COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Reference: Impacts of supermarket price decisions on the dairy industry

TUESDAY, 8 MARCH 2011

MELBOURNE

BY AUTHORITY OF THE SENATE

INTERNET

Hansard transcripts of public hearings are made available on the internet when authorised by the committee.

The internet address is:

http://www.aph.gov.au/hansard

To search the parliamentary database, go to:
http://parlinfo.aph.gov.au

SENATE ECONOMICS

REFERENCES COMMITTEE

Tuesday, 8 March 2011

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

Substitute members: Senator O'Brien for Senator Pratt

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 Eggleston, Hurley, McGauran, O'Brien, 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

Committee met at 9.00 am

CHAIR (Senator Eggleston)—I declare open this first hearing of the Senate Economics References Committee 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. To date, the committee has received over 90 submissions, which are available on its website. Further public hearings will be held tomorrow in Sydney and on Thursday in Canberra. An additional hearing in Canberra will be held at a later date.

These are public proceedings, although the committee may determine or agree to a request to have evidence heard in camera. 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 Senate 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 the witness may request that the answer be given in camera. Such a request, of course, may also be made at any other time.

[9.02 am]

DRURY, Mr Adrian, Vice President, Australian Dairy Farmers Ltd

GRIFFIN, Mr Christopher, Vice President, Australian Dairy Farmers Ltd

PHILLIPS, Mr Christopher, General Manager, Trade and Strategy, Dairy Australia

CHAIR—I welcome representatives from Australian Dairy Farmers Ltd and from Dairy Australia. I invite you to make an opening statement, following which the senators will question you.

Mr Griffin—I would like to thank you for the opportunity to present and appear at this very important inquiry. We appreciate the senators taking an interest in this issue that really does affect our industry.

Australian Dairy Farmers Ltd is a peak representative body of Australia's 7½ thousand dairy farmers. ADF's members include state farmer organisations that represent dairy farm interests in each state. There are over 100,000 people employed in the dairy industry in Australia. The vast majority of these are in rural and regional areas. Dairy is Australia's third largest rural industry, with a value of over $3.4 billion at the farm gate.

Following Coles' milk price cuts on Australia Day it is important to identify the core issue that is at stake: the price cuts are unsustainable. The last time milk was priced at a dollar a litre was around 20 years ago in 1992. Milk priced at $1 per litre is simply not sustainable. There is not enough money to support farmers, processors and retailers at that price. Selling any product for what it costs to produce or less than the cost of production is unsustainable. Australian Dairy Farmers certainly do not believe that Coles is going to absorb the reported $60 million cost. Who is, then; their customers, or those at the start of the chain: the dairy farmers?

With the devaluation of milk as a product to unsustainable levels, dairy farmers know that there will be downward pressure on milk contracts for processors and then they are next in line. It should be noted that Coles has repeatedly refused to rule out dropping prices for processors and farmers in future contracts. Rather they have tried to confuse the issue by quoting Victorian price increases when they know full well that Victoria is chiefly a dairy export market. What Coles has repeatedly failed to mention is that milk prices to farmers in the key drinking milk production markets of New South Wales and Queensland have dropped more than 15 per cent in Queensland and 10 per cent in New South Wales in the last 12 months. This includes farmers who supply milk which goes into Coles supermarket branded bottles. Processors and dairy farmers who supply the drinking milk market rely on the margin from branded milk sales for their profitability.

Competition from unsustainably priced Coles home brand milk is taking market share away from the branded products. This reduces the amount farmers receive from processors, and as an increased share of Coles home brand milk is being sold with little or no margin and less of the more sustainably priced branded milk is being sold farmers whose milk payments are linked to branded milk sales will see a reduction in their milk cheques. For some this may be as early as mid-March. If the price cuts continue they threaten to permanently strip away hundreds of millions of dollars from Australia's supply chain for drinking milk, a chain that accounts for 25 per cent of the national milk production and is the mainstay of the dairy industry in Queensland, Western Australia and northern New South Wales. Dairy farmers do not and should not trust Coles and neither should their customers. What Coles need to do is stop being tricky and raise prices to what is fair and sustainable for their milk suppliers, Australia's dairy farmers. We need to focus on sustaining our critically important food producing industries, not devaluing their products.

CHAIR—Thank you very much.

Mr Drury—I am a dairy farmer from New South Wales, vice-president of Australian Dairy Farmers. We believe there is an urgent need for Coles to acknowledge that this is a marketing tactic that has severe consequences for the dairy industry, to cease its current pricing strategy and to raise prices to the level that is sustainable for all levels of the supply chain. We also urge the ACCC to investigate pricing practices of Coles, including its guarantee that dairy farmers' returns will not be reduced, to ensure that predatory pricing is not being practised and that sustainable returns are delivered for Australian dairy farmers and processors. There should be an open dialogue between Australian major retail supermarkets and farm processors on regional supply and demand issues and strategies that will ensure that sustainable supplies of fresh drinking milk can be delivered daily to customers across Australia through a range of retail outlets. It should consider a review of the Consumer and Competition Act 2010, formerly the Trade Practices Act, to determine if the act is effective in dealing with actions such as those taken by Coles recently with a view to changing provisions to ensure that such conduct is not repeated. The government should convene and participate in an ACCC authorised roundtable forum for the dairy industry supply chain from farmers to retailers to constructively discuss solutions to ensure a sustainable drinking milk market and fair returns for all.

CHAIR—Thank you. Mr Griffin, I would like to ask you a question to begin the questions. You said 25 per cent of milk production goes to drinking milk. Where does the rest of it go? What other products come out of milk?

Mr Griffin—I would like to clarify where that comes from. Basically in Queensland almost a hundred per cent of the milk, 95 per cent, goes into drinking milk. In northern New South Wales it is the same and similarly in Western Australia. In Victoria around 10 per cent of the milk produced is consumed as drinking milk and the rest goes into manufactured products. Over 45 per cent of the products in Victoria are exported to over 100 different countries. So a disproportionate amount of milk within Australia goes into different markets, and that is where we see the threat being in Queensland, northern New South Wales, Western Australia and to some extent South Australia.

CHAIR—You say Victoria exports—

Mr Griffin—Quite a lot of milk products.

CHAIR—What sort of milk products are they?

Mr Griffin—Whole milk powder, skim milk powder, butter, cheese—across the spectrum of milk products.

CHAIR—Is there no possibility of farmers in northern New South Wales, Queensland and WA diversifying into that sort of area, which might compensate for this loss of income from drinking milk?

Mr Griffin—The issue is that there are only enough farmers in those areas to produce the liquid milk portion. That is the staple across Australia. Everyone needs to drink milk daily, so there is not any excess to go into the processed products—butter, cream, cheese, skim milk powder, whole milk powder et cetera. What we have identified is that basically in Queensland, northern New South Wales and Western Australia there is only enough milk produced to go into that drinking milk market. There is no excess, so there is no room to produce anything else.

CHAIR—So what you are really saying is that in Queensland, northern New South Wales and Western Australia farmers do not have an alternative. They have to sell their milk as drinking milk.

Mr Drury—For a dairy farmer in northern New South Wales pricing structures for years have been around having a flat year-round supply. Switching from that would take years. You cannot change a farming system overnight to reflect what the export needs are. That is why I agree with your questioning. Basically if there is no premium in the domestic market then eventually it would go to export, but the reality is that this is not just about the farmers now. It is about consumers. Australian consumers desire to drink fresh milk. That is quite unique. There are only a few countries in the world which have that taste for fresh milk that we particularly like. The option of actually drawing the milk from either Tasmania or Victoria to take it to Queensland would certainly mean much higher prices, not lower prices. We believe there is a balance between the competitive forces in Victoria and Tasmania that have produced that milk on a seasonal basis and the demand from the market in New South Wales, Queensland or the metropolitan areas.

CHAIR—You said that few countries in the world have the fresh milk option. Can you just return to that a little bit and tell us what the international picture is.

Mr Drury—I think this comes to a matter of taste. A lot of European countries now drink UHT as a point of preference, but certainly there are countries like Australia, New Zealand and the United Kingdom that have fresh milk as their drinking milk of choice. That is market forces, like everything else.

CHAIR—I am told that in France most of the milk is UHT.

Mr Drury—True.

CHAIR—What about in the rest of the European Union?

Mr Phillips—In most of the European markets it would be UHT. It has a more extended shelf life. It is not UHT that has a shelf life of 12 months; it has about a month or six weeks shelf life. But it is a UHT treated milk rather than fresh milk.

CHAIR—So what we are saying is that Australians prefer fresh milk and that its future is under stress by this pricing practice.

Mr Drury—I do not think that consumers' preferences will change overnight. I think Australia will be a fresh milk drinking country for a very long time to come. Considering that in the order of 100-plus litres per person is consumed in this country a year, I think there is a long way between that and UHT milk, which certainly has a different flavour.

CHAIR—But if this pricing regime means that farmers in northern New South Wales, Queensland and WA will find it difficult to survive then the option of fresh milk may not be there.

Mr Griffin—The issue is that the price is not sustainable and we need to alter that. Coles have taken a large amount of their retail as they have dropped their prices. They have told us that they are paying the processor more. That is certainly a squeeze. The issue is that it will impact on dairy farmer returns in the future as the contracts are being renegotiated. We need to get some sensibility into this market, because we are a food producing organisation and we can produce enough food to feed Australia plus bring dollars into the Australian economy through exporting our product and we are being told that into the future there will be a food crisis and this is impacting on our ability to produce food.

Mr Phillips—It is difficult for industry to predict whether there will be a shift from fresh to UHT ultimately in Australia; the issue is that, if there is a permanent downward movement in retail milk prices in Australia, basically that takes the fresh milk market from a low margin to an almost no margin industry for producers in those regions that Adrian and Chris talked about. That is not a sustainable long-term future. If the pressure comes back onto the farm gate price, which is where industry expects it would—if you take money out of the value chain, ultimately the most vulnerable group will be those supplying the raw product into that chain. So that would mean less fresh milk production in those regions—regional adjustment in Queensland, northern New South Wales, Western Australia. How the market then adapts afterwards, whether it is through UHT or milk being shipped up from Victoria we are not here to decide today, but it would put significant pressure on the regional industries in those states.

Senator O'BRIEN—I am interested to know whether Dairy Australia can supply the committee with details of the sorts of prices that dairy farmers have been obtaining for their milk in the various states over the last two years. Are you able to supply us with that information?

Mr Phillips—That is public information. That is up on our website. We can provide that. It is in our *Dairy in Focus* publication, which has the farm gate price by state.

Senator O'BRIEN—We are told from all the statistics that the volume of milk being produced is decreasing and that it will be go down again this year. Is that correct?

Mr Phillips—Our current forecast is that milk production this year will be stable—around nine billion litres nationally.

Senator O'BRIEN—How have the floods affected that, if at all?

Mr Phillips—Again, it is different in different regions, but particularly in Queensland we would expect to see about a 20 per cent reduction in production in Queensland—basically flood related. In northern Victoria there will be some drop in production, but less so in other regions.

Senator O'BRIEN—My recollection is that major dairy processing companies claim that farm gate milk prices are closely correlated with the international price of milk. Is that what Dairy Australia has found?

Mr Phillips—What we actually say is that for the producers in the south-east corner of Australia—Victoria, Tasmania and the south-east of South Australia—that segment of the industry is very strongly related to the international markets and farm gate prices there move very strongly in line with international markets. But in the other regions, basically over the last decade they have moved into local regional markets which are determined by regional supply-demand balance and, theoretically, what it would cost you to move from an export state like Victoria into those regions, but they are much less focused on the international market.

Senator O'BRIEN—So since deregulation we have seen a shift in the way farm gate milk has been priced, which, while not returning to the situation prior to deregulation, has seen a differential higher price in, let's say, above the Victoria-New South Wales border, for example, as compared to Victoria and Tasmania?

Mr Phillips—Even with regulation there was always a higher price for drinking milk versus manufacturing, but you are right; in the drinking milk states, because it is flat year-round production, it requires farms which have a higher cost structure, and generally the contract arrangements there are paid at a higher price for year-round flat production rather than seasonal production.

Senator O'BRIEN—And I think you said that the farm gate price of milk was determined by local factors, which I understand includes local cost factors?

Mr Phillips—Cost of production for the milk?

Senator O'BRIEN—Yes. In other words, you have to pay a certain amount to keep the producers in the market.

Mr Phillips—They do not cover their costs and they have different production costs—yes, they will not stay there.

Senator O'BRIEN—Can you describe how you think the circumstances where three-quarters of the drinking milk is priced at a historically very low price with the suggestion that it will not move? How do you think the market will work in those circumstances?

Mr Phillips—Again, what we actually see as a result of this is that drinking milk per capita in Australia is pretty stable. We do not actually see that the changes that have happened in retail pricing will have a significant effect or any real effect on actual consumption of milk in Australia. We will still consume about 2.2 billion litres a year in the domestic market.

