesfarmers' 500,000 shareholders and, from a personal perspective, restore some pride into 100,000 team members whose morale was low after years of poor leadership and direction; in other words, to re-establish Coles as the success story it has been for most of its life since its establishment in Melbourne back in 1914.

When I started at Coles, we began a five-year plan to turn the company around and establish a platform for the future growth and sustainability of the company. Central to our plan has been to rebuild trust with the Australian public by giving our customers a reason to once again start shopping in Coles and, hopefully, continue shopping there. We have been up-front about the plan which entails, firstly, to provide quality food that costs less, lowering the price of groceries to Australian consumers; second, to engage and motivate our 100,000-strong team members Australia-wide; and, third, to recognise the inescapable fact that we are very large company and that this comes with the responsibility for contributing in a real and practical manner back to the community.

On the first point of quality food that costs less, our pricing strategy has been central to attracting customers back to Coles. Only three years ago our stores were woeful; prices were too

high. You would often find identical products priced differently in different stores only a suburb apart. The quality of our fresh produce was not up to scratch and, physically, our supermarkets were so run-down that it seemed like the strategy was to keep customers away, not to invite them in.

So we embarked upon a plan to change all of this and to create a real alternative in the supermarket industry to Woolworths. For example, we have reduced the time it takes to get fresh produce from the farm gate to our stores. We have removed the ridiculous 32-zone pricing structure that we inherited and implemented state based pricing, where the same item actually costs the same in each of our stores across each state. We have taken significant measures to reduce the cost of groceries through our supermarkets.

Many people find it hard to believe but we have reduced the price of over 5,000 individual products in our stores and it is probably harder to believe, but it is a fact, that these are genuine cost reductions and they have not been absorbed by a higher amount of cost increases elsewhere. We calculate that this pricing strategy has saved Australians over \$800 million over the past year on their shopping bills from Coles. These price reductions have actually had a deflationary effect on the cost of food, with food inflation at between one and two per cent over the past 24 months, compared to food inflation of between four and five per cent over the preceding decade.

I said deliberately that these figures are hard to believe because we understood that the cost of living in Australia—and, for that matter, around the world—is the single greatest concern for most households. Family budgets are squeezed by three levels of taxes, levels of duties, rising energy bills, school fees and everyday living costs, and the list goes on. We are under no illusion that many Australian families are doing it tough and have been for many years and hence core to our plan to attract customers back to Coles is to simply reduce the cost of products that families rely on day in and day out and engender further levels of trust in our strategy.

We are also under no illusion that the big supermarket chains in Australia have often not enjoyed the greatest of reputations, be it with our customers, the suppliers, the media, or indeed here in Canberra. We acknowledge this and it is something we are seeking to remedy. This is why you are seeing John and myself here today as opposed to us sending representatives, as has been our practice in the past.

On the second job of providing jobs in the local communities, we take our responsibility as a major employer of Australians very seriously. Our parent company Wesfarmers is the biggest private sector employer in Australia, with over 230,000 team members. With over 100,000 employees in total, over 30,000 of which live and work in rural and regional Australia, Coles is one of the biggest employers outside of government in its own right. Our team members work out of 2,248 locations across Australia. With such a large employee base, we place a priority on running a stable and sustainable business which provides our team members with both job security and career opportunity.

Across 2,248 locations around Australia, we are committed to providing safe workplaces and fair conditions for all our team members. We have invested over \$2 billion in the last three years, which is focused on long-term investment in our stores, energy efficiency, safety, technology, and people training and development. We have one of the strongest graduate recruitment programs in the country and we are focused on turning the company into an employer of choice

where Australians can join our company, enjoy a long career with us and use their time with us to develop skills to apply in the next stage of their lives.

The third point relates to Coles in the community. When Wesfarmers purchased Coles, I think it is fair to say that our contribution back to the Australian community did not go far enough. I think this is an area that we can still improve upon, but I am pleased with some of the progress that we have made since 2008. We are an official partner of the Cancer Council and have been the primary supermarket sponsor of Daffodil Day since 1996. Since then we have raised more than \$10 million for cancer research. Whilst I cannot take credit for it starting, I can take credit for it continuing.

Senator Heffernan interjecting—

CHAIR—No. The witnesses are making an opening statement. They can put into their opening statement whatever material they wish to and the senators can question them subsequently. So please continue, Mr McLeod.

Mr McLeod—Thank you, Chairman. I will be as quick as I can. We are one of Foodbank Australia's top three donors of grocery products to help feed the underprivileged. We contributed \$3.6 million worth of groceries in 2010 alone. We provided over \$2½ million to local charities and communities where our stores are located over the same period. We have worked in partnership with Junior Landcare to provide over \$1.3 million for 1,000 school gardens to teach Australian children how to grow food. We are also a national partner of Guide Dogs Australia and raised nearly \$1 million for vision-impaired Australians through 2010. That is more than \$20 million in just over a couple of years in important community projects.

We have also been an active partner with state emergency services and responded to the crisis in local communities such as the Victorian bushfires in 2009 and the Queensland floods and cyclones in January 2010. Many Coles team members and our customers are directly affected when disaster strikes and are, typically, the first ones to react and support other Australians facing danger. The car park at our Healesville store in the Yarra Valley became an SES centre to manager the Victorian bushfire response. We supplied over \$260,000 worth of water and essential groceries to the SES and local communities to help during the bushfires. Many of our team members, while families and homes were at risk, still came to work at Coles to help save stores and ensure that their friends and local communities could get essential groceries.

With \$84.9 million to the Victorian Bushfire Appeal and raising another \$4.7 million through customer donation in our stores, that is a total of nearly \$10 million. In January 2011 we also rallied to support the victims of the Queensland floods.

Senator HEFFERNAN—Your job is to maximise the profit for your shareholders or you do not get your bonus.

CHAIR—I think Coles is just trying to establish that they are good community citizens, and we will accept that.

Senator HEFFERNAN—Let's get on with it.

CHAIR—So if you want to move into the—

Senator HURLEY—Chair, I think Senator Heffernan has far more delayed this inquiry than Mr McLeod has.

Mr McLeod—May I continue?

CHAIR—Yes, you may.

Mr McLeod—Thank you. In January 2011 we rallied to support the victims of the Queensland floods. At one stage over 70 Coles stores were isolated by the floodwaters. Four stores were under water and some team members even caught boats to work while electricity was cut and I really appreciate their efforts. Coles was the first company to donate \$1 million to the Queensland Premier's flood relief appeal and helped to raise another \$4.3 million in customer donations through our stores nationwide, but this is just the tip of the iceberg.

Coles absorbed over \$20 million of additional cost during the Queensland floods to ensure that we continued to supply essential fresh food. We sourced groceries from all over Australia and got 1,000 tonnes of groceries to Queensland by Coles's chartered 747s and Air Force planes, trains and trucks, and another 1,000 tonnes of groceries by chartered ship from Rockhampton to Cairns. We have also worked closely with fresh produce suppliers such as Rugby Farms in Lockyer Valley, that were devastated by the Queensland floods, to get them back up and running as quickly as possible. We rejected any push to import bananas so that we could support the quickest possible return to our banana suppliers.

With regard to milk, as I said earlier, as part of our plan to build trust with our customers and bring people back to shopping at Coles, our focus has been on providing customers a better deal by reducing the price of a range of groceries, including some which appear regularly in the weekly shopping basket.

We are acutely aware of the hardship facing many Australian families as disposable incomes are being squeezed by rising interest rates, higher taxes and charges, including water, gas and electricity. ABS data shows that Australian working families have lost approximately \$130 a month as a result of higher interest rates and higher taxes. We also believe that our customers have a preference for Australian grown and made products. In response, we make every effort to source as much Australian produce as possible to meet that demand. In doing so, we make a significant contribution to rural and regional Australia through our annual purchasing program of fresh fruit and veg, meat, milk, seafood and bakery.

The Coles 'Down Down' campaign is aimed at providing longer term price reductions of at least six months, depending on rising input costs. As part of the 'Down Down' campaign and other pricing changes, Coles has, as I said earlier, reduced the price of over 5,000 individual products. As part of this campaign, we in January reduced the price of Coles private label milk and Lite milk. Our decision to reduce the price of milk for our customers was not taken lightly. We thoroughly examined the consequences of this move on our customers and the industry, as we have with other similar price reductions.

In the lead-up to our pricing changes we took several actions to help ensure we would not hurt milk processors and dairy farmers: fully funding the retail price cut from our own profit margin; giving milk processors a higher contract price from their milk price in January; rise and fall clauses in our contracts with milk processors so that we are committed to paying higher contract prices if farm-gate prices increase. The result of these efforts, we believe, has been subsequently supported by statements from the ACCC and Treasury, who have both said that the Coles actions have done nothing to farm-gate prices in the short term and will not damage the long-term sustainability of the dairy industry.

I acknowledge of course that our decision to reduce the price of milk, as we anticipated, has generated a mixed response from the Australian public and the Australian dairy industry. We have held a range of meetings with individual dairy farms, milk processors and dairy industry organisations. Most of the discussions we have had with individual dairy farmers have been polite and constructive. When they have been advised of what we have done and how we are doing it, they have been understanding and supportive.

Naturally, they are anxious about the future, compounded by some unsubstantiated claims around the impact of our price moves and our motives. Most of the one-on-one discussions with our milk processors and dairy farmers have been polite. However, we have noticed that public rhetoric has been more strident about the outlook for the industry. We have also followed closely submissions and presentations to this committee. We take this matter and, of course, the committee's deliberations very seriously.

A strong, sustainable dairy industry is not only critical to Australia's future, as a supermarket chain it is critical to our future as well because the bottom line is that, if we cannot sell quality fresh milk, then customers will simply not be attracted to our stores. That is why in recent times we have taken several steps to ensure the ongoing viability of dairy farmers in outlying states such as Queensland and Western Australia.

We have made an ongoing volume commitment to the National Foods Malanda processing site after Woolworths withdrew volume from that site. It is widely acknowledged that our commitment to Malanda has kept it open and kept the dairy industry in the Queensland tablelands going. We have paid National Foods the biggest increase in contract price for the packaged milk in Queensland to ensure that any mix shift from branded to private label milk sales will not affect their margins and be passed on to Queensland dairy farmers. We have paid Fonterra an additional 5c a litre for contracted private label milk to be passed on to dairy farmers in WA to ensure that they would not be adversely affected by the lower contract price offered by Fonterra to Coles prior to the sale of Brownes Dairy to Archer Capital. These are just some of the examples.

As I have said, with all debates of this nature, there have been some unsupported claims bandied about and I would like to take this opportunity before John and I take questions to address some of those claims.

On farm-gate pricing, the first claim being made is that the retail price of milk set by Coles has a direct impact on the farmgate price. I would like to table a document, appendix 1, which provides an overview of nationwide farmgate price increases over the past seven, juxtaposed against the retail prices of milk set by Coles, Woolworths and ALDI. As you can see, while the

retail price of milk has stayed relatively stable, the corresponding farm-gate price has risen in the last 12 months—a grab for market share and the fact that milk is inelastic.

The second claim which has been made is best reflected by a statement from the Australian Dairy Farmers Council in which it said:

Coles' move is extremely unlikely to increase the aggregate consumption of milk.

I would like to table this chart, appendix 2, which demonstrates that, since the beginning of our price reductions to private label full-cream and light milk in late January, industry volume has actually grown above the long-run average. Indeed, Fonterra has increased the farmgate price since we lowered our retail milk price.

On UHT there has been a suggestion that, by reducing the price of milk, supermarkets will drive people to using UHT as an alternative. In fact, with respect to Senator Xenophon, who said:

We could end up with the situation that applies in Europe where 90 per cent of the milk is UHT.

In fairness to Senator Xenophon: you have not been alone in this assertion but I believe that you have been ill-advised. I would like to table this chart, appendix 3, which demonstrates that many European countries overwhelmingly use fresh milk over UHT. In fact, France, which is mentioned a few times in the context of this inquiry, actually produces 22.8 billion litres in raw milk every year but culturally the French just drink UHT milk. Eight out of 13 countries in western Europe drink 75 per cent of their milk fresh rather than UHT—or, indeed, more.

Professor Zumbo stated to the committee on 9 March:

I do not believe that Coles and Woolworths would lose any sleep if they substituted long-life UHT milk ...

Again, this claim is factually incorrect. I would like to table this chart, appendix 4, which demonstrates that no country has substituted fresh milk for UHT over the past decade. One of our competitors, Andrew Reitzer of Metcash, also claimed:

They destroyed their dairy industry in the UK and now [they] ... buy all their milk from the Netherlands ...

I would like to table this chart, appendix 5, that shows 99 per cent of raw milk in the UK is produced locally and only one per cent of raw milk is imported. Furthermore, if it would help, John and I would be more than happy at some stage during the next 2½ hours to talk through, in camera, the price we pay for both fresh milk and UHT milk.

On bottled water, some submissions to this inquiry have claimed that Coles private label milk prices are below the cost of bottled water, to somehow justify warnings that low milk prices are unsustainable. That may be a good piece of colour, but unfortunately for those making the claim, it is simply untrue. I would like to table this document, appendix 6, which demonstrates that private label bottled water in Coles is cheaper than private label milk at Coles. The average private label bottle price for water in Coles is 51c a litre. This is half the price of private label milk.

Coles private label milk is watered down and poorer quality: there have been claims that Coles has watered down its private label milk to save money. This is simply not true. Coles abides by standard milk formulation practices and, in accordance with federal government requirements, labels the key ingredients in all of its products, including the private label milk. I would like to table this document, appendix 7, which provides a comparison between the major milk brands offered on the market today. As senators will see, other than Woolworths Home Brand, there is very little difference between any of the standard full-cream or light milk offerings available in the market.

Driving corner stores out of business: finally, many submissions claim that Coles private label milk strategy is designed to drive our competitors out of business. The reality is that two-thirds of all milk sold in Australia is branded milk, not private label, and about 50 per cent of this branded milk is sold outside of supermarkets. John or I are happy to provide senators with data in camera which details the impact on our branded milk sales as a result of our price reductions. The truth is that many customers prefer branded milk and they prefer to pay for the convenience of buying branded milk in corner stores, as they do for tobacco and other convenience based products.

I have worked in the supermarket industry for 30 years in the UK and Europe in different countries and I can say that I cannot see a future without corner stores. Supermarkets may be able to compete on price but they cannot compete with the absolute convenience of location. In fact, research shows that the number of convenience stores in Australia has grown by 49 per cent in the last decade.

I would like to table the following document, appendix 8, which demonstrates this growth. If there is any competitive threat to corner stores, it has come from much bigger structural factors in the convenience market, rather than private label milk pricing in supermarkets. The truth is that Australians shop differently for big weekly shopping visits to supermarkets compared to one-off daily visits to convenience stores for selected grocery items. As such, convenience stores will always have a place in the Australian retail landscape and to suggest that Coles private label milk strategy will devastate the sector is not supported by the facts.

In conclusion, Mr Chairman, John Durkan and I have come today to respond constructively to this committee. We will respond to all questions with as much detail as possible. We have also brought with us some commercial-in-confidence pricing material which we would be happy to share with committee members in camera. I appreciate this opening statement has been longer than you may have liked, but I thank you for your accommodation.

CHAIR—Thank you, Mr McLeod. Your opening statement was quite comprehensive, I agree, but useful information. First of all, does the committee accept these documents which have been tabled? Thank you. As a bit of housekeeping, we began at about quarter past 11, so we will go through until at least quarter past one and, if you wish to have a session in camera at the end to present the other documents which you have said are commercial-in-confidence, we can go into camera to accommodate you. First of all, I will call Senator Xenophon.

Senator XENOPHON—Mr McLeod, thank you for your submission. You say in your submission that Coles is not selling milk at prices below the cost it acquired from milk processors. Have you chosen your words carefully by choosing not to focus on just the

acquisition cost instead of also including the cost of refrigeration, in-store handling costs and transport?

Mr McLeod—No. We have described it that way because it is the way in which we manage our business. On a product-for-product basis, when we are determining the margin that we make on those products, it is done on the basis of the cost that we buy at and the price that we sell at. In terms of the overall costs within our business, we spread them across the entire company Australia-wide.

Senator XENOPHON—Can you categorically say that, when milk is being sold at \$1 a litre in Darwin or Kununurra, for instance, that that is not below cost?

Mr McLeod—We take the individual prices that we pay for those products on an individual basis by the arrangements that we have with those processors in those individual states and we apply that across that state. You may recall I mentioned earlier on that we have operated since last year with state based pricing, therefore we have uniform pricing across Western Australia, across Victoria, across New South Wales.

Senator XENOPHON—But that means in some parts of Western Australia—and in the Darwin market, for instance—you would be selling milk below cost.

Mr McLeod—I am not saying that at all. As I mentioned earlier, I am more than happy to share our cost structure with you in camera, either now or later, whatever suits this committee.

Senator XENOPHON—Did you consult with the ACCC before announcing these price cuts?

Mr McLeod—No, we did not.

Senator XENOPHON—You have met with the ACCC since these price cuts were announced?

Mr McLeod—I have not personally but the company has.

Senator XENOPHON—Coles has, in relation to these price cuts. You said that you consulted before the price cuts. With which dairy farmer organisations did you discuss the price cuts before you implemented them?

Mr McLeod—We did not say that we discussed it with the dairy farmers prior to the price cuts. We said we did not discuss it with the ACCC before the price cuts.

Senator XENOPHON—Did you consult with the dairy industry before the price cuts were introduced?