What this shift would actually see, and what we understand is the key driver of this from supermarkets like Coles, is an increase in the share of that fixed consumption, which is basically coming from their private label house brand, which is a lower margin return issue for the industry. What it will actually do is not see a change in aggregate dairy consumption but a shift in the type of milk that is being consumed, with a much greater percentage of milk being consumed as a supermarket private label, which before January was low margin. It would be very low margin or no margin at the moment. It is very hard to prove because of company confidentiality in contracts et cetera, but it would be hard to see that there is any significant margin there. So there will be a shift in the channels.

We have already seen anecdotal evidence from the companies in terms of a drop of branded sales in supermarkets to house branded sales within Coles. That has been borne out by the retail supermarket data we have had for the first few weeks. It is only a few weeks data, but that is the trend that is happening there. Route trade distributors are saying that they have actually lost sales to small customers, who have gone direct to the supermarkets to buy their product rather than maintain their wholesale contract. So there is a shift in how people are buying their milk, not a shift in aggregate consumption. For the industry, ultimately that means drinking-milk sales in Australia are a lower margin, lower value product. That means that over time that reduction in value has to come out somewhere in the chain. The risk is that it will most likely come out through lower farm gate prices in the future. That is where the main risk will be.

Senator O’BRIEN—In the circumstances of New South Wales and Queensland markets, for example, they are already higher than Victoria and Tasmania. The point that I am raising with you is: is there a point below which the processor cannot go if the processor wants to keep a consistent supply of milk for processing?

Mr Phillips—There will be a challenge for them. If the retail price gets squeezed down, they will have to take it in their own margins. But since January there has not been any change in actual processing costs: the costs of buying the bottles, packaging and all that associated with production. So it is a drop in processor margins. Ultimately that will have to come back to a lower farm gate price. Given that ABARE said that the average profit for farmers in Queensland and northern New South Wales last year was 2c a litre, it does not take much of a price movement to see that farm gate profit disappear if there is a drop in farm gate prices. Then you either have a reduction in local production, and there is a question then about what actually happens to pricing in the longer term. That is one of the issues the industry have about the sustainability of the move. It may drop prices now but if we see a reduction in regional production in those areas, to get sustainable milk supplies in those volumes you are either going to have to move it from another region, with a lot of transport added in, or pay farmers higher prices. Neither of those are consistent with the dollar a litre retail price.

Senator O’BRIEN—It has been suggested in previous inquires that there is some sort of an effect which has been described as water bedding—when you put downward pressure on one area of pricing in this industry, in the retail sector you see other prices go up. Do you think there is scope for that to happen—in other words, for supermarkets and processors to redistribute the profit share onto other value added sections of the production chain?

Mr Phillips—From a dairy perspective, if you are talking about shifting it away from dairy to other products through the supermarkets I do not know that I am in a position to make that call.

But for us within the dairy value chain, what we see is the retail margin disappears down to close to zero, and Coles has talked about that, but its other competitors—Woolworths, Aldi, Franklins—have all dropped their margins to the same extent. The route distributors have had to drop their prices as well. If that discounting happens, they lose their margins in the end, and there is going to be downward pressure on either the processors to take reduced prices or the processors to pass that through onto farm gate returns.

Senator O'BRIEN—One final question, and let us cut to the chase: what is the solution?

Mr Phillips—The solution in this is that the current pricing model is not sustainable from an industry point of view. The industry has asked the government to look at ACCC examination of the pricing to see whether it is meeting the competitive objectives of the Trade Practices Act; and to have an open dialog with the industry about what the true costs of production and margins and the way of doing business within the industry. We think that the decision that Coles made was probably based on a misunderstanding, particularly in some of the regional markets here in Australia. Queensland already had lower retail and wholesale pricing for drinking milk and higher farm gate prices, so there was already a squeeze on the margins in that region before the announcement. Given some of the regional competition that occurs there, it has put extra pressure on discounting of the one line within the drinking milk market that companies make their money from, which is branded, modified milks. This move has put significant pressure on those products. If we see a shift into the low-margin house brand sales in those lines in the end there has to be pressure on farm gate returns.

Senator McGAURAN—What do you think the price should be on the shelf?

Mr Phillips—I do not think we have a position on what the price should be.

Senator McGAURAN—Do you have a position on what the price should not be?

Mr Phillips—I am here to provide some analysis of whether I see that the current price structure is sustainable and what I see as delivering a viable return to the dairy farm industry. We see that that is not going to happen, but I am not here to make the call about whether the price should be fixed.

Senator O'BRIEN—Do you want us to recommend that the ACCC conduct a review and that there be some negotiation with the industry. It is a pretty opaque solution, if I may say.

CHAIR—What you are asking for is certainly not the ACCC to find an immediate solution, but to look at the whole issue of competition, I suspect. Is that not the case? Because there is a view that they have perhaps not been as vigilant about competition issues as they could have been, which this committee has discovered on several inquiries.

Mr Drury—In short, that might be right, but I noticed that on page 4 of the Woolworths submission they talked about the voluntary Produce and Grocery Industry Code of Conduct and I suppose the picture you glean from that, from a farmer's perspective, is that without actually having a regulated price—because you are actually dealt back into the game—would be a lot better position than we had. I say that because one of the things about the industry—and we have talked about Queensland, Western Australia and northern New South Wales, although I would argue probably more than just northern New South Wales—is that there is a regional difference here that needs to be taken into account. When you have a discounting mechanism that is across Australia, no regionality is taken into account. I think that having the farm sector dealt back into the game would certainly be an advantage.

Senator RYAN—Are you proposing that there should be regional price differentiation at the consumer level? Is that one of the things you are asking for here? Because that in itself has been a contentious issue before this committee in other sectors. Should it be different in Victoria than it is in Queensland?

Mr Drury—Certainly there is a different production system and there are different cost structures, particularly the further you go up north and when you go into the tropics. Plus, farmers in the different regions are asked to produce milk on 365 days a year. If you have a difference in the milk supply in those regions it sends a market signal. If you operate without regulation it sends a market signal, 'No, we do not want milk then,' so we actually get paid less in spring than we do in the rest of the year, because he wants a flat supply. The answer to that question is, yes, there is a regional difference and, yes, that should be reflected in the marketplace.

Senator RYAN—I want to clarify what you said earlier about a regulated price and the relationship with the code of conduct. You are not proposing that the code of conduct be made compulsory or that we go back to a regulated price, are you? Or have I misunderstood what you said?

Mr Drury—No. The reason I pointed out that statement on the top of page 4 in Woolworths's submission is that it is termed 'voluntary Produce and Grocery Industry Code of Conduct' and I stress the 'voluntary'.

Senator RYAN—Sorry, I misunderstood you.

Senator COLBECK—I want to finish on regional pricing. We did some surveys of regional pricing during our previous inquiry and it appeared at that time that the cheapest milk at retail was in those northern markets where the market price was the highest. We had a bit of trouble trying to reconcile those two things. Do you have any sense as to why that actually came about? One of the questions we were trying to answer during our previous inquiry was that the retail price of milk particularly in Queensland and around Brisbane was cheaper than it was, say, in Hobart and the farm gate price in those two states was the inverse of that.

Mr Phillips—That is true. Our historical data shows that it is the case that the retail sales price of drinking milk in Queensland is lower than in New South Wales and Victoria for the same brand of product. One of the factors that we think that influences that is the nature of supermarket competition within different regions. In Queensland there a much larger proportion of supermarkets are smaller independent outlets, rather than the two large national supermarket chains. Those smaller in independent supermarkets in Queensland do not have their own house brands to use as a low-margin line to encourage consumers into their supermarkets, so historically they have discounted the branded company product in competition with the Woolworths and Coles house brand labels. That has ended up putting downward pressure on the retail prices. That is one of the reason that in Queensland the actual processor margin is already lower than the national average for drinking milk.

Senator COLBECK—That brings me nicely to my next point: Coles have told us that they are bearing the cost of this particular exercise. I might get you to give me a sense of what your perceptions on that cost might be. But I suppose the concern in this whole exercise is that if $1 milk becomes the norm that puts pressure down the supply chain and inevitably to the dairy farmer. Given that Coles told us during our last inquiry that they were making a gross margin of 22 per cent on their product, that effectively means that they are giving the milk away at this point in time. On the figures that I have seen and the advertisements that I have picked up from Tasmania, in particular, it was $2.47 for a two-litre bottle. It is now $2. That is a 23.5 per cent reduction in price if you take it in terms of the mark-up. So they are effectively giving it away. Where in the supply chain is the fat to sustain that if $1 a litre milk becomes the norm? In the letter to us, they have said that there is a heap of profit margin in the processor sector, but that is not what the processors are telling me. I am interest to know where the fat is in the margin if this is to become the normal price. If the price is going to stay down, where is the fat?

Mr Griffin—We do not believe there is any fat. That is the fundamental issue: we do not believe the fat is there. It is purely an exercise, we believe, to attract greater market share. They are doing that potentially, and in the longer term, at the cost of the dairy farmer, because it will get you back. Going back to a question in regard to what we believe the price should be, the branded price of the milk in the supermarkets is, we believe, a fair return to everybody along the supply chain. We understand that the Coles brand or the generic brands are more a bulk item and therefore the margins are not as great in that area. But the processors rely on a certain percentage of the milk being sold as a branded product. That maintains their profitability and they are then able to produce and supply the generic brands at a little bit cheaper price. Dropping it down to unsustainable price of $1 has impacted enormously on the amount of branded sales in the supermarkets. That is going to put downward pressure on the returns to farmers when their contracts are renegotiated.

Senator COLBECK—So the increasing proportion of generic milk is reducing the proportion of branded milk that is being sold, which reduces the overall margin of the processors. So this exercise is in fact reducing the margins of processors further and that is where you say the pressure will inevitably come out at the farm gate if this price becomes the norm in the long term.

Mr Griffin—That is certainly our belief.

Mr Phillips—Given that the company margins are confidential it is hard to be 100 per cent specific, but, in the work that we do in tracking it, there is probably between a 30c to 40c a litre difference in the margins for the processors between their branded product lines at the moment and what they sell to the supermarkets as house brands. If there is a significant shift to house brands then most of that milk is being sold at a significantly reduced margin and that just means that there has to be a drop-off in industry revenue somewhere that has got to be worked through.

Senator COLBECK—I think that the effect of the price reductions as a result of the global financial crisis basically going straight back to the dairy farmer is a clear indication that the dairy farmer—or the farmer in any of these supply chains—is the one that pays, because they are the ones, at the end of the day, who are the price taker. In your submission and in the evidence that you have given us this morning you say:

> Farmers whose milk payments are linked to branded milk sales will see a reduction in their milk cheques as early as mid-March in some cases.

Can you elaborate on that? My impression was that some of the contracts might be a bit more long-term than that.

Mr Drury—There is a group of farmers in Queensland who actually have an arrangement with their company where they get a certain percentage of their cheque from branded sales and then other. With a reduction in branded sales those farmers are expecting to see a cut in part of their margin this year. We do believe that there may be an anomaly in that because of the drop in production in Queensland. So the cents per litre figure might not necessarily change, but the total volume of the branded sales will change. We hope to be able to verify that when we see the milk cheques.

Senator COLBECK—So it is a proportion of production issue rather than a cents per litre issue.

Mr Drury—The market arrangement that a group of farmers in Queensland came up with—

Senator COLBECK—So it comes back to a lack of understanding of the supply chain and individual arrangements on behalf of Coles, who are driving this, as to the impacts further down the chain. You also said that transporting milk to Far North Queensland and Northern New South Wales from Victoria and Tasmania would increase the price to consumers. Do you have any figures that you can provide to us on that?

Mr Phillips—The issue is what it would actually cost to transport milk from Victoria to Queensland to land it in that regional market. Part of it depends on what you believe the world price for milk is—which drives the Victorian farm gate prices. At a 40c farm gate price in Victoria—which we believe is sustainable at the farm gate—you would have to be adding 12c to 14c to move that milk into the Queensland market, as the cost of freight. That is the kind of landed price that you would think that would need to be sustained to deliver that milk into the Queensland market on a permanent basis.

Senator COLBECK—So that really also accounts for the differential that you see in the farm gate price. The fact that the transport costs are 12c to 14c is probably a little bit more than the differential in the farm gate price. That is also an indicator of why that price is sustainable in those northern markets at farm gate under current arrangements.

Mr Drury—That is why we keep trying highlight that it is a regional issue. Not only does the farmer in the north have to produce milk year around; there is actually a purely economic reason that it is worth paying for that milk as well. Plus there is the risk of transporting milk those sorts of distances.

Senator XENOPHON—Coles has not managed to do a submission yet, with 145,000 employees. In the letter Coles wrote to the chair of the committee, Ian McLeod said that Coles ‘is right for Australian dairy farmers’ and:

> Accusations that the price reduction on private label milk will destroy the milk industry is ludicrous.

Woolworths, in their submission that was provided just last night, warned that the lower prices ‘can be expected to flow back to processors and farmers as new supply and pricing agreements are negotiated over the coming months and years’. Who is telling the truth on this?