Mr Durkan—On the price cuts, we obviously consulted with the processors in advance of cutting our prices, just to shore up the volume of supply. At no point did we discuss retail prices; we only discussed products and supply. But we met with processors before, as part of our normal arrangements.

Senator XENOPHON—How long before?

Mr Durkan—At least a month before we will have been talking to our processors.

Senator XENOPHON—Woolworths in their submission say that this is not sustainable in the longer term—to that effect—for the dairy industry. Do you agree with that?

Mr Durkan—No, we do not.

Senator XENOPHON—So let's say if all milk was being sold in supermarkets at \$1 a litre, you would say that that would be sustainable?

Mr Durkan—We believe in being consumer focused and this is all about bringing trust back to Coles by consumers, as Ian outlined in his opening statement. We actually believe that low prices for consumers will make the dairy industry stronger. As Ian also said—and I think it has been tabled—we have actually seen an increase in the overall drinking milk market in the first—

Senator XENOPHON—What was that increase? It is several percentage points?

Mr Durkan—It is nearly two per cent.

Senator XENOPHON—Two per cent. That is still relatively inelastic, though, isn't it, as a product?

Mr Durkan—That is reasonable. It is a big industry so a two per cent move in the size and the scale of this industry is a reasonable shift, considering for the last 18 months it had not moved at all.

Senator XENOPHON—Wesfarmers is your parent company. You are a subsidiary of Wesfarmers. That is a fair way of summarising it. Did you notify Wesfarmers of your intended price cuts before they were made?

Mr McLeod—No, we did not. Wesfarmers knew about our overall pricing strategy. Clearly, we discussed that with them at our strategy sessions. But the way the Wesfarmers model operates is that each of their business units operate autonomously.

Senator XENOPHON—So, Mr Goyder, for instance, the managing director of Wesfarmers, was he informed of your proposed price cuts in relation to milk?

Mr McLeod—Not prior to the cuts actually taking place.

Senator XENOPHON—But you discussed a general strategy of reducing the price of milk?

Mr McLeod—What we have been doing since we got here really is looking at how we can lower prices for consumers in Australia. We started with deeper cuts on promotions. We then moved onto state based pricing, largely because there was a high level of mistrust for supermarkets in Australia in terms of the way they priced differentially by store. Then we have moved on from there into lowering the price of over 5,000 items to bring the price of the overall

shopping basket down. What we have subsequently done is recognise that consumers are seeing that their individual disposable incomes are contracting, for 4½ million families on below average incomes or less, and we felt it appropriate that key items that hit the shopping basket every week should also be reduced where we could.

Senator XENOPHON—Sure. But I think the market forecasts are that Coles is on track to continue increasing profits. That is your job—to have a profitable enterprise. So it is not as though you are losing: with Coles's margins on their grocery items, overall, you are still making as much, if not more, money than previously.

Mr McLeod—The overall profitability in Coles has improved and that is obviously part of our role. But the way to do that is not by increasing retail prices. The way we believe to do that is engender high levels of customer trust, drive out high levels of efficiency in our stores. We invest in price for consumers for their benefit and, through that better value, we get high levels of trust, greater levels of customer traffic and a greater level of service.

Senator XENOPHON—But doesn't that efficiency also include down the supply chain; getting savings down the supply chain?

Mr McLeod—We want to make sure that customers get a fair price. We also want to make sure that suppliers get a fair price and, therefore, what we are endeavouring to do is to work with suppliers to ensure that we can offer them high levels of volume for which they can get better returns.

Senator XENOPHON—You have indicated in your submission that you have lowered the price of some 5,000 items. Have the prices of any of the other 15,000 items sold gone up? Has there been any degree of cross-subsidisation?

Mr McLeod—No. We do not cross-subsidise as a policy, either within our grocery areas or outside of it. In fact, if you look at the book—because we thought you might want to see some detail on this and we are happy to show you that in camera—on the right-hand side, that indicates the level of price reductions that we have implemented, and the book on the left-hand side indicates the level of price increases that we have implemented. So there is quite a distinct difference between one and the other. We have always said that, if there is a legitimate reason for price increases, we will listen to our suppliers and seek to absorb them where we can or, if we have to, pass them on, but we endeavour to do that as a very last resort.

Senator XENOPHON—I know many other senators have got questions for you, but can I just ask you: your campaign is based on that old Status Quo song—I do not know if you are a Status Quo fan, Mr McLeod.

Mr McLeod—I do confess to being a Status Quo fan. I do not know if you are, Senator.

Senator XENOPHON—You are, did you say?

Mr McLeod—Yes, I have been in the past, but my hair was longer then.

Senator XENOPHON—I think most of our hair was longer then.

Mr McLeod—Probably less grey as well.

Senator XENOPHON—The lyrics to *Down Down* include: ‘I found out you see. I know what you’re doing, what you’re doing to me’. I think there are some dairy farmers who have asked me that question. But with ‘Down Down’, what does that mean? ‘Down and staying down’. What time frame is there for that? Is that an indefinite period of time, subject to price fluctuations? What do you mean by that? It is a question that we have asked the ACCC as well.

Mr McLeod—Internally we talk about at least six months, if not longer. That is what we would anticipate. We think that is a reasonable time that the consumer would accept—‘Down Down, we’re staying down.’

Senator XENOPHON—Okay.

Mr McLeod—We have avoided using words like ‘permanent’ or ‘every day’, as some of our competitors have, because we believe that particular statement leads people to believe that the price would never go up. I think that would be an unrealistic position to assume.

Senator COLBECK—Doesn’t ‘staying down’ mean that? ‘Staying down’ means to me that it is not going up.

Mr McLeod—No. We have explained that to our team members as well for when people ask. The challenge that we had when we launched the ‘Down Down’ campaign—

Senator HEFFERNAN—To get market share.

Mr McLeod—The reason that we have had difficulty was that consumers in Australia are very used to short-term promotional high/low prices. We still have thousands of specials every week in Coles but we want to try and differentiate between the prices that we were lowering and endeavouring to keep down, to ensure that we move from inflation to deflation. We want to make sure we raise that and highlight it with consumers, and that is where ‘Down Down’ came from. We are sufficiently realistic to recognise that prices ultimately will rise, as you can see, in some instances, but we push very hard to make sure we absolutely limit those price increases going forward.

Senator XENOPHON—Just finally, Mr McLeod—and hopefully if there is more time I might ask at the end of the session, but in your letter to Senator Eggleston of 18 February you said:

In a theoretical worst case scenario, milk processors margins would be affected by no more than a few cents per litre.

The ABF farm survey for 2009-10 said that the average farm profit in Queensland and northern New South Wales was 2c a litre on this farm. Also, Norco in their evidence to this inquiry in their submissions say that their net profit for 2009-10 was \$2.3 million and that a 1c per litre price reduction would, if borne by Norco, cost them \$1.4 million. In other words, they are on a razor-thin margin. You have acknowledged that it might affect things by a few cents a litre. Don’t you see it affecting the supply chain and the viability of some processors and of dairy farmers generally?

Mr McLeod—That presupposes that the processors are going to push those pressures that they might have back down onto the farm gate. We do not believe that is right, we do not believe it is appropriate and we do not believe it is necessary.

Senator XENOPHON—What is Norco going to do, though? Based on their submission—

Mr McLeod—We have actually looked—

Senator XENOPHON—they are making less than 2c a litre.

Mr McLeod—Sorry, I interrupted you.

Senator XENOPHON—Yes, sorry. Norco is making less than 2c a litre. That is in their submission to the inquiry. You have said in the theoretical worst-case scenario margins could be affected by no more than a few cents per litre. That would push someone like Norco out of business, wouldn't it, unless they put the pressure on the dairy farmers?

Mr McLeod—It very much depends on the price that Norco are getting from us when we deal with them. We recognised that moving the price on a product like milk was going to be sensitive. We wanted to do what was right by customers by giving them the best prices that we could to lower the price of the shopping basket. We also want to make sure that we protect a sustainable dairy industry. That is why we gave the processors cost price increases in January. Those cost price increases were sufficient to allow them to pass more prices down on the farm gate.

Equally, when you consider the impact of the export market, there are rising farmgate prices anyway as a result of that correlation between the domestic market and the export market. We have seen a rising trend in terms of demand for Australian milk worldwide. I think Australia is the third-largest exporter in the world. I also recognise and appreciate that the further you go from Victoria then the more diluted that linkage is, but actually the linkage is still there.

Senator XENOPHON—Just finally on this—and Mr Durkan may want to answer this—do you acknowledge that by reducing the price of milk to such an extent you are actually devaluing the commodity and that there is a consumer expectation that it will always be so much cheaper, which makes it more difficult down the supply chain, including for dairy farmers?

Mr Durkan—We are not ashamed of the fact that we are giving consumers a lower price. As Ian outlined earlier, that is where we start from. In all our dealings with our new contracts with our processors we have tried to ensure that they get a fair return and the increases that Ian outlined. Also, above and beyond that, we have hopefully ensured further contracts, which are longer in tenure than they used to be. They are now two to three years, whereas Coles in the past never gave the tenure of contract. We have tried to ensure that the farmgate price does not get affected because we have a rise and fall mechanism, outlined in our contracts, to help protect the whole supply chain. It is in our interest that we have a strong supply chain in the dairy industry. We want to sell more milk, so it is really important to us.

Senator HEFFERNAN—With great respect—

Senator HURLEY—Chair, I have questions.

CHAIR—Senator Heffernan, there are other people—

Senator HEFFERNAN—It is just on that point.

CHAIR—Senator Heffernan, the feeling of the senators is that you should wait your turn.

Senator HEFFERNAN—All right.

CHAIR—We will go to Senator Hurley.

Senator HURLEY—Thank you. I did want to discuss those rise and fall clauses to processors if farmgate prices rise during the term of the contract, which I think is the way you talked about it in your submission. Your contract period is two to three years?

Mr Durkan—The majority of our contracts end in January 2014.

Senator HURLEY—Can you tell us a bit more about the nature of that rise and fall clause? How does it work? Do the processors notify you of any rise or fall?

Mr Durkan—Individual contracts are obviously commercial-in-confidence but we are happy to take those in camera at whatever point. The basic tenet of this is that if costs at farm gate do go up then those flow historically through to us. We pay them and therefore they should directly flow straight back through the processors and back to farm gate. It actually takes out that negotiation that may go on, hopefully protecting the farmers in the middle of that.

Senator HURLEY—Who verifies the rise or fall? Is that the milk processor or do you deal directly with the—

Mr Durkan—We just put these into place. We intend to use a third party to verify the costs.

Senator HURLEY—So you are notified by the farmers or the milk processors?

Mr Durkan—Unfortunately, we only deal with the processors, so we get informed by the processors.

Senator HURLEY—If milk processors notify you that there is a pressure on farmgate prices because of increased costs, you will have an independent assessment?

Mr Durkan—We use a third party to assess the cost and to ensure that the farmers get paid. This is a positive rather than us looking to save costs. We are looking to ensure that the farmer gets paid.

Senator HURLEY—The question then is whether the supply is for private label milk or for branded milk. The evidence we have had from the industry indicates that they receive more for branded milk than private label milk. The argument in some quarters has been that, because your price structure is putting more demand on private label milk, they will get less in any case.

Mr Durkan—We do not understand the full extent of the processors' contracts with the farmers.

Senator HEFFERNAN—I bet you don't!

Mr Durkan—Our major processor looks like they have one price, from what we understand, for drinking milk and, as I said earlier, we believe that a growth in drinking milk—because it is a premium to manufacturing milk—would be good for the dairy industry.

Senator HURLEY—The Australian Dairy Farmers have circulated a list of questions for Coles. Given the propensity of correspondence to this committee getting out to the media, I just want to address a few things head-on, since the implications are quite interesting. On the first page the question is about the nationality of some of the Coles executives and then it goes into questions:

How many ex-Labor government advisers now work for Coles and Wesfarmers? How many people from the former Prime Minister's office now work for Coles and Wesfarmers? How many ex-Labor politicians at both state and federal level now work for Coles and Wesfarmers?

I do not necessarily want you to go into party affiliations of any of your people, but can you—

Senator HEFFERNAN—I have got to declare an interest. Point of order.

CHAIR—Yes, Senator?

Senator HEFFERNAN—I have to declare an interest based on that. Your Mr Carpenter replaced a person who used to work for me, so I have sort of an inside into what goes on in Wesfarmers. And I milk cows.

Senator HURLEY—As I said, I do not want to know party affiliation, even if you do know them, of any of the Coles or Wesfarmers employees. But it interests me that Dairy Farmers put this on page 1. Have they spoken to you about any possible conspiracy theories? Are you aware of any allegations about Labor Party involvement?

Mr McLeod—I am not aware of any conspiracy theories or allegations.

Senator Heffernan interjecting—

Senator HURLEY—Senator Heffernan, I cannot hear Mr McLeod's answer.

Mr McLeod—I am not aware of any conspiracy theories or allegations in that regard. Senator Heffernan is correct that Alan Carpenter, the former Premier of Western Australia, is now the head of corporate affairs for Wesfarmers, but within Coles we do not have anybody employed who is from a previous political background—or at least that I am aware of.

Senator HURLEY—Did you discuss the proposal to drop the price of milk in January with anyone in the Labor government?

Mr McLeod—No, we did not.

Senator HURLEY—Thank you.

CHAIR—No further questions? Senator Colbeck.

Senator HEFFERNAN—I think I'm allowed a question.

CHAIR—No, Senator Heffernan, wait your turn. Senator Colbeck has the call, Senator Heffernan.

Senator COLBECK—I just want to go back to some things that you have said as part of your campaign. You said—and you repeated it again today—that milk prices have increased 20 per cent in the last 12 months as one of the justifications for the fact that you were not having an impact on dairy farmers. Can you tell me what happened in the previous 12 months?

Mr McLeod—It lowered.

Senator COLBECK—By?

Mr McLeod—I think about a similar amount actually.

Senator COLBECK—About 34 per cent I think it was, as a result of the global financial crisis. I just find it completely misleading that you would quote a figure on that short a time scale as justification for milk prices to dairy farmers going up, when if you look at it over a longer time series, there are fluctuations and there was about a 30 per cent increase the year before. So, in fact, if you look at it based on those two years—which, again, I do not think is probably a reasonable way to look at it—they are, in fact, behind the eight ball, and farmers in Far North Queensland and New South Wales are currently being offered price reductions as part of this process.

I am not saying that it is directly related to what you are saying, but you in your public statements have come out and said that farmers have received—according to the Murray Goulburn website—a 20 per cent increase in the last 12 months. That singular fact nobody can argue with but, in the overall context of this argument, that is completely and utterly misleading, which is one of the reasons I am really cheesed off with what has been going on in the marketing. And let's accept that this is a marketing campaign. That is what you are about.

You are running a marketing campaign to try and turn your business around. I get that, I understand it, and I do not have a problem with it. What really gets up my nose is the deception that goes on, as part of this process, to justify what you are doing. When you say and put in your submission just that one fact, that milk prices have gone up by 20 per cent in the last 12 months—which is true in itself, but in the overall context of things it is not right—how do you justify doing something like that?

Mr McLeod—Firstly, it is not a marketing campaign. What we are looking to do is genuinely reduce prices for consumers, which is actually what we have done. That is the first point.

Senator HEFFERNAN—Come on! Be fair dinkum. Of course it is a marketing campaign, to get market share.

Mr McLeod—To get more markets. The changes that we are making are to make sure that the consumer is aware of it. As far as the farmgate price is concerned, the price that was put in was indicative that there was a rising trend in farmgate prices. That looks like it is set to continue. In fact, Fonterra have increased the farmgate price to their producers twice since we reduced the price in January.

Senator COLBECK—And anticipating another price rise before the end of the season, yes.

Mr McLeod—In addition to that, in our submission, which shows you a much broader trend, we have indicated from 2004-05 right the way through to 2010-11 the individual prices that have moved and fluctuated in each of the individual states, and I think you can see from the chart here that, whilst there are fluctuations here, the last four years on average have been higher than the previous three years. So our point is that we have got a rising trend overall within Australia, we have got a rising trend overall in the export market, and that flows through to a strengthening opportunity within the domestic market as well. That relates to about 70 per cent or more of milk production in Australia.

What we do accept is that in other areas the link between the export price and the domestic price is more dilute in terms of impact. That relates to places like Far North Queensland and Western Australia. So we accept that individual element. There is still a bearing on it. There has to be, ultimately, economically. If you were in a situation where you got too far out of kilter, then you would just move to export milk in those areas in well. In fact, arguably, you could say that that would be something of an opportunity for Queensland, given the fact of where they are located and where a lot of the export milk actually goes.

Senator COLBECK—It comes back to the cost of production, though, doesn't it?

Mr McLeod—Absolutely.

Senator COLBECK—One of the impacts. I have sat down with the dairy farmers and talked to them about this. The export price is driven out of the southern states, particularly Tasmania and Victoria.

Mr McLeod—That is correct.

Senator COLBECK—We all understand that. That is where the export price is driven from, it is the lowest cost of production, and they are very competitive on the world market. There is a higher cost of production, for a range of climatic reasons, in northern New South Wales, South East Queensland and Far North Queensland. The buffer that they get provided with is the cost of getting it there. So there is the cost to transport it there, there is probably a bit of a discount that comes off that back towards what their cost of production is, and they are not going to sign up to something that is too far below cost of production. So there are a whole range of things that fit into this. But if you guys find a way to get milk to Far North Queensland cheaper than their cost of production, that is potentially a threat, if these prices are sustained in the long term. 'If' is part

of this: that has to be considered as part of this process, which is why I asked the question about 'How long down?' It is very relevant to this. That is the potential threat to those areas.

Mr McLeod—I agree. That is something that we are very mindful of. That is why we gave an additional 5c a litre to our processor in Western Australia, in order that that could be passed down to the dairy farmers in Western Australia. It is also why, at a cost premium to ourselves, we made sure that we retained production through the Malanda processing plant in Far North Queensland as well. In fact, we have done the same in the Northern Territory, where there is a small processing plant there, in order to make sure we could keep that going as well. That impact has probably cost us, in margin, an additional \$2 million or close to it. So that is a real cost to Coles. We could have saved that. We could have actually taken it, if we wanted to be aggressively competitive in terms of our cost price, but we did not because we recognised that by doing so, given the action of our main competitor, it was likely that 70 farms would be at risk. That is absolutely right. What we are endeavouring to do is try and make sure that in our quest to give the best prices we can to Australians and lower the shopping basket in Australia, we also recognise the industries in which we operate in and the particular issues that are faced and addressed in those industries in particular areas. That is what we are endeavouring to do.

Senator COLBECK—Yes. But coming back to my original point, to use that 20 per cent number as an increase, it is all very well to put it in your submission, but the media, your letter to the committee, and those same facts which were put into the public arena in a number of articles that you wrote, all talk about the dairy industry getting a 20 per cent increase over 12 months. You cannot dispute that fact, but it is not the reality if you look at it in broader terms. Okay, the price might be trending a certain way—and that is the issue, when you start pulling out specific facts to try and bolster an argument and you know that they are going to get reported singularly. From my perspective, it is like mentioning bananas this morning. Where can you buy bananas from overseas?

Mr McLeod—You cannot, and that is precisely—

Senator COLBECK—That is exactly right.

Mr McLeod—There was an advocacy on bananas that there should be importations allowed from the Philippines as a result of the devastation from Cyclone Yasi. We came out directly and said that we were not going to do that and we would not advocate it. That is why we mentioned bananas.

Senator COLBECK—But you cannot bring them in. Woolworths, your competitors, went through this about five years ago. They made a big virtue after the previous cyclone—'All our bananas will be from Australia.' Of course they are. You cannot bring them in from anywhere else. That is the sort of 'Aren't we smart?' type of stuff. Most of the community do not know that. That is why people around this table are so bloody agitated, because you provide this clever dick type argument that we are supposed to accept when we know that it is not the fact.

Mr McLeod—It was in response to an advocacy that was being tabled at the time.

Senator COLBECK—I accept that.

Mr McLeod—We were asked for our opinion and we gave it. From our point of view, on bananas, from a commercial point of view, there would have been a stronger advocacy to say, ‘Actually imports should be allowed,’ because it means that you get bananas through the country for consumers and it means that the bananas will be at a lower price so it is better value.

Senator COLBECK—Short-term gain, though.

Mr McLeod—This is where we talk about the balance between what you try and do to make sure that you have the right mix, in terms of your offer to the consumer and the price that you charge, and also what you believe is going to be right in the medium term for those individual industries. We felt that banana importation probably would not be right for those industries in the medium term and that is why we advocated against that relaxation. That is all we said.

Senator COLBECK—You mention, on page 11 of your submission, about foreign food processors. When did Coles become xenophobic? Why is that relevant?

Mr McLeod—We are not xenophobic.

Senator COLBECK—Then why put it in your submission? Why do you mention it? Why is it an argument that Fonterra is New Zealand owned and Parmalat is Italian? It is obviously part of a sales pitch. You put it in your letter to us.

Mr McLeod—Yes.

Senator COLBECK—It is part of your sales pitch that okay, you are an Australian company but these guys are foreign, and it is terrible; they earn more profit than you do. What a disgrace!

Mr McLeod—That is not the way it was intended. It is a statement of fact, for one thing. It also indicates that there are larger corporations that own the dairy processors in Australia. They have access to broader levels of funds. In the submissions that have come through from the processors, what they are seeking to claim is that their individual margins are very slim in this particular market. I would argue that in broad terms, even within Australia, their margins are higher and the broader access to funds from their new owners, in terms of investing in the industry here, should be made available to them as well.

There could be some benefits in terms of those levels of ownerships if we see broad levels of innovation and change in products that come into the dairy sector. It is not intended to be any form of xenophobic slur. It is intended to be a statement of fact, indicating that there are broad levels of funds available should they wish to utilise them.

Senator COLBECK—But you make the point that each of these processors has a clear profit margin higher than Coles. So what? Who made Coles God and determiner of how much profit their suppliers make?

Mr McLeod—It is a matter for the—

Senator Ryan interjecting—

Senator COLBECK—I was not going to go there, Senator Ryan. I was not going to offend you by suggesting that we might dictate how much Coles's margin was concerned. I understand what they are doing and that is fine. But you have to agree with me that part of the public argument—you put it in your letter to us—is that you have these nasty foreign owned companies, they are earning more money than you and you want some of their margin. That is a summation from my perspective. Tell me if I am wrong, but that is the summation of it: 'These are nasty foreign owned companies. We are a nice, warm, fuzzy Australian company. They're earning more money from you and we want to make sure that we take some of their margin and pass it back through to the consumer.' That is the target?

Mr McLeod—You allowed me to say that you are wrong, so I believe that you are wrong.

Senator COLBECK—But that is as I read your submission and your correspondence.

Mr McLeod—I do not think the word 'nasty' appears in it and I have tried to articulate the broader view in terms of the phrase 'foreign owned'. In terms of their overall margins, there is an assumption made that lowering the retail price automatically means that the farm-gate price will be put under pressure. Our view on that is that there are higher levels of profitability within those companies overall and they can look for alternatives to improve their overall efficiency, improve their innovation, improve their product development and look to other ways to make savings should they wish to protect the margin, or invest some of it in the dairy industry here. There are a number of different ways in which they can take action through their broader level of economic strength, rather than just simply taking the easy route of squeezing the dairy farmers.

Senator COLBECK—But they are going to try and protect their margins, obviously. That is part of the commercial process, isn't it? You are looking to increase yours and it was reported in the media that you have increased yours from 3.6 to 4.1. Obviously you are looking to increase that further. Your objective is to increase your margin and you will have a commercial dust-up between you and your commercial partners as to where that comes from. That is part of the market process and I understand that.

The characterisation that came through in the stuff that you are putting out to position yourselves in the argument—and I understand that is what you were doing—just does not stack up to me in the overall context of things. You are all in this game together, trying to make a quid, and one of the concerns we have is that you are looking to increase margin, you have a stated objective of harvesting some of your suppliers' margins, and they are looking to protect that. The only place they can go is to the dairy farmer and the National Foods dispute last year showed us graphically that, when push comes to shove, the person at the bottom of the chain, the dairy farmer or the farmer more broadly, is the one that pays.

The global market moved and you have quite rightly stated that there is a link to that. The global market moved and the companies had to try and deal with that. They were not prepared to see any loss in what they were doing. They were protecting their margin. The only place it can go is to the dairy farmer, which is one of the reasons we are all sitting around this table today.

Senator HEFFERNAN—I take it that when the market falls, Senator Colbeck, Coles will put the price up to protect the farmers, the same as they have taken them down.

Senator COLBECK—We will deal with separate contract arrangements on that later because we can come to that in the in-camera stuff and I appreciate that you are doing that.

Mr McLeod—Senator, I do not accept your argument that that is the only place that they can go. If they are operating on individual margins that are higher than ours then they can lower those margins should they wish to do so, if they are looking for longer term relationships.

Senator COLBECK—I do not think I have had that conversation with them.

Mr McLeod—Secondly, as I mentioned, I think they also have alternatives that they can seek in order to improve their overall efficiency if they want to improve both their overall performance and operating productivity prior to squeezing dairy farmers at the farm gate. In addition to that, what I would also like to remind you of is that we did increase the price to processors prior to taking this price reduction. We did that in order to make sure that the farmgate price would have some form of relief. Indeed, as John has already mentioned, we introduced rise and fall clauses into the contract as well in an endeavour to support the farmgate price. I take on board the argument, but I do not accept it.

Senator COLBECK—Their evidence to us in Sydney, which no doubt you have had a good look at, was that previous to the price increase they were making a loss on that product. I do not accept that it is altruism and all about the farmers, because one of the discussions you would obviously have had in your negotiations was, ‘They’re saying, ‘We’re losing money on this. We want to break even.’ Now they are saying they are making a slight margin,’ and we will discuss the rise and fall clauses later, given the obvious movement in the price of milk that’s going on. I am very interested to hear how that is going to work. You talk about 5,000 prices that you have reduced. Can you tell us what those 5,000 items are?

Senator WILLIAMS—One by one?

Senator COLBECK—We do not need to go there in that detail, Senator Williams.

Mr McLeod—Are you sure? I am quite happy to.

Senator COLBECK—I am sure you are.

Mr McLeod—In terms of the margins that the processors make, I do not know how they cost-structure their business, so whether they are making a loss or not making a loss I do not know. Other benchmarks around the world indicate that milk processors make more margin than some of them here. Also, they will be looking the same way we do. They will be looking at a blended margin across all the products they carry. Therefore, in that respect, that is when they come back to the broader level of EBITs that they have.

Senator O’BRIEN—Did you say milk processors around the world make—

Mr McLeod—Certain processors around the world.

Senator O’BRIEN—Sorry, I just wanted to be clear what you said.

Mr McLeod—Thank you. In terms of the 5,000 price reductions, yes, we can identify them. That is why we brought the documentation with us and in camera we will be more than happy for you to glance through that.

Senator COLBECK—I want to go to previous evidence that you gave the committee about your margin on milk. At the hearings last year you told us that your gross margin was 22 per cent. The price reduction that you advertised was 23½ per cent. Information I have received is that effectively you are giving the stuff away at the current price and you will deal with that, obviously, in the answer to the question. With the information that we have that you have put on the public record that your gross margin, which includes your in-store costs, is 22 per cent, how do you say that you are not selling this product below cost?

Mr McLeod—I will just explain what we did on milk, because I think it might help the argument. In the grocery inquiry in 2008 there was quite a bit of debate around the price of milk, the fact that milk was being sold for different prices and it was essentially the same product with just different wrappers on it. To our mind that felt like a disingenuous pricing strategy to present to your customers; therefore, when we have looked to reduce prices through ‘Down Down’ we have looked to eliminate those kinds of inconsistencies.

What we did with milk was we had Smart Buy as our entry price point milk. We then had Coles brand milk at \$2.47, broadly, and then we had Lite milk at around \$2.99. There was not that much difference in terms of specification between the Coles brand milk and the Smart Buy milk, so we lowered the price of the Coles brand milk to match the Smart Buy price.

We also did not believe that it was appropriate to have customers paying a premium if they wanted to drink a healthier product and I think the Heart Foundation of Australia have applauded us for what we have done. We have taken the price down on the light milk to match the full cream, so you have price alignment.

If you have Smart Buy milk and Coles brand milk at the same price in the same specification now, you do not need the Smart Buy milk any more; therefore, you can just go with a one-tier pricing strategy. It is not something which our main competitors have adopted. They still maintain a two-tier pricing strategy, with broadly the same product in two bottles selling at two different prices, but that is a matter for them, not for us.

That is what we have done on milk. If you go back prior to the change that we made, clearly most of the milk that we were selling at that time—the highest volume milk that we were selling at that time—was in the entry price point level, which at the time was \$2.09.

Senator COLBECK—I was going to ask you to give me the break-up between the Smart Buy and the Coles brand. What are the percentage ratios on those two products?

Mr McLeod—I am more than happy to provide you that information in camera. That is the point I was getting to. As a result of the changes, we have—

Senator COLBECK—But you are saying publicly that the majority of the milk was in the Smart Buy.

Mr McLeod—The highest volume SKU that we had or product that we had prior to the change was the Smart Buy milk.

Senator COLBECK—I am trying to get a sense of the relationship of the Coles and the Smart Buy. You do not need to give me the numbers now—I am happy to take them in camera—but if you had Smart Buy and Coles next to each other, and those two make 100 per cent, is the largest proportion in the Smart Buy or in the Coles?

Mr McLeod—The larger proportion would be in the Smart Buy, but I do not want to commit to actual percentages. I am more than happy to do that in camera. The point of this really is that if you look at the price reduction on light milk and the volume of light milk, if you look at the price reduction on Coles brand and if you also look at where Smart Buy was before, on a volume weighted basis you get to a different overall percentage reduction. In public, that is as much as I am prepared to say, but I am more than happy to take you through that further.

Senator COLBECK—That covers off on what I am saying, but your advertising does not indicate that. I think, in the context of just the evidence that you have given me, the advertising is deceptive because it gives the impression that you are taking it from \$2.47 to \$2. If the larger proportion of the production is only a 9c reduction, the impression you are giving your customers is that you are making a significant reduction in price, yet the SKU in your submission comes back to the Smart Buy.

The reality is that you are only giving a small reduction in price. This is the advertisement that came out of the *Examiner* in Tasmania, this is the advertisement that came out of the *Advocate* in Tasmania and this is the advertisement that came out of the *Mercury* in Tasmania, and they are all the same because you placed them all the same on Australia Day. They give the impression that you are making a significant reduction in the price of milk, yet you are not, based on the evidence that you have just given me now and that you will confirm later with the exact details.

You ought to be done for misleading advertising, not reducing the price of milk, because you give the impression to your customers around the country that you are making a significant price reduction. You would know and I would know, if you are going to take 2c, 3c, 4c or 5c off a product, that will create some activity, but if you are going to take 47c off a two-litre bottle of milk, that is something for the customers to be alerted to. But the reality is that you are not; again, something that drives me up the wall as someone who is assessing this overall process and looking at what is going on. That to me is deceptive. ‘Staying down’, to me, is deceptive. Yet it is not the reality: ‘staying down’ means for about six months, because that is what the Australian consumer expects. Do I have to write a new dictionary based on Coles?

Mr McLeod—Firstly, if the price reduction in reality has been relatively small, then I would question why we are here, because clearly it has not damaged—

Senator COLBECK—You are giving the evidence. We are just hearing it.

Mr McLeod—Secondly, those adverts are perfectly true. There is a significant volume of customers that are buying Coles brand milk.

Senator COLBECK—Yes, but you will not tell us what proportion in relation to the other.

Mr McLeod—I will in camera. I am more than happy to. The difference is that the Coles brand milk had a higher quality content than Smart Buy did and therefore it is a better quality product than the previous one that it replaced. But that is perfectly true. We probably ran other ads that you have not got which talk about Coles light milk, which went from \$2.99 down to \$2.00—

Senator COLBECK—Which came along later.

Mr McLeod—which is perfectly true. For our customers that are buying Coles brand milk week in, week out, that is a genuine price reduction. For customers that were previously buying Smart Buy milk, who did not have that available before, they had the opportunity to buy Coles brand milk at 9c below the previous Smart Buy milk.

Senator COLBECK—Where are the ads to say that you have reduced the Smart Buy milk?

Mr McLeod—We have not. The Smart Buy milk has been eliminated from our range. We only have a one-tier branded structure, which is what I was trying to explain earlier.

Senator COLBECK—No, you have moved from a two to a one. I understand that. But the impression is that you are giving a significant price reduction when the reality is that the price reduction is 4½c a litre for the majority of the product that you have reduced the price of.

Mr McLeod—On a blended basis it is actually more than that, but again I can show you in camera and you can see that quite clearly for yourself.

Senator COLBECK—You say in your submission—and you mentioned it again today—that there is a minus two per cent rate of food price inflation. Where does that number come from?

Mr McLeod—We have an independent chart which shows that and we have identified from the overall level of underlying inflation that has been recorded in the marketplace as against our own—

Senator COLBECK—What is it based on? Is it based on Coles prices, is it based on Woolworths prices or is it based on the whole market?

Mr McLeod—It is based on our internal inflation levels relative to the market.

Senator COLBECK—So that is a Coles number? I went back and had a look at the numbers, and you talked about food inflation again. This is careful use of numbers by Coles in this overall process. You mentioned, I think, eight per cent food price inflation over the last decade.

Mr McLeod—Forty per cent. That is not my number, by the way, it is Chris Bowen's.

Senator COLBECK—I just want to go through this on a year-by-year basis, because you do a cumulative one and it gives an impression. December quarter 2009 to December quarter 2010 is 2½ per cent. That is the ABS number. December quarter 2008 to December quarter 2009 is 1.9 per cent. So last year it has actually increased. 2007-08 was a big year, at 5.6 per cent. 2006-07 was 1.2 per cent. 2005-06 was 8.6 per cent.

So you have all these numbers and you are giving us evidence that you are responsible for food deflation, yet the official numbers do not stack up with what you are saying. Again, it is use of numbers in a clever way to cast an impression into the broader market, but when you go to what the numbers are in the actual statistics, okay, it is 2½ per cent. You are saying it is minus two per cent in the last 12 months, but what you are not doing is comparing like to like.

Mr McLeod—I think we are. Again, I have two charts, commercial-in-confidence, that I am more than happy to share with you to demonstrate where the numbers come from, how the stats are calculated and what time periods are used. Again, I am more than happy to show you that in camera.

Senator COLBECK—Okay. I think I will leave it there.

Senator HEFFERNAN—I applaud Coles for trying to look after the consumer and I take it that that is what you are on about.

Mr McLeod—That is correct. Yes, that is our intent.

Senator HEFFERNAN—It has nothing to do with market share and your bonus. Are you on a four-year business visa into Australia?

Mr McLeod—My contract is five years, but I am on a business visa.