Mr Drury—I do not know how we could possibly get drawn into an argument between the two major retailers. I think the point is that they have such a dominant market position. They own the shop, they own the bulk of the brand and they use strong market influence, which we believe will ultimately reflect back to farm gate price.

Senator XENOPHON—But Woolworths is acknowledging that it is not sustainable, and you would agree with that.

Mr Drury—Yes.

Senator XENOPHON—Coles in their letter went on to say:

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

That is an acknowledgement from Coles. What is the difference with some parts of the dairy industry in how many cents per litre is there in it in terms of profit margins and the difference between having a viable business and a business that is going to hit the wall?

Mr Phillips—The ABARE farm survey exercises for 2009-10, said that the average farm profit in Queensland and northern New South Wales was 2c a litre for those farms. So if you took 2c a litre off those farm industry returns, there is the farm profit for that region.

Senator XENOPHON—So when Coles says ‘a few cents a litre’, that is more than a couple of cents a litre, so that is enough to push them over the edge?

Mr Phillips—That 2c a litre is what ABARE is saying the farm profit was in those regions, so anything more than that and farms have to make some serious adjustment to meet those lower—

Senator XENOPHON—I spoke to some dairy farmers with the member for Kennedy just the other day in Far North Queensland. They say that they are on the edge. What sectors of the Australian dairy industry are most vulnerable to this discounting war?

Mr Phillips—Farmers in North Queensland, South-East Queensland, Northern New South Wales and south-west Western Australia would be the ones most vulnerable. There would be some regional dimension in South Australia for those farmers in the Fleurieu Peninsula, who are more heavily associated with drinking milk than are those in the south-east of the state.

Senator XENOPHON—Further to that, if we do not produce enough fresh milk here or if farmers walk off the land, where would we get our supply from? It would be UHT milk—long life, heat treated milk—presumably.

Mr Phillips—Not necessarily. As Adrian said, Australia is a fresh milk market, so if there was an unnecessary regional adjustment out of New South Wales, Queensland and so on, we still believe that there would be fresh milk sales in Australia, and that would be potentially divergent from international market sales to the domestic market. I do not think we are arguing that there would be imports of UHT to meet the Australian demand. That is not what we would expect at the industry level. What we are actually saying is that there would be a significant loss of production viability in a number of our regions which would cause some significant adjustment within our industry. It is too hard to work out exactly how that would respond. A few years ago in Queensland when prices went too far down for farmers, the farmers left the industry, we had a downward spiral in production and suddenly there had to be a peak in farm gate pricing again, which led to a peak in retail pricing again.

Senator XENOPHON—I might put some questions on notice for you but, in the context of what is occurring now, would the ability to collectively bargain assist dairy farmers, or is the domination of Coles and Woolworths so great that that would not help? I do not know if that is a question for Mr Drury or Mr Griffin.

Mr Drury—Certainly a lot of us already have ACCC authorisation to collectively bargain. The weakness may be somewhere in the middle.

Senator XENOPHON—How do you mean?

Mr Drury—The way that the negotiations take place between the processor and the retailer, I assume.

Senator XENOPHON—So it needs to be fixed up, from your point of view?

Mr Drury—Yes, and I think that in our submission we actually call for ACCC authorisation of a government sponsored round table. I think that is the recognition of that point.

Mr Phillips—Quite separate to the collective bargaining provision, the UK case study example where supermarkets went to direct supply with farmers put a lot of pressure on the processing industry is probably relevant there. The result of that exercise of supermarkets taking direct control of the supply chain in the dairy industry in the UK—as DairyCo, their dairy industry body, in its independent study basically found—has been lower prices for farmers and processors.

Senator XENOPHON—So we do not want that sort of unintended consequence.

Mr Phillips—It could have unintended consequences for Australia if we went down the same path.

CHAIR—There would be two losers instead of one, in effect.

Senator WILLIAMS—Mr Drury, what percentage of drinking milk, as we will call it for simplicity's sake, do Coles, Woolworths, Franklins and Aldi supply to the Australian public? Do you have any idea?

Mr Phillips—The supermarkets sell just less than 1.2 billion litres, and 2.2 billion litres is consumed nationally, so they are a bit over 50 per cent. House brand is 50 per cent of supermarket sales.

Senator WILLIAMS—I was told by a small businessman who runs a small store in Inverell that he cannot buy his milk for $2 for two litres. Would that be correct?

Mr Drury—I would agree.

Mr Phillips—Yes.

Senator WILLIAMS—I want to take in the international scene. I was a pig farmer, and we saw the importing of pig meat from places like Canada and Denmark in the early days and now the USA. The milk industry is not exposed to the importation of fresh milk because of the time delay to get it here, correct?

Mr Phillips—We do not have any barriers against the import of milk. There is some UHT and fresh milk that comes in from New Zealand.

Senator WILLIAMS—There is some fresh milk from New Zealand?

Mr Phillips—There are specific contracts for some of the specialist milks for people like Weight Watchers and so on, so there is milk that comes in from New Zealand. But generally liquid milk is not internationally traded because it is essentially water, and the economics of transporting water internationally are not particularly good.

Senator WILLIAMS—I noticed in Coles in Manuka the other day a bottle of water was more expensive than a bottle of milk. Water is free from the sky and milk has to be processed from the dairy farmer to the bottle.

Mr Phillips—Maybe the economics of trading milk when it is embodied in milk are not good.

Senator WILLIAMS—So we have half the milk in Australia being sold at $2 for two litres or $1 per litre, however you want to refer to it. They obviously buy their own-brand milk off the processors far cheaper than the branded milk. Is that correct?

Mr Drury—That is correct.

Senator WILLIAMS—How can the branded milk have a future? Let us pluck some figures out of the sky. Let us say that Coles are paying 80c a litre or $1.60 for two litres. That is the Coles brand milk. They may be paying $2.10 for the Dairy Farmers brand off the same supplier. Is that correct?

Mr Drury—Yes, but we are not sure what their figures are.

Senator WILLIAMS—We might be able to find out during this inquiry, even in an in camera session. But, going on the economic fact that when the price is lowered demand increases, how can branded milk compete if the big stores are paying even less for their own brand? Surely the future of the branded milk is looking very grim.

Mr Phillips—That has been a commercial reality. The overall per capita consumption of drinking milk has not actually changed. It has remained at around 100 litres per head for the past decade. We do not expect changes in that. The share of that 100 litres, which has been taken up by private label supermarket brands has over the last decade probably risen from 10 to 30 per cent. The higher that goes, the lower the margins there are available to be shared across the dairy supply chain.

Senator WILLIAMS—Do you think that, because of the huge sales, the huge orders by the supermarkets to the processors and distributors, the processors are in fear of losing that big sale and, hence, they have a lot pressure put on them to lower their price? Would that be the case?

Mr Phillips—Given that the house brand private label is now such a large proportion of sales on a staple product like dairy, that is a big issue for the companies.

Mr Drury—That is largely a question for this Economics References Committee and the Australian government. When they allow the competition laws to come to such a state where people who own the brand can use that market power to have an industry—in this case the dairy industry—which actually causes collateral damage in the marketing world, they have to address the competition laws.

Senator XENOPHON—Are you saying our competition laws in their current form are a joke or ineffective?

Mr Drury—I think they have allowed a situation, particularly in primary production, not just dairy, where farmers or the price takers in this game can become collateral damage because of the strength of the retailer and the brand put together. It is the two together. I do not think anybody here is saying not to shop at the supermarket. What we are saying is the market power has shifted well and truly away from the farmer.

Senator XENOPHON—So they are a joke?

Mr Drury—Okay.

Senator WILLIAMS—Is that an agreement? Finally, I have serious concerns about Coles. As I said, I was a pig farmer. I ran into a couple of Coles representatives in Senator Joyce’s office a few months ago and they brought in a regulation of their own where they will not buy pig meat off farmers who have dry sow stalls. I said, ‘How much more are you going to pay the pig farmers because of the extra expense of building bigger pens et cetera?’ I am very familiar with it after being in the industry for 15 years or 20 years. They said, ‘We cannot pay them any more because the consumer can’t afford to pay any more for pork.’ So they bring in a regulation, dump the whole cost on the primary producer and do not care about it. Now we are seeing this in the milk industry. I have concerns about the wine industry, the egg industry—the lot of them. Are we simply facing a situation where, to put it bluntly, the big end of town is simply getting too powerful?

Mr Griffin—They have now also gone out price cutting cream and butter. It is the thin end of the wedge. That is our concern. What is next? Is it cheese? There are a lot of staple food items that seem to be being attacked price-wise by the supermarkets. We are very concerned as to the outcome it will achieve.

Senator WILLIAMS—So, Mr Griffin, you are saying this price war is simply a case of short-term gain for the consumer that will end up as long-term pain?

Mr Griffin—We believe it will drive down the price to the farmers—drive down their returns—to a point where, if it is unsustainable, they will leave the industry. We need to produce food for Australia and potentially the world—

Senator WILLIAMS—And for export.

Mr Griffin—Exactly. We are a generator of revenue not only for the farmers of Australia but also for the economy, and this is going to impact on us.

Senator RYAN—I take your point. I do not use the same language about the tax on staples, because there is a consumer at the end of this. All I want to ask is—and feel free to say so if you would prefer not to answer this publicly—whether dairy farming in our current situation is sustainable in all regions of Australia in which it currently exists. It has gone through a massive restructuring in the past decade, driven by the deregulation decisions that came out of this state, because of Victoria's unique production aspects. But is dairy farming sustainable across Australia in its current form, absent and including—there are two parts to the question—what is happening now with consumer pricing of drinking milk?

Mr Drury—I will put my New South Welshman's hat on and not my Australian Dairy Farmers hat on for the moment. I think that if normal market forces were in place—and what we expected after the dairy glut in the market is that there would be some premium to year-round supply for the drinking milk market—I think it would be sustainable. We feel that that is under attack. If we took the simple equation of this year's returns on exports plus freight or some consideration for year-round supply, I think there would certainly be a sustainable dairy industry. We are seeing what we believe is an unfair influence on the pricing mechanism paid back to farms. I am sure that most farmers in the north of the country and Western Australia would say that they have a long-term future. Most dairy farmers are extremely proud of what they do and are very competitive.

Senator RYAN—It was not a comment on farmers. It was more a comment on the radical restructuring that has taken place, not just in dairy but right across the economy, over 30 years.

Mr Phillips—One of the ironies is that, if you look at international demand for dairy, we as an industry would say that we are very well placed to act. The international demand for dairy at the moment is outstripping supply, but this issue has raised regional dimensions and regional challenges in particular parts of the industry which are independent of the world market.

Senator RYAN—That is my point. The export market is driven primarily by Victoria and Tasmania. From what you said earlier, I think the point you are making is that these issues, while they will obviously affect Victorian and Tasmanian dairy farmers, will not be as drastic or severe in the short term as it could be in other areas because of the regional impact. Is that a fair comment?

Mr Phillips—Yes.

Senator RYAN—When you said ‘Okay’ to my colleague Senator Xenophon’s question about the competition laws, what specifically about the laws, not operations under the current laws, do you think characterises your ‘okay’? I do not want to use the words Senator Xenophon used, but what changes?

Mr Drury—I would love to answer that question. If I was versed in the Trade Practices Act or in consumer law, it would be really easy to answer that. That is what we are working on. We are actually working on what you are potentially asking for. If I knew the law chapter and verse, then I could answer.

CHAIR—We will raise it with other people. It is a very important point.

Senator COLBECK—I want to go back to the letter from Coles that told us that some of what we were saying was ludicrous.

Senator XENOPHON—It was not a submission.

Senator COLBECK—No, it is not a submission. It is a letter to us to tell us that what we were saying was ludicrous. Coles says in the letter that the Murray Goulburn Cooperative’s farm gate prices have increased by 20 per cent over the past 12 months. How reasonable is that statement in the context of time, given that over the past 12 months in particular we have been coming off that major slump in price from the global financial crisis? Where does the price sit with a longer-term trend? It is not really fair to say, is it, that just because prices to dairy farms have gone up in 12 months that reflects the general market? That is a recovery figure, not necessarily an increase figure.

Mr Phillips—There is actually a figure in our submission. There is a table which would show Victorian farm gate prices. You will see for 2010-11 we actually say the number is correct and we are forecasting a 22 per cent increase in the Victorian farm gate price on last year, which was a 21 per cent decline on the year before. So, in fact, this year’s price increase is a recovery of the price reduction from the previous year. So this is basically a return to the long-term trend. It is recovery but it is from a fall.

Senator COLBECK—So it is deceptive to use that one year figure in the context of their argument about farm gate milk prices.

Mr Phillips—I think the Victorian farm gate price in 2011 will finish slightly below what it did in 2008 and 2009.

Senator COLBECK—So it is hard to sustain their argument that what they are doing cannot have any impact on dairy farming.

Mr Phillips—Also, it is a number which is not the relevant number to use when you are actually talking about the farm gate price, which is most at risk from this move. I refer to the Queensland, Western Australian and New South Wales farm gate prices, which have not risen 22 per cent.