Senator HEFFERNAN—So you have to renew your visa before you can pick up your bonus. Anyhow, that is an aside. If it is all about the best interests of the consumers—

Mr McLeod—Perhaps after this, Wesfarmers might reconsider, and you might be quite happy with that!

Senator HEFFERNAN—why don't you, when the consumers get to the checkout, just give them a bulk discount on everything they have bought in your store? That would save this idea of, like I said earlier, the death duties impact on dairy farmers, which is high impact, low revenue. Why don't you just give a general discount at the checkout?

Mr McLeod—Because retail does not work that way. Then we would be accused, saying, 'Well, you give a discount—'

Senator HEFFERNAN—That is right. You've said enough. We like short answers. 'Retail doesn't work that way.' That is because this is about you regaining market share because there is an ASIC obligation—and you have been employed on a bloody good bonus—to get that back, to maximise the profit to shareholders. That is fair enough, isn't it?

Mr McLeod—Yes, it is.

Senator HEFFERNAN—You realise—through you, Mr Chairman—that it is an offence to give false or misleading evidence to the Senate? It is considered to be an offence by the Senate. Do you realise that?

Mr McLeod—What have I said that is false?

Senator HEFFERNAN—I have not said you have said anything. Is that all right?

Mr McLeod—Thank you for reminding me of that responsibility.

Senator HEFFERNAN—It is held as a contempt. So I have just sent someone down to Coles to check out the price of water.

Senator WILLIAMS—I was there this morning.

Senator HEFFERNAN—Hang on. You have said, ‘I noticed in Coles a bottle of water was more expensive than a bottle of milk.’ Senator Williams, you have said, ‘Coles brand is not more expensive than bottled milk.’ I have said, ‘Why don’t you have a price war on bottled water instead of blasting the back end out of all the dairy farmers, to get back your market share, to maximise the profit for the shareholders, and for you to get your bonus in five years and go back to England?’ I have said, ‘Why don’t you do that?’

The bottle of water that you have quoted at 51c a litre can be filled 160 times from the tap for the price of the bottle of water. That is fair enough. The bottle of water you get on Virgin Airlines you can fill 3,400 times from the tap. Down at Coles 15 minutes ago this is the price of water—and you say there is no capacity in the system to discount water and you have got the cheapest water—at Manuka 10 minutes ago: 600 mls of Mount Franklin Water was \$1.92.

Senator WILLIAMS—That is chilled.

Senator HEFFERNAN—That is \$1.92. Coles Natural branded water, 600 mls, was discounted for today at 69c. It is normally 79c. Balance Relax water was one litre for \$3.35. That is a bit dearer than milk. Coles branded milk, 1½ litres, is \$1.05. Evian bottled water, 1½ litres, is \$3.88. Noble’s two litres of water is \$2.79. Are you telling me that there is no capacity for you to go to Mount Franklin or Evian or Noble’s or somewhere like that and say, ‘Listen, brother, to get people down the aisles, as a loss leader we are going to discount your water. Therefore, you’ve got to supply it to us cheaper’? With bottled water at \$3.80 for 1½ litres—out of the tap, water is \$3 for 1,000 litres—you do not think there is a bit of capacity in the water market to give you a loss leader, instead of screwing the back end out of all the dairy farmers?

Mr McLeod—Fortunately consumers have a choice. They can choose to buy either private label water or they can choose to buy branded water. Brands like Evian are a global brand and have invested considerably in that brand, and that is why it has such a strong consumer franchise, and I guess that is why they believe that they can command a price premium.

Senator HEFFERNAN—That is fair enough.

Mr McLeod—If consumers do not want to buy bottled water, then they can just, as you say, take it straight out of the tap, or they could buy one bottle of bottled water and then keep refilling it out of the tap, as you have mentioned.

Senator HEFFERNAN—I hope that is what you do.

Mr McLeod—I tend to drink quite a bit of tap water actually.

Senator HEFFERNAN—You would drink less beer these days, I guess, because they have cut off the supply.

Mr McLeod—I drink less beer to try and keep my waistline down actually. That is the point there. In terms of the comparisons between bottled water prices and the milk prices, again, we will show you how we have developed that.

Senator HEFFERNAN—But the difficulty is, Mr McLeod—and thank you for your evidence today and your patience and your humour—where do you get your home brand water from?

Mr Durkan—We would have to take that on notice and come back to you.

Senator HEFFERNAN—You mean to say you don't know?

Mr Durkan—We have roughly 30,000 products in supermarkets.

Senator HEFFERNAN—Yes. But obviously you go to someone who is already providing a labelled water and say, 'Son, we want to sell this bottled water for' whatever you want to sell it for. So you get water, obviously, from someone who is a supplier of fresh, spring water—the world's greatest con job—and you then say, 'We'll take some water and sell it at' whatever the price is that you want to sell it branded. Then you will go to spring water out the back of Kyeamba Valley there in Wagga—I know the bloke that does it—and he will have his label water and he will compete against you. You do not think there is any room in the water market for a bit of competition?

Mr Durkan—Of course there is room in every market for a bit of competition and we offer choice in—

Senator HEFFERNAN—Well, it is good enough for you to pick on the dairy farmers—and the dairy farmers are good to pick on. I notice that you were going to do bread. I do not know if you have come up with bread yet, but I talked to the bread manufacturers you were talking to, because I have an inside sort of link there. Have you done the bread thing yet?

Mr Durkan—I want to put this in context. We have dropped 5,000 prices that we said, in camera, we are willing to—

Senator HEFFERNAN—Yes.

Mr Durkan—Milk is one of those prices. There is competition in every category, so we offer choice in every category.

Senator HEFFERNAN—But if you were seriously fair dinkum about the consumer, rather than the market share and the shareholders—which you have an ASIC obligation, by the way, to comply with—you would simply give them a discount at the checkout.

Mr Durkan—We would start with the consumer. As Ian has outlined already, this is all for consumers. The only way we are going to make—

Senator HEFFERNAN—With great respect, I am not going to let you get away with that.

Senator WILLIAMS—A point of order, Chair.

CHAIR—I think you should let the witness answer.

Senator HEFFERNAN—Yes, righto.

Mr Durkan—The only way that we are going to be a profitable organisation—and we are not denying that we are going to be a profitable organisation—is by keeping our customers happy. One of the ways of keeping customers happy and coming back to Coles—and you have to remember that this is a broken brand and we have got customers coming back to Coles now—is through giving them better prices, better quality and better service, and pricing is one of those.

Senator HEFFERNAN—Yes, I must commend you—through you, Mr Chairman—for your opening statement. It was just fantastic. If ever I have seen an AWB look-alike opening statement—AWB became a lazy monopoly and they got away with blue murder. Some of them should have gone to gaol. I am not saying that some of you mob should, but it was a great opening statement. Can I just go back to the best interests of the consumer not being at odds with the best interests of the supplier. What percentage of the market do Coles and Woolies have in the prepackaged market? I say 80 per cent. You said it is less than that.

Mr McLeod—I think it is about 60 per cent, between 60 and 70 per cent, depending which market you use.

Senator HEFFERNAN—Just say 70 per cent for a nice easy work. That would be considerable market power, would it not?

Mr McLeod—We are very sensitive to the fact that the market share that we have—and we are happy to share that with you as well—is something that you have to be very responsible with.

Senator HEFFERNAN—Is there anywhere else in the world where two supermarkets have 70-odd per cent of the market?

Senator WILLIAMS—I think it is about 80 per cent.

Senator HEFFERNAN—We will not worry about the 80 per cent, because we cannot prove it one way or the other and neither can he.

Mr McLeod—I think a lot of it depends upon the size of the market and the size of the population in those particular sectors.

Senator HEFFERNAN—Yes, fair enough. But is there anywhere else in the world that you know of that has 70 to 80 per cent of the market?

Senator WILLIAMS—Between two.

Mr McLeod—I do not know, to be honest.

Senator HEFFERNAN—Between two.

Mr McLeod—I do not know.

Senator HEFFERNAN—But you would accept that that is a reasonably solid market power position?

Mr McLeod—I think at the ACCC inquiry they identified that, clearly, the largest players in Australia were Woolworths and then Coles.

Senator HEFFERNAN—Go on!

Mr McLeod—But they also recognised that competition was increasing, particularly with the advent of ALDI coming into the market. I think they also recognised that independents in South Australia and Western Australia and, indeed, Franklins in New South Wales are also competitive.

Senator HEFFERNAN—But if you did not have 70 to 80 per cent of the market between you and Woolies and we did not have—

Mr McLeod—You keep bringing that number up every time you speak.

Senator HEFFERNAN—The dairy farmer would have a few other options in terms of retail, and if you had discounted this milk to \$1 a litre and you refused to do a water exercise, it would not have had the impact. Walmart, the biggest supermarket in the world, has got 270 million consumers, but the top five in the US, as you know, have 40 per cent of the market. The top five in Canada have 60 per cent of the market. The top two here have between 70 and 80 per cent.

If you had the proportion which Walmart has of 14 to 16 per cent and you had discounted your milk, you might not have been able to use that as effectively. And I congratulate you on the effect it has had because your bonus is looking good. But it comes back to ‘not all your fault’ and you are blaming the processors, the consolidated processing. There is a fair share of mismanagement in allowing the consolidation of the milk market to the point it is, because the reality now is that with Fonterra, the profits from Australia actually go back to the dairy farmers in New Zealand to supplement their income. So that is a double whack for our dairy farmers.

You say it is not going to put dairy farmers out of business. In the back of the crowd there, there is a bloke from southern Queensland. He has just sold 400 dairy cows. You do not care, because you say it does not affect him. Unlike a lot of commodities, wheat or something else, and like rainfall, the supply does vary depending on the spring and the feed and the sunshine and all the rest of it. Last spring I am informed that the tier 2 milk price in southern Queensland was 25c to 26c. Senator Colbeck and I were in Tasmania. Was it three years ago, Senator Colbeck?

Senator COLBECK—Eighteen months to two years.

Senator HEFFERNAN—Eighteen months to two years ago. The dairy farmers down there, because we had done away with market milk and the little bit of sunshine that gets and we had merged it all into one—we use the global price of milk as the leader—were expected to produce milk for 16c a litre, and at that time Coles and Woolies had the retail price of milk up through the roof. At the same time, we were expecting our dairy farmers to produce milk for 16c a litre. My man from southern Queensland here, who you reckon is not in trouble, is just selling 400 cows to Woolworths, as I said earlier. These cows are going to end up at the bloody abattoir. He says that this spring, tier 2 milk could go to 15c a litre. If tier 2 milk goes to 15c a litre, will you up the price in the supermarket to protect the viability of dairy farmers?

Mr McLeod—You have made a number of points there. I am not sure if I can cover them all.

Senator HEFFERNAN—Just the question at the finish will do.

Mr McLeod—You mentioned market share and, as a result, the market share that Coles might have and that that creates underlying pressure on the farmgate price. I do not agree with that.

Senator HEFFERNAN—I did not expect you to.

Mr McLeod—The two main processors in Australia have 84 per cent of the market, so I think that is where the biggest risk might lie. Going back to what I said before, whether it is tier 1 or tier 2 pricing: John can correct me if I am wrong, but I do not think that our supplier in Queensland has a tier pricing strategy in terms of the way they deal with their farmers. What we have done, though, is ensured that in Queensland we gave the maximum increase of all the states, recognising the costs of production up there are higher, to provide some additional relief.

I also mentioned previously the Malanda processing plant. Had we not continued to support it, and support the dairy farms in the Atherton Tablelands, then the chances are that 70 farms would have been at risk. So, going back to the point I made earlier, we do take our position quite seriously and try to ensure we get the right balance between what we are doing for the processors and what we are doing for customers in terms of giving them better prices.

Senator HEFFERNAN—Thanks for that, but do you really think it is sustainable to cart milk from the Atherton Tablelands to Darwin to sell it?

CHAIR—You have asked that question a few times.

Senator HEFFERNAN—But with the freight factor, do you really think that is a good idea?

Mr McLeod—That is what we are doing.

Senator HEFFERNAN—I know that is what you are doing, but do you think it is a good idea?

Mr McLeod—If we want to try and support the dairy industry up there and there is support for the locally produced products in Darwin, then that is something we want to try and support as well.

Senator HEFFERNAN—So two years ago when our southern dairy farmers were expected to produce milk for 16c a litre—because of the consolidation, by the way, not only of milk processors but they had trouble with the consolidation of meat processing as well—Europe put a subsidy on manufactured by-products of something like \$1,600 a tonne and the US matched that. If the world market reverses to where it is, will you give a guarantee that you will put up the price of milk in supermarkets to protect the viability of farmers? You are a bit lucky at the moment that the market milk is driving it. It is a bit like the trap the rice farmers are about to fall into if they sell to Spain; they have got no control over the market. Despite the variation in the season here—

CHAIR—You have asked your question. Let him answer.

Senator HEFFERNAN—you and Woolworths say that this is all determined by the offshore market. We do not have a subsidy system in dairy farming to match the Europeans and Americans, so the only way out, if there is a drought here or if something goes wrong, is to put the price of milk up, so the dairy farmer may well have double the cost of production if he is buying grain and the grain market happens to be all right. Can we be given an assurance that, in the best interests of dairy farmers—which you keep saying you are acting in—you will put the price up to protect the viability of dairy farmers, or should we blame the processors?

CHAIR—Senator, let the witnesses answer.

Mr McLeod—I think that what we said is that the way that we have renegotiated our contracts is that we have got longer term, two- to three-year, lengths of time in our contracts with our processors and within those contracts exist rise and fall clauses so that if there is a pressure on the farmgate price for whatever reason, and that can obviously be independently proven, then clearly in those circumstances there is a facility and flexibility within the contract to pass those prices on. Whether in fact we then move that through to the retail price will be a decision that we take at that time, depending on the market circumstances at that time.

Senator HEFFERNAN—Do you think you could exercise influence on a consolidated processing, given a consolidated retailing, to the point where you could influence the process and put the milk up? You do not have any contact with the dairy farmer. Do you think that you have got that sort of influence?

Mr McLeod—We would find it very difficult to exert that influence, even with—

Senator HEFFERNAN—In other words, it is up to the farmer to fly his own resources and you will just steam on ahead.

Mr McLeod—One of the things that we have said is that we do believe there should be greater transparency in farmgate prices. We know that average farmgate prices are available, but I think how the whole system operates is quite grey. If there were a higher level of transparency and also greater levels of collective bargaining available, that would strengthen the dairy farmers' position.

Senator HEFFERNAN—If you are really fair dinkum about the farmers, shouldn't you take a closer interest in the dairy farmer rather than just say, 'Oh, that's up to the processors'? Why

don't you have direct contact with the dairy farmers? I think you will find they are a nice bunch of people.

Mr McLeod—We do, and we have had, and I agree with you: they are a nice bunch of people.

CHAIR—Can I ask a question there. I believe that something like this—

Senator HEFFERNAN—Can I table a document, Mr Chairman?

CHAIR—has happened in the UK. Let me finish the question I want to ask, because it is related to this. Ten years ago a similar sort of process to this occurred, I gather. Is that not the case? And the end result has been that the supermarkets are buying directly from the farmers and then contracting out to the processors, so the relationship between the farmers and the supermarket is a direct one, not an indirect one as it is now in Australia.

Mr McLeod—John might have more detail on this than I do. Personally, I have not had direct involvement with the UK dairy industry for the best part of 15 years, but my understanding is that a more direct relationship has evolved in more recent years in the UK between the main retailers and the dairy farmers themselves.

Mr Durkan—It has also been a while since I have been in the dairy industry in the UK, but there has been some movement from supermarket to processor to farmer to some relationships that are direct, and actually we have seen a growth in cooperatives in the UK more recently.

CHAIR—Farmers' cooperatives?

Mr Durkan—Yes.

CHAIR—Which has given them more power relatively, I presume.

Mr Durkan—Absolutely.

CHAIR—So there is a greater equality of power. What has happened, do you know, to the numbers of dairy farmers in the UK over the last decade because of this process?

Mr Durkan—I cannot answer it entirely 'because of this process'. All I can see in the UK over the last—longer than a decade, is a rationalisation in terms of the farming community. But I do not know the full extent of that. I could not give you the numbers that go with that.

CHAIR—I just wonder what you would predict to be the scene in 10 years time in Australia then. Would it be something similar to that which now exists in the UK, with farmers selling directly to supermarkets, who in turn contract processors to produce their products to be sold in the supermarkets?

Mr Durkan—I think you have to take each geography on its own merits. It is a completely different environment in terms of Australia versus the UK. The UK only produce enough milk for their own consumption, as an example. Australia, being an exporter of milk, is a completely

different environment. If I were to portray the future, I think there will always be the supermarket processor and farmer in the supply chain.

CHAIR—I understand what you are saying about export. Only 26 per cent of Australian milk or thereabouts—in the 20s, anyway—is domestically consumed.

Mr Durkan—Yes.

CHAIR—So you do not see a UK type scenario developing here, where there is a direct relationship between the supermarkets and the farmers, not the processors.

Mr Durkan—I think it is just so much different in terms of the way the market is structured that it is difficult to envisage that they will be the same.

CHAIR—Thank you. Senator Heffernan wanted to table a document. Do you wish to do that, Senator?

Senator HEFFERNAN—Yes. It is just the price of water at Coles as we speak.

CHAIR—Are we happy to have that tabled? Yes. I now turn to Senator Xenophon.

Senator XENOPHON—I am going to ask you some questions in relation to performance bonuses. I am not sure if you got a chance to complete your answer, but I think you acknowledged that, as is the case for executives at your level, you are on a performance bonus, I take it?

Mr McLeod—Yes. I have got performance related elements in my pay packet.

Senator XENOPHON—Sure, which is not uncommon in the corporate world. Can you tell us whether that performance bonus is linked to market share; is it linked to profit?

Can you tell us what that performance bonus is linked to in relation to your five-year contract?

Mr McLeod—The mainstay and thrust of the bonus program is about recovering Coles to a position where it becomes a long-term sustainable business. That is the essence of what we have been asked to deliver. For sure, improvement in profitability is part of that program.

Senator XENOPHON—Including market share?

Mr McLeod—Not including market share, no.

Senator XENOPHON—So it is profitability. That is the key.

Mr McLeod—Market share does not feature actually. If you look at our overall performance, what we have been trying to do by lowering prices and improving trust is by bringing Coles's customers back to Coles. Our market share at the moment is, broadly, where it was about three years ago, so we have recovered some of the changes that have been made to market share as a

result of our programs and policies. As was mentioned earlier on, we are going to start improving the profitability, but we are also concerned about the long-term health of the business and the viability of Coles. There are a number of different factors that impact on that. For example, there are sales growth improvements that are expected to make sure that there are not huge spikes in sales that degenerate over time. There are also health businesses which look at customer satisfaction, employee satisfaction and so on.

Senator XENOPHON—I will not labour this point, but performance bonus is linked to profitability but it is also sales growth in certain sectors.

Mr McLeod—Because what the company wants—

Senator XENOPHON—Sorry. Is that a ‘yes’ or a ‘no’?

Mr McLeod—There are elements of it that are linked to sales as well as long-term health.

Senator XENOPHON—So it is linked to market share as well?

Mr McLeod—No, not necessarily, because what you do not want to do is to be in a situation where you have no sales growth at all and therefore you are jacking up profit in order to make sure that you hit a profit target. What the company is looking for is balance in terms of the overall health of the business. That is the most important thing. Clearly, sales growth will be an element of that. That is what you would expect.

Senator XENOPHON—In certain sectors.

Mr McLeod—The main thing really is the long-term health of the business and it is a critical point in this. Going forward, if the long-term health of the business criteria are not met to the satisfaction of the Wesfarmers board, then your future bonuses could be zero.

Senator WILLIAMS—Mr McLeod, Mr Goyder says in a radio interview:

Coles acquires five per cent of the milk produced in Australia.

It is not really a big proportion of Australia’s production of milk, five per cent, is it?

Mr McLeod—That is true, yes. We are about five per cent of the total milk production.

Senator WILLIAMS—When you break it up, we produce about nine billion litres of milk a year, about five billion exported—process exported; about four billion domestic; half of the domestic, two billion, processed—cream, cheese, butter et cetera. So we now get it back to two billion litres basically which are drunk in Australia in a year. Would you agree?

Mr McLeod—I think perhaps you are looking for what our share of the drinking milk market is.

Senator WILLIAMS—Yes. How many litres of milk do you—

Mr McLeod—It is much higher but it is below 20 per cent.

Senator WILLIAMS—How many litres of milk do you sell a year? Do you sell around 500 million litres of milk?

Mr McLeod—I do not know what the precise number is. Do you know that, John?

Mr Durkan—It would be a smaller number than that. We can take this later in camera, but we are sub 20 per cent in terms of the drinking milk market.

Senator WILLIAMS—So around 20 per cent of the drinking market. That sounds a lot better than—

Mr Durkan—So less than—

Senator WILLIAMS—when Mr Goyder put the spin on it—'Just five per cent of Australia's milk produced that Coles acquires.' I question whether he would get a job with the Prime Minister as a mentor of spin doctors or something. But we will move on to—

Mr McLeod—I think it is important—sorry. If I can just finish on that point, I do respect the fact that there are differences between our share of the total milk production market and the drinking milk market, but I think when we are looking at the overall market we are back to the variation and difference in the overall market and the link and connection between export and domestic. I think that is just putting a context around it, but you are right to point out that our drinking milk share is higher than our total milk production share and you would expect that.

Senator WILLIAMS—Mr Durkan, did I meet you in Senator Joyce's office about six months ago?

Mr Durkan—No, Senator.

Senator WILLIAMS—I met two representatives from Coles there about five months ago.

Mr Durkan—It certainly was not me.

Senator WILLIAMS—You were not one of them?

Mr Durkan—No.

Senator WILLIAMS—It was not a very good meeting. At about one minute we were in a blue. I know that is hard to believe! But the reason we got into a blue, as I said to these two gentlemen from Coles, is that Coles has insisted that you will not buy pig meat off any piggery in Australia that has dry sow stalls. Agree?

CHAIR—That is in their submission.

Mr Durkan—What we have said is that we want to take sow-stall free in the future.

Senator WILLIAMS—Yes, exactly.

Mr Durkan—Along with Australian park.

Senator WILLIAMS—Yes, exactly. Of course, we do not import any fresh pork to Australia because AQIS regulations insist on that because of the fear of bringing disease here. I said to the Coles representatives, ‘Okay. You’re insisting that all the pig farmers do away with their dry sow stalls,’ and I am very familiar with that—I have still got the burn marks on my arms et cetera from when I was welding them up at home—and they said, ‘That’s right.’ I said, ‘How much more are you going to pay the pig farmers for their extra costs of building large sheds or large pens or even running the sows outside where they’re exposed to the sun and then you have more pregnancy failures and less production? How much more are you going to pay the pig farmers for their pork because of what you’re insisting on?’ The answer was, ‘We can’t pay them any more because the consumers can’t afford to pay any more for pork.’ What I am bringing you to is this: you make a decision that directly affects the cost to a farmer, in this case the pig farmer, but you are not prepared to pay them any more because you insist on some certain husbandry standards. Isn’t that unfair?

Mr Durkan—I would not mind correcting that. What we have actually said is that we will fully absorb any additional costs of going to sow-stall free in pork in Australia.

Senator WILLIAMS—Sorry, you will absorb—

Mr Durkan—Absorb any additional cost for the farmers is what we have said.

Senator WILLIAMS—For them to establish their new larger sow pens et cetera?

Mr Durkan—Sow stalls. Absolutely.

Senator WILLIAMS—That is in contrast to what your two representatives told me in Senator Joyce’s office when they said, ‘There won’t be an increase because the public can’t afford to pay any more for pig meat.’

Mr Durkan—As with milk, we do not intend to pass on any additional costs that are in the supply chain with the pork.

Senator WILLIAMS—Do either of you regularly visit farms? When I say ‘farms’, dairy farms—

Mr Durkan—Yes.

Senator WILLIAMS—pig farms, chicken farms? You do visit them?

Mr Durkan—I do, yes.

Senator WILLIAMS—Mr McLeod, have you visited any farms in Australia while you have been here?

Mr McLeod—Yes, I have.

Senator WILLIAMS—Have you gone out and spoken to the dairy farmers?

Mr McLeod—Yes, I have.

Senator WILLIAMS—Been through the piggeries?

Mr McLeod—I have not been through a piggery. I have been out in the middle of Queensland looking at cattle.

Senator WILLIAMS—So you have had a look at the beef industry and that sort of thing. Are you building a relationship with those farmers?

Mr McLeod—Yes, we are.

Senator WILLIAMS—Good. You have led the discount war, the price war on milk. You have said, in a letter that Senator Xenophon got into a bit of hot water over—I do not know the story: ‘Coles has cut prices on more than 5000 products—including milk—to help stretch the weekly pay packet of Australian families.’ You have said in that letter:

... the fact sheet that dispels the myths that our dairy farmers will be paid less.

You are familiar with the letter, of course.

Mr McLeod—Yes, I am.

Senator WILLIAMS—Under the Parmalat agreement, we have now seen Mr Goyder saying that the sales on your generic label milk have increased by 15 to 20 per cent. Under the Parmalat agreement, contract arrangements, the dairy farmers contracted to Parmalat get 58c a litre for the branded milk and 44c a litre for the generic brand. So, consequently, the dairy farmers contracted to Parmalat are selling 15 to 20 per cent more of their milk that they are producing on a dairy farm at 44c a litre instead of 58c a litre. You agree?

Mr McLeod—I am not familiar with the contract arrangements with Parmalat.

Senator WILLIAMS—That is the evidence that this committee has heard and I assume—and you should never assume—that we were not given false or misleading evidence. Assuming that is correct, you can see that, your decision to lower milk prices hence increase the percentage of your sales volumes that Mr Goyder said many times, has actually set up a situation where the dairy farmers are being paid less. Agree?

Mr McLeod—I do not agree with that, no. The situation that we have put in place is that we have given price increases to processors. When we look at the price increases that we have given to the processors and we look at the change in mix in terms of sales between the brand and private label that we have in our stores, we believe that the increase that we have provided more than compensates for the mix change that they have and that it still leaves some cents per litre

spare to provide for the dairy farmers themselves. We are more than happy to show you those, again, in camera so that you can see for yourself.

Senator WILLIAMS—We are well aware that you have paid the processors more. We heard from National Foods that they were losing money providing you with your generic brand milk and now it has stayed up to where they are making a whisker of profit. I think that is on the public record. But let's go back to the dairy farmers contracted to Parmalat. This is not rocket science, because I understand this and I am only a broken-down shearer. If you see 58c a litre for branded milk and 44c a litre for generic brand, and all of a sudden 20 per cent more of the dairy farmers' milk is going into the 44c bin and 20 per cent less into the 58c a litre bin, surely you can see those dairy farmers are getting paid less at the end of the week?

Mr Durkan—We do not fundamentally believe that milk is inelastic. We believe that there will be a higher demand for drinking milk, which we believe carries a higher premium to the farmer. We believe the growth in drinking milk plus the increases we have given to all of our processors should offset any changes that you see in mix.

Senator WILLIAMS—As I said, these people are contracted and it is clear in their contract—we have heard the evidence—hence Parmalat is paying 44c a litre for more of their milk, rather than 58c a litre. Surely from the information I have given to you—and I believe it all to be true—you can see that the dairy farmers contracted to Parmalat are receiving, on average, less per litre of milk at the farm gate than they were before you started your price war.

Mr Durkan—But what we do not see in the middle of that is how much volume has gone up in total milk to offset any change that may be within their contracts.

Senator WILLIAMS—Even if the volume goes up in a contract, a dairy cow—jersey, Friesian, whatever—it is not as though their teats are taps and you just turn them on and get more today, less the next day and more the next day if you want it. It does not work like that. But you can see that under that contract with Parmalat your decision has returned less cents per litre average to those dairy farmers contracted to Parmalat because they are selling more at the lower price of 44c and less at the higher price of 58c. You can see that?

Mr Durkan—I can see in your explanation, absolutely, what you are saying.

Senator WILLIAMS—That is the point I make. I hope you understand and realise that and I hope you look further into it, because the bottom line is that I do not think \$1 a litre for milk is sustainable. Anyway, let's move on to eggs. What have you done so far: reduced the price of your free-range eggs down to—no, your organic farmed eggs down to equal free range?

Mr Durkan—No, we have moved free-range pricing down.

Senator WILLIAMS—Do you intend to have a price war on eggs?

Mr Durkan—As we said, we have cut 5,000 prices. Eggs and milk are only two of the products that we have cut in price. We believe that we should be lowering prices to consumers.

Senator WILLIAMS—I am going to take you on to beer. You certainly hit the headlines with Fosters. They were concerned you were going to sell beer at less than wholesale price. Correct?

Mr McLeod—That was their concern, yes.

Senator WILLIAMS—And they pulled the grog out of Linfox's truck—sorry. They removed the packaged beer from the transports of Linfox trucks. That is probably a better way to put it.

Mr McLeod—From what they say, that is what they did.

Senator WILLIAMS—Do you believe that to be true?

Mr McLeod—I do not know whether they did that or they did not. Certainly there was a phone call to us to say that they were not prepared to supply a product at a particular price, given the retail price that was being charged for it at the time.

Senator WILLIAMS—They were lucky. Beer does have an expiry date; it is a perishable item, and I have consumed the odd one or three in my life. But with milk you cannot just pull it out of the truck and go and store it somewhere, can you? It puts them in a far better position.

Mr McLeod—I do not quite follow the contrast and comparison, because in the milk market we have a long-term product and what we have done is reduced the price for a long period of time, hence why it is a 'Down Down' promotion. The beer was not a 'Down Down' promotion. It was a special for a week and the beer industry—

Senator WILLIAMS—How much were you going to sell it for? How much were you going to sell a carton of VB for?

Mr McLeod—It was not \$28, that is for sure. We had no intention of selling any beer for \$28. The beer was going to be sold at a competitive price in the marketplace. What I have noticed is that the dynamics in the beer industry are very high/low in terms of style and they are also very aggressive in terms of the level of discounting. That has been symptomatic of the beer industry for probably the last 20 years. Certainly in the last 12 months the beer industry itself has actually felt a tightening in terms of overall demand. That has meant that discounting overall has been even more aggressive than it was previously and that has happened through the market.

There are a number of specials that have been run by different competitors and each one of these—and I am happy to show them to you—have identified products in each of them where we believe those products would have been sold below cost. From our point of view we have an approach here where we want to make sure that we have competitive prices on our beer, therefore we cannot stand away from those particular price situations. If we have a market position where we are saying, 'We beat everyone's liquor prices,' then we have to be true to that from a brand integrity point of view and a customer integrity point of view. That is really what has driven a lot of our pricing in here. Previously Fosters had been quite happy to supply at prices where we believed that at market they might have been below cost. What has brought about their change of heart now? I do not know. That would be a matter you would have to ask them.

Senator WILLIAMS—I have shopped at Coles in Inverell for 30 years—good people, good to get on with. I do not shop at Woolworths because of the experience I had with them in the pig industry when they said they would not buy imported pig meat. Along with my brother Peter, I was supplying pigs to Woolworths and of course six months later there was a cheaper price from overseas Canadian pig meat, so they went back on their word.

Mr McLeod—We appreciate your custom, Senator.

Senator WILLIAMS—I am only halfway through the story. Do not get ahead of yourself.

Mr McLeod—I thought I would get in while I was ahead.

Senator WILLIAMS—That was the good news. But I said to my wife last week, ‘Do not shop at Coles again.’ I said, ‘Make sure you shop at IGA in Bingera’—a little town you have probably never heard of—or ‘IGA in Inverell.’ If I were to say that publicly in a media release I would probably get sued. I would not do a media release on it. But the point I make is that some of us have been brought up on the land in the bush all our lives and we do not like what we are seeing. Are you fearful of getting a reverse reaction to your ‘Down Down’ prices from people like me who have said we are leaving Coles?

Mr McLeod—No, and that is certainly not our experience. The 4½ million families in Australia operating at either average income levels or below and having \$130 a month taken out of their pay packet based upon increases in gas, electricity and interest rates and so on, are looking for some relief somewhere. The place they are getting relief at the moment is in lower prices at Coles. That is what we want to maintain. We are not out to damage any part of Australian farming. We want to make sure we have good relationships with the agricultural industry. We want to see some change in some areas, particularly in relation to animal welfare, and we want to work with our suppliers to deliver that. We are certainly not out to make enemies of the dairy industry or any other agricultural industry.

Senator WILLIAMS—You have not got off on the right foot with us.

Mr McLeod—What we have to recognise is a balance between what we provide in terms of support for the agricultural industry and what we provide in terms of lower prices to our customers. That is what we are here for ultimately: to make sure that we give the best deal we possibly can to ordinary working Australians.

Senator WILLIAMS—You are here to give the best deal to ordinary working Australians, not to make a profit? I am surprised you are not wearing a Santa Claus suit. But let me move along because time is running out.

CHAIR—Senator Williams, time is running out—

Senator WILLIAMS—Yes. Okay, two things. Senator Heffernan has come to order.

CHAIR—so if you could make this your last question.

Senator WILLIAMS—Senator Heffernan has come to order. I want to get back to the whole idea of this committee inquiry. You would be familiar with the Trade Practices Act in Australia. You would be familiar with Senator Barnaby Joyce’s Birdsville amendment, backed up in the other place by former Treasurer Peter Costello, about predatory pricing.

I am going to ask you a question. How would you feel if this committee recommended a truth-in-pricing act in the Trade Practices Act where every three months you had to declare to the ACCC what you are paying, the real cost landed in your stores for your products, including any kickbacks that might come later if you buy so many in bulk? The reason I ask that is because little stores are buying their Coca-Cola and their milk from you. They cannot get it from Coca-Cola cheaper than buying it at a Coles store.

How would you feel about truth-in-pricing legislation in the Trade Practices Act that committed you and every other store, especially in the big end of town, to give details of your pricing and costs to the ACCC in confidence so that they can monitor what you are paying for your goods?

Mr McLeod—It would be such an extensive level of bureaucracy that I think it would be very difficult to maintain.

Senator WILLIAMS—What if we picked just 10 or 20 items?

Mr McLeod—But what would be the point?

CHAIR—Let the witness answer, Senator Williams.

Senator HEFFERNAN—The ACCC would not know if they were on fire.

CHAIR—All right, have you—

Mr McLeod—Personally, I would not see the value in doing so, but I am not here to set policy for government. That is really a matter for them in terms of what they wish to pursue. Certainly our intent is to operate within the law. Our intent is to operate in a way that we can commit to delivering lower prices for our customers and our intent and policy is to ensure that we maintain effective and constructive relationships with the agricultural industries as well.

CHAIR—Senator Williams, you will have to wrap up and we will go to Senator O’Brien.