Mr Drury—They actually took a substantial cut in the last 12 months.

Senator COLBECK—I understand exactly what you are saying. I wanted to make sure it was on the record that some of the arguments that are being used by Coles in this whole debate are pretty spurious. In their letter they talk about transparency in pricing. You gave some evidence that farm gate prices are on your website, so it is pretty easy to get information on farm gate prices. The real place where prices are hidden is, in fact, between the wholesaler and the retailer. That is where we have trouble getting a real understanding of what the numbers are. So where costs are really hidden is not at the farm gate; they are, in fact, hidden because of commercial-in-confidence reasons between the wholesaler and the retailer. Would that be correct?

Mr Drury—Yes.

Senator COLBECK—You do not have any sense of any of those numbers?

Mr Griffin—No, I am not aware of any. I have asked the question: is it commercial in confidence? That is the answer we get.

Senator COLBECK—So for Coles to claim that the lack of transparency is, in fact, at the farm gate is not necessarily the case.

Mr Griffin—That is right.

Senator COLBECK—I have no difficulty in finding out what farm gate milk prices are. I have talked to dairy farmers. But the real difficulty is, in fact, finding out what Coles are paying for their milk. The only hint that we have is based on their submission at the last inquiry when they said they were paying a 22 per cent gross margin on their product, which obviously we will explore with them next time around. Thank you, Chair.

CHAIR—Thank you, Senator Colbeck. Senator O'Brien has a question which he feels he would like to put on record.

Senator O'BRIEN—Mr Drury, you gave some evidence this morning about arrangements in Queensland whereby dairy farmers had entered into some differential arrangements between supermarket branded milk and retail branded milk, although I am not sure how you would describe the two. I am interested to know when that occurred and how it works. Can you tell us who the processor is?

Mr Drury—My understanding—and it would certainly be a question you could get reinforced with the Queensland Dairyfarmers Organisation, who will be appearing this afternoon—is it is an arrangement with an authorised collective bargaining group in Queensland. The arrangement is between that group and Parmalat, I believe.

Senator O'BRIEN—So there is a lower price paid for the Coles and Woolworths branded milk proportion.

Mr Drury—You certainly should inquire of QDO this afternoon, but my understanding is there is a premium for the branded sales and others.

Senator O'BRIEN—So it is lower or higher? That is your understanding?

Mr Griffin—That is correct.

Senator McGAURAN—The difficulty is that for many years we have had the cry that there is not enough competition between Coles and Woolworths—and now we have it. I am sure you can see that difficulty. I understand the knock-on effects but the difficulty is that we cannot actually interfere in raging competition on the supermarket shelves. I do not think any parliament could. But if you want to protect your farm gate prices, which is your job—and rightly so, and I am on your side for that—you have to get serious. The collective bargaining laws are there but they are limited. The tax advantages for cooperatives are there but they are not wholly used, and I guess they are limited. Calling in the ACCC—limited yet again to try to prove predatory pricing. The point is you cannot have it both ways. Either we have competition and want Coles and Woolworths to compete amongst the others, or we return to protecting the dairy farmer, an element of re-regulation and bringing in a form of floor price—perhaps not a selling price—for the farm gate. I want to know this: is that a policy that you would support?

Mr Drury—The truth in that is that every Western country at this stage has some form of competition or anti-trust legislation to protect weaker players from monopolies, duopoly or businesses which have too much power in the marketplace. I do not think anything we are asking for is inconsistent. We are not asking for re-regulation; we are asking for a fair, competitive go. That is consistent with not only the laws in this country but most other Western countries. When you look at the anti-trust legislation in the United States you see that it was set up in to stop over zealous market power by monopolies. There is not much difference in this case between a monopoly and a duopoly. I do not think we are asking for anything we should not be asking for.

Senator McGAURAN—I am saying you should be. I think that is the only fair dinkum answer to protect the farm gate prices.

Mr Drury—Re-regulation?

Senator McGAURAN—Not a total re-regulation. I am saying that but you are not. I just want to put that on the record one way or the other.

Mr Drury—The difficulty is getting a regulation which every sector in the dairy industry would agree to.

Senator McGAURAN—If you do not want re-regulation—and I know it is a difficult thing now to put the egg back together—it is possible, the states can do it, Queensland and New South

Wales no less, but Victoria may have a completely different attitude. You have to be fair dinkum. If you want to protect the farm gate, that is the only way to go. Otherwise, let Coles and Woolworths rage with their prices. As long as the cost is kept above cost price we have no argument. You are going to be battling in a public relations exercise like this. You have to go to the heart of the matter and the heart of the matter is floor price at the farm gate or just become public relations agents.

Mr Phillips—To go back to the comments Senator Xenophon raised, this is not a competition between Woolworths and Coles. They are going to match each other in price just to maintain market share and position. It is competition but in the end they are not going to wear the effects of that competition because Woolworths has said that this is not sustainable, that they will have to drop the prices they pay their dairy suppliers. In the end, dairy suppliers will wear the cost of that competition. That is our challenge. That is the concern we are raising.

Senator McGAURAN—But you cannot jawbone your prices up again. I am on your side—that might surprise you—but I do not want any public relations jawboning. Let us get to the crux of the matter.

Mr Phillips—This is not a public relations matter; this is about what will happen with unnecessary regional adjustment in Queensland, Western Australia and New South Wales.

Senator McGAURAN—You ought to be calling for re-regulation in Queensland and you ought to be calling for it in New South Wales.

CHAIR—That is a very interesting point. Thank you very much repairing.

Proceedings suspended from 10.04 am to 10.23 am

HOGAN, Ms Camille, Chief Financial Officer, Norco Cooperative Ltd

McNAMARA, Mr Gregory James, Chairman, Board of Directors, Norco Cooperative Ltd

Evidence taken via teleconference—

CHAIR—I welcome Norco to this hearing. Would you like to make an opening statement?

Mr McNamara—We would just like to make a broad summary of our submission. We believe that the current pricing strategies of the major supermarket chains will reduce processor margins in the longer term. We are not convinced that the retailers will not pass these reduced prices down the food chain at a point in time. We think it is important that there is a mix of branded and generics to maintain the profitability of the processing sector. We are also concerned about how smaller retailers will get support in the event that this is an ongoing program.

We believe that if it goes further down the food chain, farm gate returns have to be impacted because the processing sector cannot absorb it. It is a low-margin business and we cannot support further reductions in processor margins. Farm sectors have had significant incidences of droughts and floods during the last period of time and they have increased their debt levels significantly, which will increase pressure on them. We also believe that the farmers' inputs are starting to rise. We are seeing inputs in grain, fertiliser, fuel and electricity. Even interest rates increases affect farm gate viability.

We believe that consumers ultimately will see reduced choice. If there is not a highly profitable dairy sector you will see a lack of innovation and a lack of industries wanting to invest in the dairy sector. That could see less innovation in the industry. We believe that the smaller retailers cannot afford to match the larger retailers and are therefore at risk. Consumers will then have less choice on where they buy their milk products from. Another point we would like to add is that we think the addition of permeate to milk is not an innovation; it is a cheaper form of milk on the market. Consumers are confused by that and we believe that labelling laws should address that issue.

We also believe that there are opportunities for significant damage to regional communities if farmers leave the industry. The situation and outlook report created by Dairy Australia said that for every dollar that is created at the farm gate there is an additional $3 created in regional communities. This additional money is created across the community through shops, veterinarians, buying fertiliser or agricultural chemicals, and things like that.

We also think that there will be an increased risk with food security. As farmers exit the industry many of their farms will be sold off and split up, and that agricultural land will be lost forever. Much of the coastal land in New South Wales and Queensland is around the Brisbane and Sydney markets [inaudible] which will mean that that land is lost.

We would also like to make the point that if retail prices lead to farm exits there will be the potential for a skill set loss. The farming sector has a unique set of skill sets that have taken a long time to build up, especially in the northern parts of New South Wales and the southern parts of Queensland. This is an area that needs to be given consideration because a new industry will not be able to start up in 10 years time if this current program continues.

We would also like to make the point that there are other dairy processors that will be impacted by this, even if they are in the commodity market supplying cheeses or milk for the export market. Those reduced volumes of milk across Australia will have a significant impact because their businesses will need to supply the fresh milk market and their ability to hold their margins in their businesses will be changed. Those are a number of areas. My CFO, Cam Hogan, would like to make a comment.

Ms Hogan—I would like to comment on the retailers' margins and the unsustainability of the current pricing. We know, via the tender processes that are very tough with the retailers, that they aim for a 30 per cent margin on their own brand of product in deals. When we go through a tender process against other processors we are pushed very hard to get the lowest prices to make sure that the retailers get the lowest price and maintain those margins. The current pricing reduction from $2.47 to $2 for two-litre product is a 19 per cent reduction in the white milk market, which is a low-margin market for that staple item. A 19 per cent reduction means that somebody at some stage must make a loss. The retailers, we believe, are currently making that loss. We do not believe that they can possibly be making a profit at $2 for two litres. How sustainable is this in the long term?

The impact on the brands will be quite significant. We have already seen a lift in the unbranded products since 25 January, when this was introduced. We are concerned about the growth in the light milk in particular with the $2 for two litres. As the unbranded products grow, branded products will lose facings and therefore the processors will be under pressure to reduce those prices to maintain their facings, and therefore their profitability will be impacted. Processors need a mixture of retailer brands and their own branded products to maintain their margins. It is not unusual for a processor to take a loss on a retailer's brand in order to keep their factories full.

CHAIR—Thank you very much. Could I just ask you what the total value of the milk processing industry is? What is your gross turnover?

Mr McNamara—Gross turnover in total is around $350 million but, of that, milk itself equates to around $85 million.

Ms Hogan—Milk processing is $85 million. On top of that we have our milk supply business which ties into that, which is around another $80 million. So for Norco in total it is $165 million.

CHAIR—What sort of business was that one? I missed that.

Ms Hogan—There are two sectors to our business. We have the processing business—that is the $85 million turnover—and we have our milk supply business and milk collection. That is another $80 million on top of that. So that is $165 million for us.

CHAIR—How many people does the industry employ?

Ms Hogan—We have 600 people.

CHAIR—Is that just in your operation?

Ms Hogan—That is just in our operation. On top of that, there is also the Fonterra business, which has another 100 plus people. In our business we have 165 farmers and on average there are two people per farm, so that is a bit over 300 people there. So Norco plus Fonterra would have about 1,100 people impacted within this industry.

CHAIR—Is that just in Queensland or across the country?

Mr McNamara—That would be from around Newcastle right through to probably the other side of Brisbane.

CHAIR—That is interesting. Some of the evidence we heard this morning was that retailers might deal directly with the farmers and exclude the processors. Have you heard any suggestions that that might be something which could occur in the future?

Ms Hogan—If they get their own factories. I find it quite difficult to work out how they would get their milk processed.

Mr McNamara—You cannot process milk on farms. First it is pasteurised, then it has to be put into a bottle and then it has to be distributed. No individual farmer today is capable of fulfilling the requirements of the supermarket trading system.

CHAIR—So the implication of it, if it were the case that the retailers were to deal directly with the farmers, is as I thought—that they would have to set up their own processing operations.

Ms Hogan—They would have to go and spend $200 million or $300 million and set up a factory somewhere.

CHAIR—What would that do to the end price of the milk and the products? What would it mean to the consumer?

Mr McNamara—We think the price would have to rise. There are two parts to this. First, we believe that the price of milk would have to rise, but there would have to be some very strong checks and balances in place to make sure that the quality is there every day. I just do not know how the farm sector could actually even organise themselves to create that process that exists today in the processing sector. There are some very rigid guidelines about testing of milk to ensure that it meets quality standards, whether it is bacteria counts, antibiotics in the milk or chemicals. All those sorts of things are tested on a daily or weekly basis, but I do not believe the farmers have the capability to undertake that.

Ms Hogan—Or the capital.

CHAIR—Thank you very much. That expands our understanding of that issue quite well.

Senator COLBECK—I want to clarify a couple of points you made in your opening remarks. You talked about the supermarkets demanding a certain margin as part of their negotiations. Could you just clarify that number for me please?

Ms Hogan—It is normally an expectation—it is industry knowledge—that the retailers like to enjoy around a 30 per cent margin. It is not a trade practices issue where it is enforced upon us; it is just an expectation that we know what their level of margin normally is.

Senator COLBECK—Do you see that margin reflected in prices, based on what you are supplying to the supermarkets and their retail prices?

Ms Hogan—It is possible. The issue with our numbers is this. There are two steps between it leaving our factory and getting it on the retailers' shelves, which is via the distribution chain, and we are not aware of what those margins are. It is an assumption on my behalf around: if that shelf price was not at this, this is what they would expect.

Senator COLBECK—So you cannot give us any specific details of the relationship between your selling price and the price on the supermarket shelf?

Ms Hogan—That would have to be done in conjunction with Fonterra, and it is information that is commercially very sensitive.