Senator WILLIAMS—My pleasure, Chair.

Senator O’BRIEN—Thanks, Senator Williams. I’m glad you’ve conceded the call to me at last! Mr Durkan, you talked about the elasticity of demand for milk, which I understand has been conceded by many as being relatively inelastic. I want to be really clear: what potential are you suggesting there is for the consumption of milk to increase as a result of prices which are historically low?

Mr Durkan—The dates that I used were from Dairy Farmers Australia and their recent sets of data in terms of the drinking milk industry in Australia. Our view is that making milk more

affordable for everyday families allows either more people to get into the market and use more milk or more milk to be consumed in terms of in-home use. It is very early days in terms of the data, but we are seeing a tick-up in terms of an overall—

Senator O'BRIEN—What do you call a tick-up? It might be two per cent; it might be five per cent; it might be 10 per cent. What do you think it is?

Mr Durkan—It looks like it is somewhere between one per cent to two per cent, and from what we have seen it is towards two per cent. But, as I said, it is early days in terms of the numbers.

Senator O'BRIEN—It is a period where you started with a very low price in comparison with what the price was, or least that is the perception and that is how you are advertising it, and that has achieved a one per cent to two per cent increase in volume, in Coles's experience.

Mr Durkan—No, this is across the market. We are not talking about Coles sales here. This is independent data that is regularly published.

Senator O'BRIEN—Do I presume correctly that you want to give us in camera the details of how your share has gone?

Mr Durkan—We can do that in camera, absolutely.

Senator O'BRIEN—But you do not want to do that on the record?

Mr Durkan—It is commercial-in-confidence.

Senator O'BRIEN—I just want to be clear. It is always better for these inquiries to have evidence on the record so we can use it in our reports. The committee may come to you and ask if we can use certain aspects of the in-camera evidence and consult with you about that, but I am sure you understand how the in-camera processes of the Senate committees work.

Mr Durkan—Yes.

Senator O'BRIEN—You take a very different view from your main competitor Woolworths about the sustainability of these price circumstances. In fact, your submission says:

We believe that there is no reason why Coles retail milk price reduction in late January should have any impact on the farm gate price.

Are you saying that we can expect that to be the case into the future, or you saying that that is the immediate impact of that policy?

Mr Durkan—We cannot predict the future, and commodities, as we know, rise and fall. In relation to the immediate impact, it really goes back to the last question. We have seen a rise in the overall market in terms of drinking milk. As we understand it, there is a premium paid for drinking milk to farmers, and therefore the return should be better.

Senator O'BRIEN—We are happy to test that conclusion. According to this morning's *Age*, you had a three-hour war room meeting of senior executives yesterday and then announced that there would be a serious price reduction for chicken. Is that how it took place?

Mr Durkan—We reduced the price of some chicken products last week as part of our overall 'Down Down' campaign in terms of lowering prices. We have regular meetings of the senior management within Coles, and it sounds as though the *Age* has a little over-exaggerated any meetings we would have internally.

Senator O'BRIEN—Mr McLeod, you are quoted in the *Age* as saying:

The latest product to have prices reduced as part of our Down Down campaign is fresh Coles chicken and we have more price cuts planned in the next few weeks ...

Was that a reference to chicken or something else? I am only quoting what is in the newspaper. I am sure you are aware of it.

Mr McLeod—Our approach to lowering prices is something we want to continue with and, if we have the opportunity to do so, we want to make sure that we give the best value we can to our customers. So in time we would expect to see further price reductions occurring. You can perhaps appreciate that, given the commercial sensitivity of where those reductions might come, it would not be appropriate for me to discuss them now.

Senator O'BRIEN—I took it that you meant chicken. I am happy for you to disabuse me of that assumption if that is not your intention, because it would seem to be a strategic comment on the eve of this inquiry, which is obviously to do with public relations.

Mr McLeod—Mr Durkan has mentioned that we have made some price moves on chicken already.

Senator O'BRIEN—Is that a 'Down Down' price?

Mr Durkan—That is part of our campaign.

Senator HEFFERNAN—But you're not sure!

CHAIR—Senator Heffernan, good point, but we will let Senator O'Brien continue his questions. Thank you.

Senator O'BRIEN—Perhaps if we can deal with some serious evidence and leave the sideshow for later.

Senator HEFFERNAN—It is serious.

Senator O'BRIEN—It is not serious, Senator. You are just chirping from the sidelines. I am trying to ask some questions, and it is not very helpful that you are. In terms of your relationship with the chicken processors, is that comparable to your relationship with the milk processors? In other words, do you have a tender process, or is that a more flexible marketing arrangement?

Mr Durkan—We have a range of chicken suppliers across the country in each state, and the business does get tendered from time to time. I do not today have the length of the contracts we have with each one.

Senator O'BRIEN—So the chicken price is also a tender arrangement, or it is from time to time? I am not sure.

Mr Durkan—We would be in contract with a chicken supplier.

Senator O'BRIEN—There are a small number of major suppliers. There are a few others around the margins which I know would supply supermarkets like yours or those of your competitor, but the major suppliers are fairly large operators.

Mr Durkan—Yes.

Senator O'BRIEN—In that market, as well as in the milk sector, there are a set of contractual relationships between Coles and those major suppliers.

Mr Durkan—Yes. With most of our products, especially in private label, we would have contracts with suppliers.

Senator O'BRIEN—Is that a recent event or is it something with a long history?

Mr Durkan—No, Coles historically have had contracts with suppliers.

Senator O'BRIEN—So it is not something that has been influenced by events, for example, in the UK?

Mr Durkan—No.

Senator O'BRIEN—Some people are suggesting that there is a policy being introduced here that has its genesis with developments that occurred in the supermarket sector in the UK.

Mr Durkan—Coles have been selling private label now, I believe, for more than 30 years and have had various contracts along the way, some longer than others. There has been no change in policy in terms of contractual arrangements in the last three years.

Senator O'BRIEN—But this announcement now as one of the so-called 'Down Down' prices—

Mr Durkan—Absolutely.

Senator O'BRIEN—would seem to indicate a much less flexible range of prices for the processors in the future.

Mr Durkan—No. Our chicken supply base is different to our milk supply base. My understanding, especially with the providers that supply for us, who tend to be large, vertically-integrated suppliers, so growing the birds and—

Senator O'BRIEN—I think they contract grow actually.

Mr Durkan—I think there is a mixture. I think we have four or five suppliers around the country who have various ways of growing animals. Our chicken arrangements are different to our milk arrangements, and they would be different across many other products. So the contracts in place are different in different categories.

Senator O'BRIEN—So there is a state tender, is there, rather than a national tender?

Mr Durkan—It will depend on the category. I have not brought the detail of our chicken contract arrangements—

Senator O'BRIEN—The reason I am raising it is that it seemed to have been raised by the company in the context of media inquiries about this inquiry. It is in today's *Age* and *Sydney Morning Herald* and I am not sure where else.

Mr Durkan—With our chicken contracts, from memory, we have one big supplier and then a range of smaller suppliers throughout the country, and that one large supplier obviously has state based supply because of the nature of the product.

Senator O'BRIEN—So it varies between the states?

Mr Durkan—It does vary between states, but it could be the same supplier in different states.

Senator O'BRIEN—Yes. It has been suggested in one of the farm publications in Western Australia that Mr Goyder of Wesfarmers has acknowledged that Coles' marketing policy has created a problem in Western Australia, Queensland and northern New South Wales because those areas were primarily domestic markets. Is that something that has been drawn to your attention, Mr McLeod?

Mr McLeod—No, I am not aware of Mr Goyder making those comments.

Senator O'BRIEN—So that has not been drawn to your attention?

Mr McLeod—Obviously the decision to lower the price of milk, as I mentioned, was taken independent of Wesfarmers. Obviously, subsequent to that, given the level of publicity that it generated, naturally there would be inquiries made as to our approach. Therefore, I briefed Wesfarmers on our approach and gave them the reassurances they were looking for and they were satisfied with that.

Senator Heffernan interjecting—

Senator O'BRIEN—I am asking the questions, Senator. Just ignore the comments from the side. So you have had a conversation with Mr Goyder?

Mr McLeod—Yes, I have.

Senator O'BRIEN—Did you suggest to him that it would not be helpful if comments were made that portrayed your campaign as being damaging to the farm sector?

Mr McLeod—As I said, I cannot comment on comments that I am not aware of.

Senator O'BRIEN—No. I am asking what you said to Mr Goyder.

Mr McLeod—Mr Goyder ultimately is the person I report to, so it is entirely his prerogative to offer his opinions either on or off the record.

Senator O'BRIEN—That does not answer my question. Did you suggest to him that it would not be helpful if he made those comments?

Mr McLeod—No, I did not. I did not suggest one way or the other. I just briefed him on what was our approach. I gave him the reassurances that I have given the Senate committee, I hope, in relation to the approach that we adopted. I endeavoured to communicate to him that there was a broader move that was at play here; that it was about delivering better value to customers; it was about engendering higher levels of customer trust; it was about aligning prices on products where it was essentially the same product in two different bottles sold at two different prices. I also gave him the reassurance that we had given increases to the processors and that we expected that to be passed on at the farm gate.

I also told him that we had rise and fall clauses in the contracts as well, in order to make sure, as best we could, that the dairy farmers were protected. I also mentioned that, clearly, in the locations in Western Australia and Far North Queensland, we were paying particular attention in those areas and taking steps to ensure that we made special provision in those particular areas. Given that briefing and that discussion, he was satisfied that what we were doing and the balance that we were adopting was the right thing.

Senator O'BRIEN—That was somewhere a lot closer to 27 January.

Mr McLeod—We have had several conversations around it, but it was sometime after 26 January. He was on holiday at the time that the change was made. He was overseas.

Senator O'BRIEN—The comments were reported on 17 March, so it would have been well before then that you spoke to him?

Mr McLeod—It will have been, yes. To be honest, I do not know what he actually said. I think that he would have natural concerns around those outlying areas, as indeed we do, and I suspect that is probably what he was indicating in his comments.

Senator O'BRIEN—The only thing that arises in my mind is that, if you gave him the sort of briefing you gave, why would he make the comments that he did about having fears of damage to the sector in those outlying states?

Mr McLeod—I do not know, as I said, it is coming cold on me—

Senator O'BRIEN—I understand. Sure.

Mr McLeod—so I do not know what the comments were. But my discussions with Richard have been more around what are we doing overall, which I have given reassurance on, and I also said that we had taken specific measures to reassure him in relation to Western Australian dairy farmers and, indeed, those in Far North Queensland as well.

Senator O'BRIEN—Does Wesfarmers have any oversight of Coles's decisions in this regard? Is it a decision that you make and you just inform them or do Wesfarmers have some input, via the board or in some other way, about the sorts of decisions that you are making now about your approach to marketing?

Mr McLeod—We regularly have board meetings with Wesfarmers and, during the course of those board meetings, we will update the board on progress that has been made in the turnaround so far and also give insights into broader strategic change that we might be wishing to propose going forward. So there is a strong connection there anyway. Some of it is formal; some of it is informal. So there is a good relationship between the two companies.

Senator O'BRIEN—So Wesfarmers would have had a broad strategic view of where you were headed without necessarily knowing that, for example, you were going to discount milk on 27 January?

Mr McLeod—That is correct.

Senator O'BRIEN—But you would inform them after the event and give them a full briefing, through one or other channel, about where you were headed?

Mr McLeod—Yes, that is correct.

Senator O'BRIEN—So there is no doubt that Wesfarmers are on board with the strategy that Coles is pursuing?

Mr McLeod—Yes. We have got their full support in terms of what we are doing.

Senator O'BRIEN—There are a lot of questions we could ask, but we do want to go into camera and we have been going for two hours now without doing so.

CHAIR—We are also going to go to Senator Ryan. We will have to run over time, but I do not think that is particularly important in the broad context of things. So I will now call Senator Ryan.

Senator RYAN—I had to step out for half an hour for other commitments, so if these questions have been asked please just say so and I will get it off the transcript myself. I did not want to interrupt my colleagues.

Mr McLeod—They have been asked.

Senator RYAN—Some of my colleagues might think that. Do you know, and can you say publicly—either from an industry point of view or from your point of view as Coles—how much money is being saved by consumers since the introduction of this? I know in your submission you have the numbers around food price deflation and how much that is saving consumers. Do you have a number around what the price cut on milk is saving consumers?

Mr McLeod—The figure that we have quoted is about \$1 million a week, I think.

Senator RYAN—About \$1 million a week. Do you have any idea of how many individuals that represents? You know obviously—and if it is in confidence I am happy for you not to say—how many people come through your stores every week and buy milk. Do you have a sense of either that or, again, industry-wide, how many individuals are benefiting from cheaper milk prices?

Mr McLeod—I would rather do that in camera.

Senator RYAN—Sure.

Mr McLeod—But I think we can share that information with you. Certainly we have seen a larger number of consumers coming in and buying milk from us. From the information that we have had in terms of the overall growth in the market, we would assume that our competitors are seeing similar growth as well.

Senator RYAN—I appreciate we are going to go into camera and have a discussion around the elasticity, but in general terms one could describe that as reflecting both the numbers of people making purchases and the purchases themselves.

Mr McLeod—Yes, that is right. I think it is, from information that I have seen; and then there is more anecdotally, so I would have to research this further for you.

Senator RYAN—Sure.

Mr McLeod—But our understanding is that it appears to be that more families with young children are buying more milk than they were before as a result of the change. Given the pressures that there are on the family budget, you can perhaps understand that.

Senator RYAN—Sure. The brand of milk that you have in your supermarkets—the Pura, the Dairy Farmers, various—do you set the prices for that on the shelf?

Mr McLeod—Yes, we do.

Senator RYAN—You do set the prices for that on the shelf? You make a higher margin on that, presumably, than you do on your private label milk?

Mr McLeod—Yes, we do.

Senator RYAN—You may not wish to comment on this, but I read the business pages too and it will not surprise you to know that a number of people are writing that one of Coles' strategies

is to move to more private label sales in its supermarkets generally. Given the sensitivity of this issue, did you consider reducing the margin on your branded milk to the same as it is on your private label milk so that, therefore, the previous cost differential between the two would be maintained?

Mr McLeod—No. I mentioned before that in some areas we have lowered prices in broader categories. In other areas we are looking at lowering prices on individual commodities that hit the shopping basket on a regular basis: the Smart Buy milk, which has now been replaced by the Coles brand milk, was the largest volume skew that we had within our range and, therefore, that is why we targeted the entry price point, because that would have the greatest benefit to consumers overall.

Senator RYAN—Milk is different to beer. Presumably if people walk into a Liquorland or a store of some variety and want VB, they are probably not going to go home with Tooheys. Milk is much more a commodity.

I will get to the issue of what you are aware of the processors paying farmers in a minute. Because of the potential shift from brand to generic or private label, there is obviously an impact on the processor because they have higher margins on the branded milk. Do you reject the assertion that that could have an impact on the farmgate price, or do you think it could have? If you do not know, feel free to say so.

Mr McLeod—Our perspective from the numbers that we have seen—because that is all that we can go off—is that the shift between brands and private label has not been of sufficient magnitude to warrant some substantive change in terms of the overall economics for the processor; therefore, our conclusion would be that the farm gate should not be affected, particularly when we have got rise and fall clauses in our contracts anyway and we gave them a price increase before we reduced the price.

Senator RYAN—Just to clarify what I have read and what I have heard earlier, it is your view that the price increase you provided before this retail price cut is sufficient to maintain farmgate prices regardless of the switch that is currently going on from brand to private label?

Mr McLeod—We see no reason that the move that we have made and the increases that we have given will have a bearing on lowering farmgate prices.

Senator RYAN—I like to play devil's advocate, Mr McLeod.

Mr McLeod—I am delighted to hear it.

Senator RYAN—So I will move on to the processors now. It seems to me that the processors have a significant amount to lose here. They have paid a lot and invested a great deal of money in brands, for a product that is more difficult to brand than other retail products like the beer example mentioned earlier. You do not see a reason that the processors should be reducing prices paid to the farm gate. Do you see there being further efficiencies in the processing space between the farmer and yourself that can sustain these lower prices in the medium term? Is that something that Coles is trying to drive?

Mr McLeod—I am not close enough to the economics of the processor to really comment on that in detail. What I would expect the processors to do if they are broader, forward-thinking brand owners is that they would look to see how their brands differentiate in the marketplace, both against other brands and, indeed, private label. That can come in a number of different ways. Senator Heffernan has made a strong case for, ‘Why on earth would anybody buy a bottle of Evian at the price that it is when you can just pour it out of the tap?’ It is because of the amount of money that Evian have spent and invested in developing a global brand in the bottled water market. I think that, whether it is a global brand or an Australian brand, there has to be investment in that brand in order to maintain its position in the marketplace. I do not think brands can take that for granted.

Our position on private label is to lower prices for consumers, because our view is that if consumers bought private label they would actually save themselves 10 to 20 per cent on the average branded price, and maybe more, so it has an opportunity to lower the basket price. In that circumstance, what we have to do within our private label program is make sure that the products that we carry are of sufficient quality that the customer accepts that there is something there that is going to be wholesome for them to feed to their families.

We are working very hard on not only developing the quality of our existing range but also adding value in terms of more range—for example, free-range turkeys and the hams that we did at Christmas. These are added value products. So if you are a responsible brand owner, you would expect to see greater levels of innovation and change coming through over time. You would expect to take a blended margin over products where you are adding value to it, and therefore you would expect to command a price premium in the marketplace, and a combination of those individual factors would get you to a position where you could grow overall.

There are some milk products that are out there in the market, in the branded space, that have probably withstood better than others, albeit that it is early days. There is a product called a2 which has got a different protein mix and therefore they are aiming to differentiate themselves. Betta Milk in Tasmania appear to have a strong franchise and I think they have gone out publicly and said that the impact of the change has mitigated as far as their product is concerned. I think that where you have got brands that can differentiate themselves and market themselves more effectively then there are opportunities for them to continue to grow and establish themselves as a strong player in the marketplace overall.

Senator RYAN—That is something for the processors to do, as the owners of the brands, presumably. It is not something that is a particular concern of yours, given that this is closer to a commodity than many other products you have in your supermarkets.

Mr McLeod—It is important to us in relation to what the consumer demand might be for those individual products. Clearly, if you have a product that has been invested in by the processor, or any branded supplier for that matter, and there is a consumer demand for it, from our perspective then it makes sense for us to sell that product on through our stores because the consumer demand is there.

Senator RYAN—You mentioned earlier that you have moved to state based pricing away from the 32-odd regions you had.

Mr McLeod—That is right.

Senator RYAN—Inherent within that state based pricing will be different costs. The examples I used before were lettuces and tomatoes in Melbourne or Warrnambool or Wodonga. If you have state based pricing, inherent in that will be some averaging, I suppose. I do not want to use the term ‘cross-subsidy’—but some averaging of prices to ensure you make a margin, taking into account the volumes you sell. Is that true?

Mr McLeod—That is correct. Specifically with regard to produce, we do not adopt a state based pricing approach on fruit and veg. Because fruit and veg is such a local product and the markets vary so significantly—not just from region to region but from day to day—it would be logistically impossible for us to do so, so we said up-front when we first brought the state based pricing in that fruit and veg would be excluded from that.

Senator RYAN—Do you do it with other what I might call fresh or quickly perishable products? Milk is a relatively quickly perishable product. Do you have state based pricing for other products with short shelf lives?

Mr McLeod—Yes, we do.

Senator RYAN—Such as?

Mr Durkan—Other dairy products would be an example.

Senator RYAN—Let us move outside dairy. Other than dairy, do you have state based pricing for things like bread? We all know the symbolic importance of milk to a retail strategy. Do you have it for other products that, if not as important, are at least similar?

Senator COLBECK—Salad and lettuce, for example.

Mr McLeod—That again is fruit and veg.

Senator COLBECK—But that is produced in certain regions and marketed pretty broadly. For example, a large proportion of the pre-packaged lettuce comes out of Tasmania. Why is that different to, say, milk?

Mr Durkan—We have tried to pick categories rather than individual products. To explain our state based pricing, and be transparent, we picked whole categories so customers could understand where we were going to be, across the state—

Senator COLBECK—Yes, but it does vary within those categories.

Mr McLeod—That is a good argument, Senator. I do not want to talk without having the detail behind me, but I will take that on notice and come back to you.

Senator RYAN—Can you say whether there are perishable products other than dairy—I appreciate dairy is different from white milk—

Mr Durkan—Bread would be a good example.

Senator RYAN—And the costs of that might be slightly different in various parts? The reason I ask this is that it is obvious that the cost of acquiring fresh milk in Darwin is different from what it might be in a suburb of Melbourne. You do not, presumably, truck milk from Melbourne to Darwin. So there is an inherent averaging in this, isn't there?

Mr McLeod—There is, by state.

Senator RYAN—Yes. But I suppose this is a national milk price, which is why I am asking.

Mr McLeod—It is. In this respect, you are absolutely right: it is a national based average.

Senator RYAN—Some people have mentioned the prospect of somehow compelling the big chains to release the prices or release contract details. Are there any other areas of where you acquire supply where you are compelled to publicly release your prices or expose your contracts to the public glare?

Mr McLeod—Not that I am aware of.

Senator RYAN—Would this be a first? If someone said, 'We're going to say there needs to be legislation to find out exactly what you pay National Foods'—or whoever you are supplying—that would be a first, wouldn't it? There is nowhere else where we go in and require you to expose your personal, private contracts?

Mr Durkan—I am not aware of any contracts that we would be exposing outside of our agreement with the supplier.

Senator RYAN—I just wanted to clarify that. I did not think there were, but I figured you would probably know more than I would, off the top of my head. I want to go to this issue of market power. Did I hear you correctly when you said all your private label milk contracts expire in January 2014?

Mr Durkan—Most of them do.

Senator RYAN—And that would be more than half of your volume?

Mr Durkan—Yes, more than half of our volume.

Senator RYAN—If, for example, there was a problem with one of your big suppliers—you have three big ones—or if, in the next round of negotiations, one could not agree on a price with them, how easy is it to source that volume of milk quickly, if you wanted to replace the supply of your private label brand?

Mr Durkan—I would argue that the regionality of milk makes it really important for us to be in the right areas in terms of production; therefore, we would aim to have a sustainable and wide supply base—as wide as we could get it—in terms of ensuring that we are not transporting milk huge distances. Hence, that is one of our reasons for supporting the Far North Queensland

Malanda area. We are trying to keep a buoyant processor sector in place as well as a farming sector to ensure that we have the whole chain secured for the future.

Senator RYAN—Not all the market power is with you. You cannot compel people to supply. It is a negotiation, isn't it? You take tenders, you negotiate over prices. It is not an issue of you simply demanding a price, is it? Market power is a very important issue that we look at in retail, because we do have two very strong players. You ironically have a lesser share of the fresh milk market than you do of the groceries market overall. What planning do you put in place to make sure that a processor cannot say, 'If we do not agree on price, there will be no milk in Coles as of 1 July?'

Mr Durkan—As best we can with the processors, we try to ensure that their viability. Projecting into the future, there will always be a strong supply of fresh milk in all of the regions and therefore there will be a strong processor sector in terms of how we deal with that. That is different to other places around the world. Looking forward, I envisage that this will still be a strong competitive marketplace as 2014 comes around and we go out to tender again for our contracts.

Senator HEFFERNAN—Your tenders screw the dairy farmers in the meantime, because there are only a couple of you to deal with.

CHAIR—Senator Heffernan.

Senator HEFFERNAN—Will you do something to look after the farmers? You do not have any contact with them at the moment. You just say, 'That's the processors part of it.' You hide away from them.

Mr Durkan—As we stated, in our contracts with our processors we have rise and fall mechanisms in the contracts that should protect the farmers that deal with Coles.

Senator RYAN—You do not have contractual relationships with the farmers.

Mr Durkan—No, we do not.

Senator RYAN—You have contractual relationships with the processors through which you seek to enforce those arrangements.

Mr Durkan—Yes, we do.

CHAIR—I would like to ask you a quick question in relation to that. You have contractual relationships with the processors. But this concerns the farmers. What industry groups have you met with and when? Have you, for example, met with the Australian Dairy Farmers, which is a peak group? Then there are the second tier state based groups, such as United Dairy Farmers of Victoria and the Queensland dairy farmers group. Have you met with these industry groups?

Mr Durkan—I have personally met with two of the industry groups.

CHAIR—Which were?

Mr Durkan—Australian Dairy Farmers and the Dairy Farmers Milk Cooperative.

CHAIR—Thank you.

Mr Durkan—That was post our—

CHAIR—So you have been in contact with them and discussed these issues with them.

Mr Durkan—Absolutely.

Mr McLeod—I have met with the Dairy Farmers Milk Cooperative as well.

Senator HEFFERNAN—Is it true that you are buying refrigerated trucks to directly deal? I am talking about the vendor share of the market here.

Mr Durkan—I am not aware of that.

Senator HEFFERNAN—Are you buying up refrigerated trucks or planning to do direct marketing because vendors are going to Coles now to buy milk because it is cheaper there than through the processors? Are you intending to buy trucks and deliver direct?

Mr McLeod—The answer is no.

Senator HEFFERNAN—So that is not true.

CHAIR—Thank you very much.

Senator COLBECK—Just on the topic that Senator Eggleston was talking about a moment ago, Senator O'Brien asked a question and your response in relation to prices and the increases that you provided to the processors back in January was that your expectation that price increases would be passed back onto farmers as part of that process. Isn't that inconsistent with the other evidence that you have given about the fact that you do not set milk prices? We all know that you have given an increase to National Foods as part of the negotiations. That is on the public record from them and from you. You said to Senator O'Brien that your expectation is that those increases will get passed back to the dairy farmers. But in your other evidence you said that you do not set milk prices so you do not have any influence on that. How do those two things line up? This comes back to the consistency argument that I was making before. It is true. National Foods in their evidence told us that they were losing money on that milk before and that they are now making a slight margin. How are the two statements that you made consistent?

Mr McLeod—Thanks for raising this. To clarify, what we believe is that the increase that we provide to the processors gives the processors with the flexibility to provide additional funding to the farm gate. But I appreciate that it is not something that we have direct influence over.

Senator COLBECK—So there are no contractual conditions in the contracts to say that there should be something passed back?

Mr McLeod—No. Our expectation would be that if we have given them an increase they should pass that down the line. But that is really a matter for them at the end of the day. That is probably it.

Senator COLBECK—You talked about a price premium for drinking milk. What is your understanding of how that is sustained in all the markets? My understanding is that that level of premium varies in different markets around the country. I accept that there is a premium, but from my direct conversations with the dairy industry I understand that it has been negotiated away in some of those areas because of the strength of the negotiations between the farmers and the processors. What is your knowledge of that?

Mr Durkan—We do not have a deep knowledge of the contractual arrangements between farmers and processors. From what we have heard from our processors, they pay a premium for drinking milk.

Senator HEFFERNAN—What about in Queensland?

CHAIR—Senator Heffernan, we have to go into camera. We could ask that question in camera. It takes a little while to clear the room.

Senator HEFFERNAN—While they are clearing the room, can I ask a question?

CHAIR—No, Senator Heffernan. Let us just follow the process.

Senator HEFFERNAN—What is the point of asking it in camera? It is a public question. I want to know if you bottle any Parmalat milk in Queensland.

CHAIR—The members of the committee, Senator Heffernan, would prefer if we went in camera.

Senator HEFFERNAN—The farmers want to hear the answer.

CHAIR—I would now like to clear the room of everybody except the witnesses and the officials and other personnel associated with this committee.

Evidence was then taken in camera but later resumed in public—

[3.23 pm]

LEVEY, Mr Matt, Campaigns Manager, Choice

ZINN, Mr Christopher, Director, Campaigns and Communications, Choice

CHAIR—I welcome the representatives of Choice to this hearing and invite them to make an opening statement.

Senator O'BRIEN—And thanks for your patience.

CHAIR—Before you begin, we apologise for being so late. But we did spend a lot of time with Coles, which was useful for the purposes of the inquiry. We thank you for being so patient.

Mr Zinn—We fully understand that. We have been very keen for Coles to show some of their figures, and at least they have shown them to you if not to the wider public. But we might get to that in time. First of all, I would like to thank the committee for the opportunity to make this submission and appear here today. Choice welcomes the scrutiny that this inquiry is bringing to the impact of discount price decisions. We believe that this goes to the heart of issues around the operation of supermarkets in Australia today.

For 50-plus years now, it has been the role of Choice to speak out on behalf of consumers. Our mission is to put consumers at the centre of everything that we do. That is why we have consistently supported measures to address issues around competition in various sectors of Australian business. Banking notwithstanding, supermarkets and the grocery sector has been a key area. That regularly ranks among the top concerns of our members. It is important for us to say that Choice believes that competitive pricing is critically important, particularly with staples such as milk and bread. For a consumer group, we find ourselves in a very interesting position, sometimes having to ask questions when people bring down prices, because they rightly say that we have been calling for such things for some time.

We absolutely believe that cheap fresh milk is a good thing. It will remain a good thing as long as it remains as inexpensive as possible. The question that we have addressed in our submission is whether the short-term benefits and the seduction of certain discounts could be outweighed by negative impacts on consumers down the track due to high levels of concentration in the supermarket sector. That basically underlines our whole interest in this. It is really the fact that—as you have heard doubtless many times—there is a duopoly. Eighty per cent of the dried grocery goods are sold by two players.

There is a range of issues important to consumers. Price is just one, but a significant one. There is also product quality, nutrition, choice, diversity of retailers and other issues, like environmental sustainability and food security. It is obvious that, if you have a sector in which some players wield significant market power, the fact is they may use that power to discount a particular product and that is not necessarily in itself evidence of healthy competition. We know that this inquiry has heard evidence on a range of potentially negative consequences for consumers resulting from the so-called price war. I use the phrase 'so-called' because they all have exactly the same price, so I wonder what sort of war it really is. This includes future scenarios about fresh milk having to be transported longer distances, increasing costs and lowering quality.

We also note—and perhaps this is a key area in terms of the milk debate—the move towards generic products. Those push other branded products off the shelf, reduce choice and undermine product innovation and investment. There is also—and this is a particularly an area of concern for many of our members—impacts on smaller, independent retailers, who are unable to compete on price, which drives them out of the market. Running through all of this is the concern that the major supermarkets could grow even stronger and hence further entrench their market power.

Looking at all these possible consequences, the common thread seems to be a lack of transparency and a lack of clear understanding as to how anti-competitiveness flows throughout the supply chain. Choice believes that this situation must change. We believe that the key issue here for consumers—whether this is about milk, bread, eggs, beer, chicken or whatever else—is that supermarkets should be regarded as fair. That means that prices should not be distorted one way or the other through excessive market power, and that includes the power of suppliers as well as processors and retailers.

That is why Choice is calling for the establishment of a supermarket ombudsman. The ombudsman would ensure that there is a constant focus on reform and competition in the supermarket sector. The ombudsman could drive greater transparency along the supply chain, helping provide consumers with the confidence that they are paying fair prices. The ombudsman would also be able to direct inquiries and make recommendations for change where regulations or legislation is not working as it should. Choice is not the only stakeholder calling for such an ombudsman. Interestingly, the Food and Grocery Council is behind this idea as well. I say that because we are strange bedfellows as we are often at odds on issues around food. But we are very much united in the call for an ombudsman.

I want to finish by saying that Choice believes that it is important that issues with milk or any other supermarket product are not looked at completely in isolation from food policy more generally and broadly. That is why we have welcomed the federal government's steps to set up a national food policy working group, of which we are part. We want to see this process extended further so that there is a lot more coordination in nation food policy. The last thing that Choice wants to see is an ad hoc approach that in the end delivers a less efficient and a less competitive market for consumers when they go to the supermarket.

CHAIR—You have called for a supermarket ombudsman to be established and you obviously know about the produce and grocery industry ombudsman. How do you think an ombudsman would have dealt with this issue, given the difficulty in obtaining hard information from the parties involved—particularly information on the transactions between the dairy farmers and the producers?

Mr Zinn—We are aware of the produce ombudsman, who had all of 10 complaints, apparently, in the last financial year. We see the duties of that produce and horticultural ombudsman could be drawn into this area. I will pass this on to my colleague, Matt Levey, who will give a bit more technical information about how the ombudsman would work. We have worked with the Food and Grocery Council and met with the National Farmers Federation and even the National Association of Ombudsman to see exactly how this model would work. While they would not have coercive powers to perhaps pull any information out of Coles, we believe that they could have a very great leadership role in terms of steering fair competition in this area. But I will let Matt fill us in on some of the details.

Mr Levey—It is the sort of office that could be what you wanted to make it. Our approach has been to look at what is missing from the current competitive landscape and, if you like, working backwards to see what sort of powers that you want in this sort of position. A good example is what is happening in the UK, where they have a grocery code adjudicator. The government in the UK has referred issues around milk discounting that has gone there to that adjudicator. From our point of view, this would be a role that would be both supply side facing and consumer

facing. In the UK, what they have is an office that is very much focused on the relationships in the supermarket supply chain. We think that that person would have a role in dealing with consumer concerns as well.

As Christopher said, it would basically be an office that would drive a lot of proactive focus on this. In this inquiry's terms of reference, you refer to what happened since the last inquiry into milk reported. There were suggestions made for some research and market analysis to be done, which as best as we could discover has not occurred. We think that if you had an office like an ombudsman making some binding recommendations and driving activities from the ACCC or the Productivity Commission then you would ensure that there was always a presence—a constant presence—proactively looking at supermarket competition.

Outside of that, there are a number of technical issues and pros and cons with different design features. We would be very happy to put further information to you about that. But the position would essentially be about transparency and ensuring that someone with a high profile is looking at supermarket competition every day and not perceived to be doing in a slightly fuzzy or low profile way.

Mr Zinn—I would add that the supermarket industry is massive and powerful, as you have gleaned from these hearings. The ACCC has oversight in this area. They did have a grocery inquiry a few years ago. We would suggest that having someone who has intimate knowledge of this area and who, as Matt was saying, has the power to make binding recommendations would make a big difference. Whether they would sit within the ACCC or they report to the ACCC are things that we can iron out. We are undertaking further consultations with other interested parties on that.

CHAIR—What advantages would you see to flow from having this ombudsman within the structure of the ACCC?

Mr Zinn—One of them is efficiency. We do not want to create another bureaucracy. But, as the ombudsman pointed out to us, one of the roles of ombudsman is to be independent and outside some of those agencies of government. Obviously, we are conscious of the fact that the supermarkets might try and dismiss this idea as being a costly one that will end up costing people more. We think that the cost need not be significant. You can set up one of these things for not a high cost. Given the \$80 billion that goes through the supermarket industry, we do not think that it would not be an unnecessary impost. We do not want to have a turf war going on between these agencies about whether or not it should be within the ACCC. There needs to be a clear delineation. We wonder if the ACCC is providing leadership in the area of supermarkets. They might be doing a lot of things behind the scenes but—while I am not saying that an ombudsman would have offset the need for there to be an inquiry such as this—this ombudsman could, when other issues come up with some of the products that I have already mentioned, be someone on the ground who understands how supermarkets work and how the supply chain works. They could thus give a lot of guidance.