Senator COLBECK—So we would have to talk to Fonterra about that as well?

Ms Hogan—Yes, you would. We would have to do it in conjunction.

Senator COLBECK—Okay. We might pursue that down the track. Can I ask you about any movement in your sales since this marketing campaign started on Australia Day?

Ms Hogan—We have seen a two per cent uplift in general in the unbranded products, and there has been a material uplift in the light product because of the significant reduction in price of that particular product—it went down from about $2.99 to $2. So the light product has significantly jumped. The full-cream product jumped by about two per cent—enough for us to notice the difference.

Senator COLBECK—In the products that you are selling to the supermarkets—which are, I understand, in some circumstances, organic product—

Ms Hogan—Very minimally organic product.

Senator COLBECK—Sorry?

Ms Hogan—We only sell a small percentage of organic product.

Senator COLBECK—So a small percentage is organic. Have you seen any move away from the product that you are selling since the campaign started?

Ms Hogan—We have seen a two per cent lift in the unbranded price in total. That is therefore a two per cent drop in our brand. We need a few more weeks' data to see whether there will be a lift from that two per cent.

Mr McNamara—Our other concern is that, the longer this program continues, we believe that the consumers over time will become less attracted to the brands and move to the cheaper-style products. So if it continues for six to 12 months we believe that the data will be quite different from today.

Senator COLBECK—You mentioned in your submission that you made a net $2.3 million profit in 2009-10. Is that on the total $350 million? Or is that just on your milk processing and supply?

Ms Hogan—It is on a total of $350 million of turnover. We are not a high-margin, high-profit business.

Senator COLBECK—So when the supermarkets tell us that they are going to squeeze process and margins, there is not a lot in your business to be squeezed?

Ms Hogan—No. Our submission talks about the fact that, if we had to bear a one cent per litre milk price reduction, that is $1.4 million, and anything above that we would have to pass down the chain to our suppliers. Retailers have reduced the price by 23c a litre. That is obviously a very alarming number to us, and it will send Norco and a number of farmers into bankruptcy rather quickly.

We would also like to highlight the importance of Norco in the industry. We see ourselves as a smaller third player. So we are up against the big players—those being Parmalat and National. Obviously, Dairy Farmers are no longer in the industry. So we see ourselves as an important small cog in that industry in making sure that farmers have a place to go and making sure that we keep competitive prices for consumers on the shelves.

Senator COLBECK—In the circumstance that you are making—on my calculations, 0.28 per cent profit on your $350 million turnover—supermarkets tell us that they make about 3c in the dollar. They are making 10 times the margin that you are making, yet they want to squeeze your margins, according to what they tell us in the letter they wrote to us last week.

Ms Hogan—Yes, which is obviously a very big issue for us. We do not pay a milk price above the market price. If anything, our farmers at times tell us that we are one to two per cent below the leader, below the market. We are always trying to make sure that we pay a market-competitive price for market milk in our area, therefore we cannot afford to reduce the price to our farmers and maintain an industry in northern New South Wales and southern Queensland.

Mr McNamara—I would just point out that one of the questions in your inquiry was to look at why the industry has moved from 11 billion litres back to 9.2 billion litres in the course of almost a decade. A lot of that can be driven by the fact that, yes, the industry is deregulated, but with farm gate returns well below the cost of production, the farmers with their debt, at a point in time, will say that this is something that they can no longer sustain and they exit the industry. The farmers are very aware—they are very astute people these days—that any reduction in farm gate prices will put them into a position of increasing their debt or choosing to exit the industry. We have already experienced one or two farmers looking to exit the industry due just to the concern with the current discounting. Fundamentally, we are of the view that there will be a quick change towards farmers not making money who will actually exit the industry very quickly versus taking on debt to sustain a business. That is something that we cannot highlight enough.

Ms Hogan—As a result of that, we have to ensure that the retailers stick to their word and that they do not pass the pain of this cost reduction down the supply chain.

Senator COLBECK—I think we understand that as well. The real concern is that the retailers tell us that in their advertising this price has come down and is staying down. We know they are not a benevolent society. At some point in time they are going to want to make a margin on what they are currently effectively giving away, based on previous evidence that they have given us. If it does become the retail price of milk, there is only one place where the margin can come from and that is to be pushed back down the supply chain.

Mr McNamara—There is a second viewpoint that needs consideration too. We are seeing significant increases in costs, especially for things like grain. We have seen fuel prices rise which not only affect the diesel and petrol prices for farmers but also affects their supply good prices, and you have got the cost of electricity, interest and rates. If the retailers hold their price at $1 per litre and the cost of producing a litre rises 3c a litre and it has moved up the chain, again it will have the same impact of reducing farm numbers and volume over time, because those farmers are very acutely aware that increasing debt is not going to solve their problems. They will choose to exit the industry now rather than continue on farming and increase debt.

Ms Hogan—Another point to add there too is that in our appendix A, as per Dairy Australia, it shows that only nine per cent of drinking milk in Australia is UHT, so 91 per cent of Australians enjoy fresh milk, whether it be reduced fat, full cream or flavoured. If the industry is brought to its knees because of the moves by the retailers, where are Australians going to get their fresh milk from?

Senator COLBECK—I want to go now to the pricing that you have listed in your submission. You say that your average price to dairy farmers in the financial year 2009-10 was 54.11c per litre. If $1-a-litre milk becomes the market norm, you would have to reduce that price to 30.61c, a reduction of 23½c a litre. That is obviously well below the sustainable cost of production for dairy farmers in your region.

Ms Hogan—Absolutely. We know the break even position, as the person who [inaudible] it was put at around 6c a litre. That is well below break even so the industry would cease.

Senator COLBECK—How do you calculate the 23.5c reduction?

Ms Hogan—I actually did that work myself. I just said that the price reduction would go directly down the supply chain to the first person, which is the farmer. I took the difference between the $2.47 and the $2, which is 23.5c a litre, and then I took it off the 54.11c to get 30.61c.

Senator COLBECK—So basically you are saying there is not enough margin in your business to carry the cost of any price reduction, so the only way that you can do it for your business to survive is to pass it on to the farmer?

Ms Hogan—Absolutely, and they cannot survive at 30.61c a litre.

Senator COLBECK—So that basically puts both of you out of business?

Ms Hogan—Yes, and it would put the majority of the Victorian farmers out of business too, we would like to add. We know that our cost of production is higher up here, for various reasons, around cost of land et cetera, and the fact that we produce milk 365 days a year for the in-market milk market, not for the commodity market. At 30.61c, it would be well and truly below the Victorian break-even price. Ninety-one per cent of Australians want fresh milk, so that sort of pricing would put the entire Australian milk industry at risk.

Senator O'BRIEN—Thank you for your evidence so far. It seems to me that the inevitable consequence for your region, in terms of milk pricing, is that dairy farmers in your scenario would simply say, 'We cannot remain in this business,' and leave. On other evidence we have, that would apply to a lot of New South Wales and Queensland too. How does a supermarket like Coles or Woolworths continue to supply fresh milk if that is the consequence of their action?

Ms Hogan—They would not be able to, unless they could import it, which would be very difficult because it is a fresh milk product. The irony of that is that, if you import milk, you have to process it before you send it from overseas. You then have to reprocess it when it gets here, and the cost would be well and truly above the 50c a litre, I would imagine, so they would be back to looking for fresh Australian milk.

Senator O'BRIEN—So you think it is a bit circular, it is a bit like that which happened under deregulation—that there was an initial price drop and then the price gradually rose back up because it was unsustainable?

Ms Hogan—Correct.

Senator O'BRIEN—Do you think we are going to go through that cycle again—that either the supermarkets will decide it is unsustainable to have the price they have claimed and transfer their marketing point to another product or something else will happen?

Mr McNamara—That is true. A point that is worth making too is that dairying today is actually a highly skilled business, like agriculture in general. So, in the event that there is a market failure and a demise of the industry, rebuilding the industry is not a simple task—rebuilding the farm gate, rebuilding the processing sector. If you went back down and you played it out in the next six months, if the industry in New South Wales and Queensland were short of milk, we would bring it from Victoria into our processing facilities. But, at a point in time, processing sectors in this part of the world will make a decision about whether that is a long-term sustainable business model to run. If it is not, they will actually close those factories. As Cam said, milk will have to be either brought up the highways or imported. The question is what the consumers want. We believe they want fresh milk and they want it on a daily basis across Australia. One of our experiences in recent times was of the ability for the Brisbane market to receive fresh milk in the floods that they had in Brisbane. Norco immediately, on hearing of the problem, gave National Foods and Parmalat the ability to use our factory, which was not flood affected, to ensure that the community actually had milk. We were out of milk for two days. We did that program. We think that you should also be thinking about food security and food bowls in catastrophic events. The industry—not only dairy but agriculture in general—needs to be aware that populations have to be able to get fresh food day to day.

Senator O'BRIEN—What do you know about the cost of transporting milk? I see from Dairy Australia's figures that the price differential from Victoria to Queensland in 2009-10 was about 22c, for the farm gate price per litre.

Ms Hogan—That is correct.

Senator O'BRIEN—Can you tell us anything about the cost of transporting milk from Victoria to Queensland? Do you know what that costs? You have just given evidence about getting some milk supplied in bulk.

Ms Hogan—Yes, we can give you that information. At the moment, we purchase the odd load here and there, and it costs us 21c per litre to get it from Victoria to Queensland for processing.

Senator O'BRIEN—21c per litre is the transport cost?

Ms Hogan—Yes, the delivery cost—farm gate price plus transport. Part of the issue with that milk coming up the highway [inaudible] to process up here is the fact that we have quality issues. Tankers are not refrigerated. Therefore, the quality of the milk deteriorates on the drive. It takes up to two days to get here then we have all sorts of issues with getting high-quality milk on shelves for our consumers. It often occurs where that milk has to be turned into skim milk powder because the quality of the milk on landing is not high enough for human consumption via a bottle. It is on the road for 38 hours.

Senator O'BRIEN—Do you know what it costs to ship packaged milk? Do you have any idea?

Ms Hogan—It is actually more expensive. Take Parmalat, for example, who have a factory in Victoria and a factory in Queensland, as do National Foods. The reason they ship bulk milk and process it up north is because the cost to ship crated milk where there is a lot of air in between the bottles is far higher than the 21c per litre. I do not exactly know that number, but we know that it is more expensive than sending processed milk.

Senator O'BRIEN—Thank you. What is your solution to the current situation?

Mr McNamara—Obviously, we believe that the supermarket trade should cease their current activity to ensure that all parts of the chain make a margin. That is the outcome that we would like to see—that there is a fair margin for all involved in the process. We believe discounting milk is quite predatory in the current market. The forgotten group in this are the smaller retailers who do not have the capability to support a program such as Coles and Woolworths are doing at the moment. So they are at risk. We also have the vendors—the people who deliver the product. They are also being put at risk with this by ensuring that there is product on a daily basis.

Senator O'BRIEN—Are you saying the problem is market power and that we need to do something about it?

Ms Hogan—Absolutely.

Senator O'BRIEN—What do you think we should do?

Mr McNamara—First of all, we think you need to make sure there is some legislation around predatory pricing [inaudible] and legislation around it now. We think it is too slow. Companies could find themselves in bankruptcy very quickly if this [inaudible] down the chain and not be restored. We think that laws need to be very quick about how they treat this cease this activity. Secondly, we also think that food labelling laws should be addressed immediately in regard to those organisations who have found an alternative way to make a cheaper milk to make sure that consumers are aware that they are taking a product that is of lesser quality than a full, natural milk. As we said, the consumer will not know whether a milk has permeate in it or not. We think consumers should be aware of that.

Senator O'BRIEN—We touched on the permeate matter before. I think this committee would appreciate it if you would give us some detail about the influence on milk quality and the price of the addition of permeate.

Ms Hogan—Permeate is a legal food. However, it is essentially a watered down [inaudible] product. It is far cheaper per litre to put into products than full cream milk. Legally, up to 10 per cent can be put into a litre. Two litres can have 200 millilitres of permeate in the product and still legally be milk. However, the quality of the milk product is reduced because it is essentially a watered down milk product rather than full cream milk. Norco does not add it to its product. The reason processors add it to their product is to get the cost down—full stop.

Senator O'BRIEN—So one of the potential solutions for some processors is to include a higher proportion of permeate in the drinking milk to ensure that they retain a margin.

Ms Hogan—You cannot put more than, I think, 12 per cent in the product.

Senator O'BRIEN—But if they are not putting that amount in, they could increase the quantity up to that amount?

Ms Hogan—Correct.

Senator O'BRIEN—Is that what you think would happen?

Ms Hogan—We think there should be labelling laws to make sure that people understand that they are drinking it, and that they are giving their kids and their families tummy aches because it is a lower quality product and you do not get the nutrition you do from 100 per cent full-cream milk.

CHAIR—Senator Xenophon, we are running a little bit behind time because we started a bit late. So we might go a little longer but not too much longer.