Senator HEFFERNAN—Couldn't the ACCC do it?

CHAIR—That was my next question: what do you think of the ACCC and its functioning?

Mr Zinn—We said at the time of the grocery inquiry that we thought that the ACCC could have gone a little harder on the supermarkets. We have said a number of times that we would like the ACCC to be more interventionist, particularly in the area of supermarkets. In terms of some of the creeping acquisitions, they have allowed Woolworths to buy Macro, which was a wholefoods store. That was something that we objected to but which went through anyway. We think that over time one of the reasons that we have this issue with a duopoly is that the ACCC has perhaps leant back from rather than leant into this particular issue.

Senator HEFFERNAN—Aren't we ignoring the problem if we do not do something about the ACCC? The ACCC did not think that a company having 73 per cent of the wholesale market in fertiliser, which came about as a result of the Incitec and Pivot merger, and 100 per cent of the manufacture was a monopoly. Between 70 per cent and 80 per cent of the pre-packaged market of Woolies and Coles is not considered to be excessive market power.

Mr Zinn—We agree with you. It may well be that the ACCC takes a particular line and looks very closely at the laws that they work within—

Senator HEFFERNAN—I am sure that they do.

Mr Zinn—as opposed to looking at the broader issue of what could be done to correct those laws. As I said, we would have liked the ACCC to have taken a stronger line on this. I had a meeting with Graeme Samuel last week. He seemed to indicate that there were perhaps things going on behind the scenes that they were looking at that they could not talk about. But we think that there is a need for an ombudsman who can take that more general leadership role to give people information as to what is actually going on.

Senator RYAN—In your submission, you have a lot of catch phrases, such as 'the potential for anti-competitive impacts' and 'the possibility discounted pricing may have negative consequences'. You talk about regulatory gaps. You use the words 'reform' and 'proactive' and the phrase 'constant monitoring of consumer issues'. But what I see are implications. I do not see any evidence that consumers have suffered as a result of this nor any modelling that shows that they will. Is that true?

Mr Zinn—I do not think that we would proclaim to be an economic think tank. It is merely our role as a consumer group to look at things that might impact consumers. As I said, this puts us in a very interesting situation. We want discounted prices for consumers. We want lower prices. But at the same time we have to be aware that there can be consequences in the medium to long term if that takes place—

Senator RYAN—The point that I am making is that there is no evidence of any negative consequence of this in your submission.

Mr Zinn—I would probably agree with that, because we are not saying that there will definitely be negative consequences to this. We are saying that there is a problem because who knows who to believe. We have Woolworths saying one thing and Coles saying another. We think that that drives our call for some sort of independent adjudicator who can let people know what is good for them or otherwise.

Senator RYAN—Why? Why should there be an independent adjudicator—who, from what I gathered from what you said earlier, would have some sort of power to make binding decisions—

Mr Zinn—Binding references.

Senator RYAN—Why should there be an independent adjudicator looking at private contracts and relationships between suppliers and supermarkets in this particular sector of the economy when we do not have it for the relationships between Holden and car dealers or in most sectors of the economy? It is a huge leap to go from saying, ‘We think that there might be a problem; we have not been able to establish it,’ to, ‘We should put in place some sort of regulator.’ If anything, history shows us that regulators drive prices up rather than down.

Mr Zinn—With respect, we have been saying that there is a problem for some years in terms of these two supermarkets and their market power. It is for that reason that we believe that there needs to be a change. As I said, we are not an economic think tank. But we are not alone in thinking that there could be problems, either in terms of the primary producer or at the retail end, with this market concentration that we have seen.

Senator RYAN—This gets to my point. Assertion over time does not make fact. Surely what has happened with milk pricing, with Woolworths and Aldi matching it, is a sign that competition—even in this relatively concentrated market—is working at the consumer level.

Mr Zinn—Yes. Again, we want consumers to enjoy lower prices. I do not think that at any stage in our submission you will find it saying that there is anything wrong with milk costing \$2. That is for others to say. We would just say that, if there is a reasonable belief that down the track the supply of milk, the quality of milk, the types of milk or the brands of milk that are being available or other people who retail it could suffer as a result, then the setting up of an ombudsman is warranted. This would not be an issue were it not for the duopoly that is in existence. So I accept the fact—

Senator RYAN—Nothing that you say here applies only to a duopoly. You talk about factors other than price being important to consumers. Aren’t those other factors, even in what you describe as a duopoly, already being taken care of? On one of the contentious issues, for example, animal welfare, one of the majors has gone to not having sow stalls, which is causing quite a lot of friction. One of them has also moved to not having HGP in their beef. Isn’t that showing that the market is working and the other concerns of consumers are being reflected?

Mr Zinn—We have not taken particular issue with this development. I would say that thank goodness that Coles has risen to the occasion. For a long time, they have been very lackadaisical. Now they are getting investment, taking action and being energetic. That is a definite plus for consumers. But in terms of this war that is going on between the big two, we are conscious that there is a risk of collateral damage to others and that risks damaging consumer interests down the track. We agree that this is not a definite yes but a possibility. I would suggest that the fact that we are here at this inquiry says that we are not alone in that feeling. That is why we have come through with a couple of suggestions. It is not just about milk. It is, as I have said, more broadly about the power of the supermarkets. We believe that an ombudsman is one thing that could redress some of the consumer detriment that could flow. So, yes, I qualify that with lots of

words like 'could'. We do not know. I wonder who does know. You have heard a lot of evidence. I wonder if, even after all the hours that you have heard, any of us really know what the consequence might be. But we are able to make some decisions.

Senator RYAN—That is the whole point of the market: that there is no one single answer. You could have us all sitting around here with as many experts as we wanted, but we do not have a planned or regulated economy for that precise reason.

Senator HEFFERNAN—That is bullshit.

Senator RYAN—Let me put this to you: you expressed concern about smaller retailers, a concern that many of us share. We used to have a lot more smaller retailers before the supermarkets were invented. Are you saying that you would protect the smaller retailers at the expense of higher prices for the consumers? We know that as retail has got scale, we have lost the community general store and there are not as many greengrocers or independent butchers as there used to be. I can now buy meat after midday on a Saturday in Victoria; I can now shop after midday on a Saturday in Victoria. Are you saying that there should be some sort of regulatory environment that protects smaller retailers at the expense of higher prices?

Mr Levey—The point that we are making is that this debate has been characterised by a lot of claims and counter claims and a general lack of transparency and certainty around who is wearing the cost of what is going on. As a consumer organisation, a very large part of our constituency want to know that the prices that they are paying are fair.

Senator RYAN—With respect, I challenge that. Most of your constituency want cheap prices. If they wanted to buy branded product or if they wanted to support a corner store, there is no restriction on them doing so. The truth is that they go to Coles, Woolies, Aldi or one of the larger chains. The point is that they can do that. There is no law stopping them doing that. It is the old economic question about their stated preference versus their revealed preference.

Mr Levey—I understand what you are saying. My point was that it is not so much that there is something stopping doing that, but there is certainly a lack of clarity and understanding. A consumer going into one of the major supermarkets and buying \$1 milk might have heard a lot of people arguing that they are part of something that is going to have a very damaging effect on the dairy industry on the one hand and also heard a whole bunch of claims on the other side that that is not true and that it is just the market sorting itself out. We would see an office like the ombudsman as providing greater certainty for people that fairness is running through the whole system.

Senator RYAN—Those two things are not mutually exclusive. The market can sort itself out but it can also be damaging. We do not make televisions in this country any more. There are hundreds of thousands of people who used to work in metal working and manufacturing. The market does sort things out, and occasionally it is difficult. It is not necessarily an either/or proposition, is it?

Mr Zinn—We are not interventionists by nature; in fact, we do not see the ombudsman as interventionist or doing anything that will necessarily raise prices. We feel that there is a situation with this duopoly. You mentioned the car industry. If there were, say, two car

manufacturers and you did not really have the choice of going with anyone else, we would suggest that that would be a problem. We are suggesting that that is a problem in terms of supermarkets. We often say that supermarkets are very good at what they do. But they do a large number of things. They are not super when it comes to everything. They are not always cheapest, they are not always freshest and they are not always best. We would highlight the good independents who are out there.

Senator RYAN—I used to work in one.

Mr Zinn—But the marketing might of the big two can often make those things less obvious to people. So we do not want intervention.

Senator RYAN—My fear, Mr Zinn, is that every other group that you have mentioned as a stakeholder is a producer. You claim that you represent the consumer. Usually, when producers get together it is a historic fact that the interests of producers are put higher than the interests of consumers. I would have thought that it would be critical for you to not set up situations where producers can get together. We deregulated milk for a reason: to allow the market to work and to allow consumers to get cheaper prices. Surely what we have seen over the last few months shows that that is working. Yes, we have to look at issues of market power. The fact that the ACCC does not publicly say that it has found breaches could mean that there are none, could it not?

Mr Zinn—And we would accept that entirely, but we would feel that if there was a structure of an ombudsman in place that would mean that there was not necessarily the need for inquiries of this nature.

Senator HEFFERNAN—To take up an earlier point of Scott's, with HGPs, even Coles will privately tell you that it is just a marketing ploy. It is absolute garbage that they sell HGP-free meat. You tick a bloody box in the national vendor declaration and say, 'Yes, I have not fed it this.' There is no test. It is just a marketing ploy. Saltbush lamb is another one. Organic—

Senator RYAN—Senator Heffernan, the point I was making was that the Choice submission talks about factors other than price. We may disagree over the relative importance of those factors. My point being that for better or for worse I am not as well informed on them. Factors other than price are currently at work in the marketplace.

Mr Zinn—They are, but of course price is the one that is really highlighted so much. It is not just in terms of supermarkets—in terms of other retailers who are now facing competition from elsewhere. That is something the Productivity Commission is looking at. But, again, I think one of the interesting aspects of this is that 30 per cent of people are still buying branded milk at \$3.40 for two litres as opposed to \$2.00. They obviously think there is a difference. We are conscious of the fact that people are prepared to pay more as long as they have the choice, and we want to make sure that choice is there not just in terms of supermarkets but in terms of retailers and the goods on the shelf. The rise of private labels offers a lot of benefits for consumers, including for milk, but sometimes, because of the peculiarity of the duopoly we think that there are situation that are possible—not definite—where the consumer could suffer. That is why we blow the whistle in this case and why we with others call for it. And you are right about producers—in terms of the old economic textbooks—and it not being in the

consumer's interest. We have to be very 21st century now as a consumer group. We do sometimes work with people who used to be the bad guys. We will probably work with the supermarkets in the future. The thing that is important for us is that there should be a consumer benefit as opposed to a consumer detriment.

Senator RYAN—My view is that the consumer is the person who is in the best position to make that judgment.

Senator XENOPHON—You had a meeting with Mr Samuel, chairman of the ACCC, recently—

Mr Zinn—That was a regular meeting that happens with consumer groups with the ACCC.

Senator XENOPHON—You raised this issue in terms of the discounting war?

Mr Zinn—Yes.

Senator XENOPHON—So you not quite sure what the ACCC is actually doing?

Mr Zinn—I suppose I got the impression—and this is a broad impression I got—that the ACCC does not always signal what they are doing in terms of investigation. I do not know if that applies to supermarkets. I think it was argued that perhaps there needed to be more prominent smoke signals, as it were, to the ACCC. Basically, they have been very quiet on this whole issue. I think many people would have looked to them to have real guidance in terms of what was and was not predatory pricing and what was and was not in the consumer interest.

Senator XENOPHON—In relation to predatory pricing, we have heard some evidence today about what the definition of 'below cost' is. The ACCC has got a certain understanding of it. What does Choice say? Is it the cost of acquiring a good or the actual cost of transporting it, storing it, allowing for wastage, and related issues? What is your understanding of what predatory pricing below cost is?

Mr Zinn—I will refer this one to Matt first of all, but in a broad sense generally we are not in favour of laws about predatory pricing because we are concerned that they actually provide a disincentive for discounting, which can benefit consumers. We believe that there can be other ways of controlling that issue.

Senator XENOPHON—What other levers do you think there are—

Mr Levey—Sorry, that refers to some evidence that I think might have been given about reintroducing section 49 in relation to price discrimination.

Senator XENOPHON—How would you see that working if it were reintroduced? Would you see it being reintroduced in identical terms or a modified version?

Mr Levey—I do not think we necessarily support it. I guess that is the point we would make, because I think there has been evidence that it can have detrimental impacts on consumers in terms of restricting their freedom to buy private label products at a cheaper price.

Geographically it might have impacts as well, and perhaps also in wholesale arrangements. But I think we certainly support having a closer look at how the predatory pricing provisions are working in practice. On your initial question around whether that relates to the initial cost to the retailer of acquiring that good as opposed to once they have factored in the various other costs that they have in getting that to the shelf, it is our understanding that it has always been the latter—that it would be the cost that the supermarket is incurring once they are actually selling that product to the consumer. Again, I do not know that we have had something that you could call Choice's official position on that question.

Senator XENOPHON—This committee has to make recommendations in the next couple of weeks. What does your VECCI consumer advocacy group say are practical measures, apart from having an ombudsman who can blow the whistle, monitor things and intervene or at least advocate in cases of unfair practices? It is the balance between maintaining a competitive market but there not being any abuse of market power that could constrain competition in the longer term.

Mr Levey—It is a good question. Based on some of the evidence that the committee has heard so far, we think it would be worth looking at the existing legislation in terms of an effects test. That is in terms of predatory pricing and whether it should be looked at not only in terms of anticompetitive purpose but also anticompetitive effects. Again, I think there has been discussion over some years of the pros and cons of that. If there were to be some additional analysis around whether the law could be beefed up that would a point at which we think it would be worth being done.

Senator XENOPHON—Are you talking about the Birdsville amendment, for instance, and other sections?

Mr Levey—Yes, I believe that is correct. So this is around predatory pricing and whether it is assessed on the basis of the business having been shown to have an anticompetitive purpose, which is I think a very hard thing to prove, as opposed to actually having an effect of substantially lessening competition.

Senator XENOPHON—I will just take you to the line of questioning of Senator Ryan in terms of competition. He has strong thought-out views in relation to this. Is there another way of looking at this? Do you try to distinguish between price discounting as a result of healthy competition and market power? Presumably, if it is as a result of market power, those price discounts could be short lived and there could be ramifications for the structure of the market, which could affect consumers. I am just trying to work out where you stand on that, because I thought Senator Ryan's line of questioning was perfectly legitimate in terms of his concerns.

Mr Zinn—I do not think we would necessarily claim to know what the difference was. We would certainly be concerned and certainly that raises a red flag for us where that seems to have been the case for milk. But we are conscious that we want discounting to remain active. We want to send a signal to Coles that we actually want them to take risks. Woolworths has had the lion's share of it and now Coles is biting back. It is important that they continue to take risks and go out there. But at the moment there does not seem to be someone who is signalling clearly to them where they might be crossing the line.

Senator XENOPHON—But if the cost of Coles biting, back as a result of their new aggressive strategy to take on Woolworths, is that it actually squeezes out the smaller independent operators, is that something that would concern Choice?

Mr Zinn—Definitely. And that is what I mean in terms of someone who could blow the whistle or could see the structure of the industry. Yes, it definitely does. They could go back to lick their wounds and go back to the old days of being standoff and basically matching each other's prices, in the way that Ansett and Trans Australia Airlines used to work, and basically the collateral damage would have been those smaller retailers or whatever primary producers or other producers who were caught in the crossfire. That is actually the worst possible outcome from all of this.

Senator XENOPHON—We have the ombudsman and we could maybe look at strengthening the effects test. Is there anything else that you think could make a difference? For instance, Senator Heffernan and other raised disaggregation. Have you looked at other markets where no one company can control more than 20 per cent of the market? I think that is the case in the United States, where Walmart has 15 or 16 per cent of the market. Do you think it would make a difference if there were a longer-term disaggregation policy?

Mr Zinn—In terms of our evidence to the grocery inquiry, yes. We suggested that that would ultimately be the sword of Damocles hanging over the supermarkets. If there were such a power it would certainly constrain them. But before that there are issues around creeping acquisitions—we have had a few years since then when they have continued to expand—and stopping the greater concentration. The ACCC will say—

Senator XENOPHON—Do you have a particular policy view on Metcash and Franklins and the way that that would impact on competition in the marketplace?

Mr Zinn—Yes, I suppose we see that smaller players like Aldi have more effect on the market than Metcash and Franklins have done, because they have been able to compete more aggressively in terms of price.

Senator XENOPHON—Would it necessarily mean that consumers would be better off if you had four operators rather than two controlling 70 to 80 per cent of the market? Does that have more potential to foster competition, or not?

Mr Zinn—That is probably more akin to the UK, where you have four or five supermarkets. They still have a need for a grocery code adjudicator. But, yes, in our dreams that would be a fantastic place to be. But quite how we get to that, given the historical precedents that have given us the situation we have now, is another question. But, certainly, if we saw the supermarkets getting stronger, or the situation not being changed by whatever reforms there might have been in terms of lifting restrictive covenants on shopping centres or by the predicted growth of Aldi, then we may well need to get into some stronger legislation.

CHAIR—Thank you for your evidence.

Committee adjourned at 3.57 pm