Senator XENOPHON—I only have one question. Further to Senator Colbeck's line of questioning, when Coles says that processors' profit margins are already higher than our own in any event, and Coles talks about processors being able to improve operating efficiencies to fund investments in value, are you saying that Coles is wrong in relation to that?

Mr McNamara—Yes.

Ms Hogan—Yes, we are. Certainly, they will be even more incorrect if they put pressure on the branded products that are the funders of our ability to improve our factories.

Senator XENOPHON—Thank you.

Senator WILLIAMS—Mr McNamara, do you actually sell any Coles brand milk or Woolworths brand milk? Do you sell any of those to any of those big stores?

Mr McNamara—Yes.

Ms Hogan—Yes, we supply 10 million litres of the Coles unbranded product, and we supply 17 million litres of Aldi New South Wales product. We supply milk to Parmalat that goes into the Woolworths product, but we do not actually process that product.

Senator WILLIAMS—I would like to ask you some questions about how much you sell that product to Coles for, compared to, say, the two-litre Norco milk that I see in a store in Inverell. I am aware that you may not wish to answer that publicly. Would you like to answer those questions and give the details of those costs? This committee needs to know where the money is flowing and who has got the advantage here as far as purchasing prices go, but you might not wish to make that public. Would you like to answer them in writing to the secretary of our committee or would you prefer to go in camera now?

Mr McNamara—We are conscious that we do not want to compromise anyone in the process. So we would prefer to go in camera or put it in writing to you on a confidential basis.

Senator WILLIAMS—Okay. What if I were to send you some questions, or the secretary did, and you replied to them in writing to the secretary?

Ms Hogan—That would be fine.

Senator WILLIAMS—I am just aware of time. Senator Xenophon would like to go in camera now and ask you some questions. I will run it past the chair.

CHAIR—I do not mind us going in camera but we are a little behind time, so we would only, at the most, have ten minutes.

Mr McNamara—We would be happy to take those questions and then come and see you and present them in a different format. So it is up to you. We are happy to answer them now or take the questions and put them in writing.

Senator WILLIAMS—Put them in writing then; I would be happy with that. Since you have seen this discounting war with the big supermarkets, have the sales of Norco brand milk dropped away?

Mr McNamara—They have, by two per cent. But we have actually had a very strong regional program. People are very aware of the program and are supporting it. But our long-term question is: how long will this last? We believe that the current program will be eroded as time goes on—

Ms Hogan—as memories fade and people go to the cheaper product.

Senator WILLIAMS—Exactly, especially as the cost of living rises and more pressure comes onto the family budget; that would be obvious.

Mr McNamara—Yes.

Ms Hogan—Correct.

Senator WILLIAMS—I will sit down with the secretariat and put some questions to you, and I will put it to the committee that your answers should be kept in confidence and not be made public. The committee can see exactly what you are selling milk to the big end of town for, compared to the smaller shops et cetera. We need to know the price discrepancies there—the differentiation in the pricing—for the committee's sake when it comes to making recommendations at the end of this report.

Mr McNamara—All right. That would be good. We look forward to being able to do that.

CHAIR—What you have to do is mark your responses as a confidential submission to the committee. The confidence of that submission will be honoured by the committee.

Ms Hogan—Thank you. What is the timing of that submission?

CHAIR—Senator Williams will provide you with the questions. You should know that even submissions in confidence or evidence given in camera can, by order of the Senate, be made public, but it is a very rare event for that to occur. If you are prepared to provide a confidential response it should be marked 'confidential submission' and there is little likelihood of it not remaining confidential. If that is the feeling of the committee, we will conclude this segment of evidence. Thank you for your appearance.

[11.01 am]

MARINO, Ms Nola, Member for Forrest, Commonwealth Parliament

CHAIR—Welcome! Ms Marino is the federal member for Forrest in the south-west of Western Australia, in which electorate, I think, is located almost all of the Western Australian dairy industry. Would you like to make an opening statement?

Ms Marino—Most certainly. I want to make the point that if the ultimate outcome here is consumer benefit then over time, with this move by Coles, consumer benefit could well mean that there is only one choice of milk, which could be a branded product, whether it be from Coles or from one of the other majors. There could also well be an issue about milk quality. You have heard about the permeate issues and about a potential UHT product over time as this moves on. If there is a lack of competition in the market place, once the competition has been driven out will consumers face an increase in price? They are all issues in relation to the consumer interest in discussing this issue. It could be a case of short-term gain and long-term pain for the consumer. That is an issue I have in addition to the issues facing many of those I represent—the dairy farmers and the dairying industry in the south-west of Western Australia.

Our farmers are up for a renewal on their milk pricing in June, so this is a very real, very immediate and extremely urgent issue. The issue that keeps coming back to me from dairy farmers and organisations is the unsustainability of that price in the market place. When supermarkets engage in a battle for market share through long-term discounting, the lower prices, as I think you have heard consistently, will inevitably filter back to the dairy farmers.

There are food security issues here, as well. The global food task is increasing and we need numbers of food producers to be able to meet that task in a genuine sense. I know that we have seen one estimate putting the cost to the dairy industry of the reduction of branded milk pricing this year at $730 million. The frustration for so many dairy farmers is that they are already producing at some of the lowest costs in the world. They are in an incredibly competitive environment already, producing one of the lowest cost and best quality milks in the world, yet this is where they find themselves. I will table the old milk carton that was an explanation, pre-deregulation, of how the milk price was broken up.

CHAIR—Thank you. We will accept that as an exhibit.

Ms Marino—I think you are aware of the vulnerability of the white milk states—the liquid milk states of WA, Queensland and New South Wales. Both New South Wales and Queensland have suffered falls in milk prices in the last 12 months. In Western Australia, over 70 per cent of our milk goes into that market, 64 per cent in New South Wales and 93 per cent in Queensland. In Western Australia, we are down from 419 dairy farmers to around 165. That is where we are at. We are facing some of the lowest prices in the world and we already operate in a highly cost-effective production process. It appears that retailers are using their market share in home brands to dominate the market at the expense of others in the supply and value chain.

One thing I am really concerned about is the fact that, in a broader sense, the major supermarkets appear to me to be designing Australians' diets by their market dominance and gross profit margins. In my position, that is something that I have grave concern about. Again, on the dairy farmer issue, it has been mentioned here and I heard earlier that farmers cannot move in and out of this industry overnight and you cannot buy their expertise and the breeding that goes with a dairy herd overnight. It is, at least, a seven-year turnaround. They are issues that affect the continuous flow of a high-quality product.

As I said, there is a real urgency. We need to find out from the processors what impact this is having on across all of their milk sales, not just on the branded sales and on those that they provide to the supermarkets. Interestingly, for your information—and it may give you an indication—at a recent WA pedigree dispersal sale there were 201 lots, and only 12 were bought by WA buyers. That really gives you an indication of where the industry is at.

With respect to the current market and where we see it, I understand that home brand milk volumes have increased by 50 per cent. In fact, they could well have doubled. What is really interesting to someone like me is the fact that this scanned data that is normally available at this time is not currently available for you or me to look at. So I have concerns about that.

As I understand it, Coles has said that its milk sales have risen by 15 to 20 per cent and vendors have indicated a reduction in trade. A Tasmanian company has lost at least 10 per cent of its business. I understand from the newspaper that one brand has lost 37 per cent and another has lost 20 to 30 per cent. So the impacts are right there. It is definitely an issue for the market. Of course, the price that the processors are paid across all the various categories of milk they supply affect the price that they are then able to pay to dairy farmers directly. So if it is being used as a loss leader or in a predatory sense that could certainly put downward pressure on prices, which we will see, and also on smaller retailers, family businesses and corner stores. I seek leave to table this graph.

CHAIR—Leave is not required.

Ms Marino—I seek leave to table it, anyway.

CHAIR—We will accept that document.

Ms Marino—Thank you. I am glad that you were given a true indication of the process. It is a very real issue. From the processors' perspective, I would ask that the inquiry investigate. I have listened to you requesting information from the previous witnesses. I think it is an indication of the actual market power of the supermarkets that so many people cannot speak out and speak openly. The issue right here is that there are those who feel they cannot speak out. As an Australian I take that very seriously and I am hoping the rest of you do as well. That market power is such that these people cannot feel as though they can come out in this environment and tell the truth.

I am concerned that the processors cannot speak out or that food manufacturers in general cannot speak out. That bothers me. I am concerned that they will have less money for product innovation, marketing and investment, less capacity to pay farmers and, as sales from branded milk fall, their margins will be severely cut. It would be worth the committee checking what the price is that processors require across all of their sales of milk to be able to support farm gate prices in each state. I understand that the price could be around $1.11 to be able to support a 45c price to a farmer. I would ask you to check that in relation to section 46(1AA) of the Trade Practices Act. I have heard that margins may be two per cent on drinking milk and virtually very little at all on home brands and that that will force a move to home brands.

I would also ask you to investigate whether a processor, wanting to retain their market share, were perhaps prepared to ‘special’ their product in competition within that same environment, would in fact be allowed to do so. I would ask you to check that in relation to section 46C. I would also bring to your attention the fact that the loss leader on perishables is really quite a deliberate strategy. Consumers cannot stock up on milk. Yes, they can freeze so much but, because it is a perishable product, it brings people through the doors every day. That in itself is a vulnerability; people buy a whole range of other items at the same time. So I would encourage you to check that. The strategy, as I see it, could have longer term negatives for our consumers. I would also like to table a letter from a very young dairy farmer, 19 years of age, in my electorate. She is very desperate to do what she does best, which is survive and compete in what is now a very competitive industry.

CHAIR—We will accept that letter. Do you want to read part of it?

Ms Marino—I am happy to read it, if you are in a position to listen to it. This letter is from a 19-year-old young woman. I am really pleased to be able to do this, given the current international women’s celebrations. ‘My name is Nicky Slee and I am 19 years old. My whole life, I have lived and worked on my family’s dairy beef farm in Yoongarillup and never once have I regretted being a farm kid. For years I have been told by both friends and family that I work too hard, that I work too many hours but I have always just accepted this as being part of a farming lifestyle. Farming is not a job to me or my family; it is our lifestyle. Our lives revolve around caring for our stock and doing everything we can to improve our farm business. My dad and I run the dairy and this is my favourite part of it all. I love working with animals and I’ve been working with cattle since I could walk. But I am finding the dairy industry of Western Australia is increasingly unstable. I’m sure you understand what I am saying when I tell you how little grade 1 milk is worth, regardless of which companies supply. Coles and Woolworths are effectively deciding what milk is worth and putting their prices as low as $1 a litre. This means that the dairy farmer is the one who takes the hit. We work our backs to the bone, 24 hours a day, seven days a week. There’s no real holidays or days off. If something happens, you have to be ready for it and try to fix it. And for what? You’re lucky to get 36c a litre for grade 1 milk. We never expected to become rich through dairy farming, but we have hoped for a long time to be able to make a decent living. This isn’t fair, Nola. My family supplies Harvey Fresh and they’re doing what they can—the best—to pay us, but it still isn’t enough. They have to be able to compete with Coles and Woolworths who sell milk under their personal labels as home brand. The way things are going I’m worried that, within the next 20 years, there will be no dairy farmers left in Western Australia, simply because we can’t afford to produce milk for as little as we’re getting paid for it.’ She goes on, but that is the intent of the letter.

CHAIR—We will accept that letter.

Ms Marino—Just briefly, I am sure that the committee will look at a range of issues for the ACCC in relation to predatory pricing—prolonged, below cost or aimed at driving out a competitor. Also, I am sure the committee will investigate why processors cannot tell the truth here. That is a critical issue. I would also ask the ACCC, through this committee, to perhaps look at whether it is false and misleading advertising to claim that generic milk sold at fuel stops, owned by the same companies, is being sold by the company for $2 a litre, when it can perhaps be sold for $3.50 at those same outlets? I think we need to look at the national competition policy on the total side of the supply chain. And, finally, I do not know whether you are taking evidence from the Queensland University of Technology lecturer, Mark McGovern, but I have an article that refers to the lecturer and I will leave it with you. I believe he would be of value in your considerations.

CHAIR—Do you wish to table that?

Ms Marino—Yes, I certainly do.

CHAIR—We will accept that.

Ms Marino—I draw your attention to the urgency relating to farm gate prices that will be set, not negotiated, in June. I would also encourage you to talk to members of Challenge Dairy Cooperative Ltd in Western Australia, which has been a casualty and which is now no longer in existence.

Senator XENOPHON—When did they go out of business?

Ms Marino—In the last three to four months. I would also ask if you would investigate the UK market in relation to what type of milk is on the shelves: is it UHT by majority? Is it another long-life milk? Is it fresh milk? What choice do the consumers have? I also ask that you source the scan data that I have not been able to do in the run up to this to give you some real sales figures and a clear indication of the impact of this price war. That is about the extent of my submission, but I am really seriously concerned about the consumer, choice and the lack of competition in the longer term.

Senator WILLIAMS—You said that you would like the processors to tell the truth. I do not think that you are inferring that they have been telling lies, but perhaps they could be more open about delivering the facts; is that what you are saying, instead of just—

Ms Marino—Being able to come here and openly tell you how it is for them in the marketplace.

Senator WILLIAMS—And you fear that they cannot do that under the system?

Ms Marino—It is the very market power. For instance, if you were supplying a perishable product to a major supermarket and you were having difficulties but perhaps the contract might be worth $20 million to $30 million, or perhaps you would not be able to supply a branded product in that same market; that, in my view, is something that we need to consider. We want them to be able to come here and speak openly to you about the actual market and how it operates so that you get good information and it gives you the capacity to look at all of the issues in this supply and value chain. I think that is very important.

CHAIR—In your submission you say:

When production falls it does not necessarily result in the market (processors and supermarkets) responding by increasing the farm gate price. It has been indicated that processors have been using permeate, a milk waste product, to top up milk volumes by up to 12%. Milk labelling laws do not require processors to disclose topping up milk by using permeate and Dairy Australia figures are not cross checked or audited.

Would you like to make some comment on the topping up with permeate?

Ms Marino—The permeate itself is not the issue; the labelling is. If permeate is being used, and I understand it is being used in flavoured milk, then it should be clearly labelled. One of the issues is—and I think it was said earlier—that the value of a fresh product needs to be reflected. I think it is another issue that is well and truly in that supply and value chain, but the consumer has a right to know whether they are actually accessing a fresh product or whether it contains the likes of permeate and an additive. I think that needs to be on the label and the consumer can then make a choice. But then if the farmers are producing that fresh, quality product that also could potentially be reflected in the price for that fresh product. Perhaps when there are shortages over the summer months is where you will notice that issue.

CHAIR—Essentially, it is a misleading labelling issue?

Ms Marino—I think it is a labelling issue and I think we need to get the labelling right.

Senator XENOPHON—Thank you very much for your submission and actually setting out some potential solutions. Choice have called for a comprehensive and coordinated national food policy and for a supermarket ombudsman to be established. They have been calling for this for some time. Do you think that having a supermarket ombudsman with some real powers to investigate these sorts of practices would be useful step in this process?

Ms Marino—It would depend on the parameters, wouldn't it?

Senator XENOPHON—Sure.

Ms Marino—Until I see those, it is difficult for me to be able to say yes or no. I would want to see what is being proposed and look at how it will work. I think that is the issue. How would this work and how could it address the issues in the marketplace? That is what I would want to see.

Senator XENOPHON—If the horticulture code of practice was applied in a mandatory sense to the relationship between the supermarkets, the processors and suppliers, would that be useful?

Ms Marino—You would also need to look at the word 'mandatory' and how it affected the whole supply chain. That is the work you would have to do with that.

Senator XENOPHON—That is a solution.

Senator HURLEY—Just in terms of the dairy producers you were saying were going out of business and the reduction in dairy farmers you have seen in your area, we have seen a deliberate restructuring package introduced that was only just recently finished. There has been a productivity increase in dairy farming, with a tendency for dairy farmers to have more stock and to get productivity increases that way. Do you think that has been a failure? How have you seen that working out?

Ms Marino—I think the only reason that the majority of dairy farmers are in business is that they made those changes. There is no doubt that our dairy farmers are some of the most efficient and productive. But they also produce some of the best quality product. That is the issue we need to look at.

Senator HURLEY—You were saying that there has been a marked reduction in the number of dairy farmers.

Ms Marino—There has.

Senator HURLEY—Was that part of the restructuring package or was that people following the restructuring who still went broke?

Ms Marino—It is a combination. I see it all in my part of the world. There are those who are going to leave the industry over a period of time for personal reasons or simply because of age. The average age of a dairy farmer is 58. The problem I have is with the next generation coming through. When we look at the health of the industry, it is often reflected in the numbers of young people and mature people prepared to take it on and have a go.

Senator HURLEY—That is not only the dairy industry, of course.

Ms Marino—It is across the board.

Senator HURLEY—In terms of the price of milk then, if we are looking at in some way preventing the supermarkets from reducing the price of milk that is a big step. We have all been discussing costs of living. We on this committee have also had a long look at how to increase competition between supermarkets to reduce prices. So now the prices have been reduced and we are saying, ‘This isn’t good.’ Some people are saying that this is a really bad idea. If we are to look at stopping this, it has to be for a very good reason.

Ms Marino—I would go back to my earlier statement. What we need to look at is what is in the consumer’s best interests in the longer term. Is the consumer’s best interests served by having competition? How do we retain competition? Do they have access to choice, and do they have access to a quality product? That is a part of the consumer interest as well. I understand very well. I deal with the families every day who are doing it tough with the cost-of-living pressures. I certainly would not question them for one moment taking advantage of those prices that are offered—not for one moment. But we also—

Senator HURLEY—But you are also advocating that they not be allowed to take advantage of those prices!

Ms Marino—What I am advocating is looking at the bigger picture in the long term and all of the pressures in this and saying, ‘What is in the best interests of the consumer and how do we achieve that?’ That is what I am saying here. We need to look at the bigger picture. Will the short-term gain be long-term pain? Those are the sorts of deliberations that you as a committee will have here on this issue.

Senator WILLIAMS—So what you are saying is that Coles is in a grab for more share of the market. Let’s be frank: who goes into a supermarket and walks out with just a bottle of milk?

Ms Marino—You do not.

Senator WILLIAMS—Very few people, perhaps one per cent of them or probably less. So they are using this as a magnet to get people in the door to buy other products and the end result might be—and I put this question to you—that in Western Australia dairy farmers fall over. The committee has heard today it is 21c a litre to transport milk from Victoria to northern New South Wales and the product has deteriorated somewhat by the time it gets there. It is a long way across the Nullarbor from Victoria—South Australia probably will not have access although they might have. It will virtually blow Western Australia away from having fresh milk.

Ms Marino—Well, that is what I said in the first instance. They are some of the impacts over time. Will it happen tomorrow? No, it will not happen tomorrow. But it is a progression. Just look at the costs in the actual supply chain for a major supermarket. Would there be greater profits in perhaps having a non-refrigerated product on the shelves? That is why I said to you it would be great if you could have a look at what is happening in other markets, like the UK’s. I suspect the answer is it feeds into the profit margin to have a non-refrigerated, long-life product on the shelf as opposed to a fresh refrigerated one. So it is part of your consideration.

Senator RYAN—There is a lot of identification of challenges around this. There is a lot of discussion around potential impacts along the supply chain. No-one that I have heard is proposing a regulated price in any way or is proposing that there be a floor price, for example, or that somehow we restrict the ability of retailers to offer a price for milk. First of all, is that a fair characterisation of your submission? In politics identifying a problem is easy in many ways. Identifying a solution that does not make a situation worse is the hard bit. What proposals do you think need to be looked at to address your concerns?

Ms Marino—There are the three points I raised earlier. I encourage the committee and the inquiry to look very seriously at the three issues I raised. Within all that lie some potential answers for you.

Senator RYAN—And they are what used to be called the Trade Practices Act issues.

Ms Marino—Yes, what used to be called the Trade Practices Act issues. I referred to a couple of specific parts of the Trade Practices Act. What we are talking about here is a perishable product of farmers. They are absolute price takers. They do not have market power at all. By the way that milk is sold their price in the liquid milk states is directly linked to the price that the major supermarkets charge on their shelves. That is it in a nutshell. So, Senator, I think that by focusing on the issues for the consumer, as I mentioned earlier, therein lies a proportion of your answers. The labelling issue is another one that I think we need to consider.

Senator RYAN—With the labelling one I think you have highlighted an issue of particular interest. I suppose it is not appropriate, I would say, for the committee to be determining whether there are breaches or otherwise of what I will call the Trade Practices Act. We have an independent agency for that. It is appropriate to consider the enforcement of those issues and it is appropriate to consider whether those provisions are achieving the objectives set up by the parliament when it legislated that way.

Ms Marino—Also, I suggest too whether the small producer has access, through what is existing in the Trade Practices Act, to take a case, given that the onus of proof is upon them in this process.

Senator RYAN—Are you proposing that the onus of proof be reversed?

Ms Marino—I think that is what we need to look at: where the onus of proof lies for a grower. Take the fact that if I were to take up an issue with a supermarket, for instance—and I had this issue previously—then I would have to provide all of the evidence and the cost and time away from my business as a small business person.

Senator RYAN—True. The burden of proof is one thing, and I know there are issues to do with the act about the amount of information required, but are you proposing that the onus of proof be reversed, as in it is up to the retailer to prove—

Ms Marino—No, the burden of proof is on the grower or the small business person. How they manage the burden of proof is the issue to me.

Senator RYAN—You are not proposing that people need to defend their innocence but that the case needs to be proven that they are misusing market power. You are not proposing a reversal, are you?

Ms Marino—I am not.

Senator RYAN—I was not sure if I had misunderstood what you said.

Ms Marino—No, but what I am saying is that the process for a small-business person or a grower or a group of growers to take their case and prove it in a way that is necessary under the act is extremely difficult, costly and a major issue.

Senator RYAN—And that is true of many issues to do with the act broadly.

Ms Marino—Yes.

Senator RYAN—Chair, a number of people have flagged issues of concern about people not feeling able to speak freely. That is a fairly important issue. I would say it is something that we should discuss in a private meeting and not in public, because it is an issue for the broader Senate if there are people who are openly saying that they cannot talk freely to a Senate committee.

CHAIR—It is a very serious issue, in fact.

Senator WILLIAMS—I want to take you to an issue of truth in pricing. I have a serious concern when the corner shop can buy their cans of Coke from Coles cheaper than they can buy them off Coca-Cola. This is what we are seeing now everywhere—the purchasing power is so great by the big end of town that the little end of town cannot compete. I will give you an example. I know the terminal gate price of unleaded fuel at Newcastle may well be $1.30, but I also know that a small business independent fuel station pays $1.32 to land it in their fuel station and then sells it for $1.37 while Woolworths down the road are selling it at $1.26, which is 4c under the terminal gate price. Should we have a case of truth in pricing which means showing the kickbacks to the big companies et cetera and having more transparency in it, or do you think we should just leave it to the market forces?

Ms Marino—Transparency is not a bad thing. But I think that when you have a monopoly or a duopoly the issue is the market power and buying power and actual controlling power of that, isn't it?

Senator WILLIAMS—Yes.

Ms Marino—It is how to manage that within the market that is the greatest challenge, I think.

Senator WILLIAMS—I do not think it is going to be long before this committee sees the same issue on wine, on eggs; it will not only be milk. There is going to be more to come is what I am saying.

Ms Marino—I gave evidence at the previous Senate inquiry, and what bothers me is that there has been no response to any of that.

Senator WILLIAMS—Yes. That is frustrating.

Ms Marino—You deliberated very strongly. I wrote a letter to the minister saying, 'How are you going to respond? There were some very good recommendations that came out of that report that you did, *Milking it for all it's worth*.' Nothing has happened on even one of those. So I think there are a number of recommendations out of the previous report that would assist in your deliberations or in managing some of these issues that need to be revisited.

Senator COLBECK—Ms Marino, you are a dairy farmer, your family are dairy farmers—

Ms Marino—I am indeed—and a proud one, Senator.

Senator COLBECK—I just want to get a sense of your perspective, particularly in the context of your having a direct relationship with your processor, on the assertion by Coles that they do not influence the price of milk. As I understand your evidence this morning, there is a process commencing or about to commence for a change in contracts as of June-July. What sort of feedback are you getting from your processors at the moment in relation to where this whole situation sits?

Ms Marino—I think it is disingenuous. Coles are very well aware that, irrespective of what proportion of the market they have, every other competitor in the retail sector has to meet that price to stay competitive. Across the board there will be a lower price being paid to processors and therefore a lower price available to flow through to producers. So I think that is disingenuous in the first instance.

I am getting an indication from processors that this is having an impact across the whole value of their milk and that that will come back to farm gate prices. So I think it is going to continue—the greater the proportion of the market that is sold in home brand milk the more that will come to back to farm gate prices in the liquid milk states of Western Australia, Queensland and, perhaps particularly, northern parts of New South Wales. That is the way it is. That is where their market is.

Senator COLBECK—You have indicated that those areas are liquid milk regions. What other possible markets might there be in the circumstance that that particular market is not available to you any further?

Ms Marino—I think the other question possibly is: given that their margins will be seriously reduced as a result of this market war, will they have the capacity to invest in markets and innovation? I think that is a question that we should actually be answering because the reduced margins that they will be suffering as well will impact on those types of decisions quite strongly I suspect. Whether you would be able to achieve a return on investment post that period on innovation and alternative marketing is another matter.

Senator COLBECK—Regardless of whether there is another market or not, effectively this has the potential to limit the capacity to move into that market?

Ms Marino—Absolutely.

Senator COLBECK—What sort of cycle in a production sense is there in moving from one market to another? We know that the drinking milk supply cycle is to provide a flat supply across the year and that involves calving at different times and providing feed supplements to cows. There is a greater cost to doing that.

Ms Marino—There is a greater cost to producing milk 365 days of the year.

Senator COLBECK—What sort of time cycle is there to prepare to move into a different supply market?

Ms Marino—It would depend on what the market was. Given that it takes three years for you to calve a cow—by the time you have the heifer mated and it actually produces milk, you have got a three-year turnaround—that is the sort of time frame. You are not in a position to react overnight. I think that is the issue for this dairy industry. As I said, even if you were to buy into a property and if you were able to buy an established herd with good genetics capable of producing the fat and protein that you need, that may be a shorter term answer but I would question how many are actually taking that option, particularly at the moment.

Senator COLBECK—So it is potentially a three- to four-year cycle. You had a conversation with Senator Ryan about the Trade Practices Act and features under the Trade Practices Act. Can you give me a sense of your experience in relation to collective bargaining in Western Australia? I think Senator Xenophon has also asked some questions about that previously.

Ms Marino—Going back several years I was chair and deputy chair of Dairy WA. We did put in an application to operate as a collective bargaining agency for milk negotiating. The ACCC refused that application. Collective bargaining does need to be strengthened and I think it would be useful to actually evaluate whether something in the nature of a small group of suppliers are able to achieve the same prices as one major other competitor. I think the tensions within that would be worth the committee investigating as well, particularly in the perishable market.

Senator XENOPHON—Following on from that, the ACCC is going to be giving evidence tomorrow in Sydney on this issue. Could you provide the details of that knock-back on the collective bargaining issue to the committee by tomorrow morning? It would be very useful.

Ms Marino—The response was that we had the capacity to substantially alter competitive forces in Western Australia. At that time I think we were at around 300-odd farmers. We are down to 165. We can see where that competitive force has gone I suspect. I think we have got to be very aware as well, when we are talking about food production capacity, of concentrating risk in geographical areas. If you look at the issue that has faced Victoria, it is an area where there are good opportunities for milk production but we have also seen significant drought followed by floods. I think, if we are talking about food production capacity and food security issues, we also have to look at the geographical risk issue.

Senator XENOPHON—I just want to follow up a couple more things in relation to that. Coles is basically saying that the processes can be more efficient—I am trying to summarise them—that it is ludicrous to say that the milk industry will be damaged or destroyed by this. They talk about dispelling the myths being spread by agripoliticians. Presumably you are one of the those agripoliticians.

Ms Marino—I suspect I am a culprit.

Senator XENOPHON—Not aggro politicians, agripoliticians.

CHAIR—There are both aggro and agri I think.

Senator XENOPHON—That is right—justifiably, Chair. However, Woolworths in their submission, which was provided last night—Coles have not done a submission; they have just sent a letter to the chair and I think a few others have not bothered to send in a submission yet—said that the lower prices:

… can be expected to flow back to processors and farmers as new supply and pricing agreements are negotiated over the coming months and years.

So they have broken ranks with Coles on this.

Ms Marino—They obviously acknowledge that these prices are unsustainable in their view.

Senator XENOPHON—There is another issue and a further set of questions that you have been asked, including by Senator Colbeck. Coles in their pricing campaign use the words from the old Status Quo song: ‘Down, down, prices are down’ and they keep prices down and they stay down. How close is the WA milk industry to a tipping point where you will have more significant job losses and people walking off the farm?

Ms Marino—That is going to depend as well on the prices that they are offered. It was a really telling thing for me when I was at a Lions auction at Cowaramup on Saturday. I met a dairy farmer who has been a very efficient dairy farmer, and he said to me: ‘Nola, this is it for us.’ When I am looking at 165 dairy farmers—and falling—I am getting those sorts of contacts from farmers on a regular basis. As I said to you previously, Senator, do I think it is going to happen tomorrow? No, it is not going to happen tomorrow. But I am getting frequent phone calls from people who are literally punch-drunk.

Senator XENOPHON—Finally, how far north is milk produced in WA?

Ms Marino—Probably up to about North Dandalup, closer to Perth. But the majority are in the south-west.

Senator XENOPHON—Can you explain to me how the hell you can get fresh milk shipped up to Kununurra and still be able to flog it off for a dollar a litre?

Ms Marino—Perhaps, Senator, that is a question you need to ask somebody else.

Senator XENOPHON—I know. But just in terms of the food supply chain and your knowledge. It would have to come from south—

Ms Marino—Someone is going to pay for that.

Senator XENOPHON—It would have to be below cost, though, on your knowledge of the dairy industry.

Ms Marino—I gave some figures earlier on and I refer you to those.

Senator McGAURAN—I just have a point on background knowledge. The number of farmers has dropped in the last decade from 419 to 170. You actually quote that 340 litres of milk have been produced. That is from the 170, isn’t it?

Ms Marino—Yes. I think we are below that now. The most recent milk figures are below that, but our milk production figures—

Senator McGAURAN—There is a chart.

Ms Marino—Have you got it?

Senator McGAURAN—That chart may answer the question.

Ms Marino—Dairy Australia has the most up-to-date figures. The thing that I was more concerned about, Senator, was the lack of scan data on the movements in the market.

Senator McGAURAN—I am just trying to gauge the efficiency of production and whether milk supply has been maintained or has increased under fewer farmers.

Ms Marino—That is the efficiency argument. But the other issue for those of us who live and work in regional areas is all about the number of small businesses that are affected every time one farmer leaves the industry and about their involvement in their regional communities—how they contribute to regional communities. They are actually part of the emergency services as well. Every time we lose a farmer we lose someone who works at a school, someone who helps out and carts kids around, someone who helps out with the state emergency services. I know it is not a pure economic argument, but it certainly is a very real and live issue in regional communities.

Senator McGAURAN—No, the cascading socioeconomic effects from the reduction of farmers, who are the base of any rural community, is a very pure economic argument.

Ms Marino—They are small business people, Senator. Those small businesses, like every small business, contribute to almost half of the economic activity of this nation in the employment sector and others. We underestimate the small business sector and their value to regional communities at our peril.

Senator McGAURAN—My point is that, knowing the metropolitan Australian, all they see is that there has been a reduction in wheat farmers but there is more wheat, more milk, more wool. They do not feel the pinch and the effect you are talking about out in the rural and regional areas and they do not know the value of the number of farmers. All they look at is the size of the production, you might say—the pure economic argument. But it is not so pure. Where I am leading with this is that we need numbers out in the rural and regional areas for socioeconomic reasons—the knock-on effect.

With respect—and to the previous witnesses too—you are hardly going to get that by toughening up the Trade Practices Act because I have seen it toughened up over and over again. There is collective bargaining there. You can tinker with that. There is predatory pricing. You can try and prove that. There are tax advantages for cooperatives. That is good. It is not enough to get the numbers up that you are talking about for that 19-year-old lady to stay on the land. You have to be more serious than that, I would think. To keep the farmers on the land, do we not have to revert to some form—not total—of protection at the farm gate floor price?

Ms Marino—The word ‘protection’ is a concern that I have. I would put it to you that our dairy farmers are the second most efficient but some of the lowest paid. We can compete if we are given a fair go. I have no question about a need for protection. If we are given a fair go, we are up with the best in the world, and all we are asking for in that supply chain is the fair go because we know that we produce milk at some of the lowest costs and the best quality. I defy anybody else in this world to produce a better milk and dairy product than we do in this nation. I am biased, but I will support that argument because, if we are looking at a consumer benefit, what is better than that?

Senator O’BRIEN—Would it be fair to say that, given the disproportionate power of the retail sector relative to the farming sector, one of the solutions to the problem is likely to be a greater empowerment of the farming sector? Therefore, should we be focusing most on the collective bargaining provisions under the Trade Practices Act?

Ms Marino—I think the solution will be a bit of a circle. There will need to be more than one potential way of managing this. Strengthening it will be important but it is not the only answer. It certainly does not deal with the impact of the marketplace for that particular group of growers. It is part of the answer, but they need to be able to negotiate in good faith and to be able to negotiate the types of outcomes that you would expect from that. If they negotiate, and yet they are still no better off, what has it achieved? I think that is the issue.

Senator O'BRIEN—It sounds like you are saying—and you may not mean it to sound this way—that the next step is really what Senator McGauran has been putting to witnesses, and that is basically you are going to have put the hand of regulation into the equation to ensure that the negotiation leads to an equitable outcome rather than letting market forces work with some adjustment of the power of the players in the market.

Ms Marino—To me, it is a multiheaded response and it is going to be a number of issues. I would refer you back to the previous report—the *Milking it for all it's worth* report.

Senator O'BRIEN—I was part of that.

Ms Marino—There were a number of very good measures within that report that I would encourage the committee to consider but that I would also encourage the minister to respond to.

Senator O'BRIEN—One of the provisions was strengthening of the collective bargaining provisions.

Ms Marino—Yes, that is one of them. I think that is an issue, but again the power of that particular small group to negotiate an outcome still reflects their position in the whole supply chain. That is another issue.

CHAIR—Thank you for appearing this morning. That was very useful evidence. Before we move to the next witness, there has been a request that the letter provided to the committee by Coles in lieu of a submission at this stage should be made public and available to journalists. Does the committee agree? We will have a private meeting at the lunch break.

[11.51 am]

MARKHAM, Mr Russell Paul, Chief Executive Officer, Foodland Supermarkets

REYNOLDS, Mr David Roy, Owner-Operator, Yentrac, trading as Goolwa Foodland

CHAIR—We welcome you this morning to this inquiry and invite you to make an opening statement, after which the senators will question you.

Mr Markham—Good morning, and thank you for the opportunity to appear. As a bit of background, I represent 41 unit holders of Foodland businesses for a total of 111 Foodland stores in South Australia. We compete in most of those outlets with either a Coles or a Woolworths. We are here today to voice our concern about the milk issue.

We believe there are four areas that ultimately will be affected by this strategy. The effect on the dairy industry is well known, and no doubt you have heard about that from a lot of witnesses today. A number that was quoted in our press recently was that there were 1,730 dairy farmers in 1980 in South Australia and now, in 2011, there are 306. The effect on small business and also on the independents is also another area. There is also the effect on family distributors and, obviously, the flow-on effect to the community.

Obviously we agree with a lot of the views that the long-term concern is that our dairy industry does not become unsustainable in our country. That is basically it for me. David is one of our retailers. He runs a store, and has done for 25 years, in the major dairy production area of South Australia, the Fleurieu Peninsula.

Mr Reynolds—As Russell said, I am a small operator in the southern part of South Australia. I have had direct contact with the national chains impacting on my business. In the beginning of 2004, a Woolworths store opened within 50 metres of our store. How they achieved that was probably a little bit underhanded, I suppose, and it really does concern me that the impact of the milk issue will be just another nail in the coffin of the independent retailer. We have been in the area of Goolwa for 25 years. We employ local people and their families, and have done for a couple of generations.

When I first went into business in the area, there were 10 independent supermarkets and one multinational. Now there are five local supermarkets and four multinationals. Our stores range in size from 200 square metres to 735 square metres. The Woolworths stores range in size from 2½ thousand square metres to 4,000 square metres, so their footprint has encroached on the independents, who do employ and support the local community.

As a small business, in the last 10 years we have put about $180,000 back into the community through donations and sponsorships and that is where we find that the chains do not. The Fleurieu Peninsula is one of South Australia’s largest dairy areas. I have spoken to the mayor of Alexandrina—he is a dairy farmer—and he is very concerned at the impact of what Coles is doing. Only just a few weeks ago we lost probably our second biggest dairy producer in the area.

They had 500 cattle, which have now been on-sold, and 1,000 acres are up for sale. That producer has gone, and that was a fourth generation dairy farm within our area.

I have spoken to our milk vendor. When Woolworths went direct with their milk deliveries, he lost 20 per cent of his volume of milk so he has had to get back on his feet. With this new price war with Coles and Woolworths—mainly Coles—he has lost 15 per cent of his business again in major centres where the snack shops are not buying from him but are going direct to Coles. That is a distribution problem that he has to sustain if this escalates. He believes that the milk vendors then are going to subsidise him because he has to supply orange juice. I believe that they are on to it and they are buying out daily juice distributors to compensate his loss.

We as a small independent carry the same skews as Woolworths do, in fact we are only three less than what the major chains do and their stores are four times the size of us. It is a real concern. I have experienced the chains pushing on us; they are in our store continuously watching prices. I believe milk is the start of it; eggs will be next. They are pushing teas; they are pushing toilet rolls. There are only so many products that we can sustain. Unfortunately, down the food chain—the dairy farmer, the distributor—everybody is suffering because of this. That is all I have to say.

CHAIR—What you are talking about there is competition. What is your view of the effectiveness of the ACCC on current competition law?

Mr Reynolds—I find that it is not putting enough pressure on the industry because we have only got the two major players. There need to be more players within the competition and there has to be some kind of protection for the independent retailer because the independent supermarket cannot sustain the price reductions that Woolworths and Coles are putting on us. I have seen it in our area, and I know it is happening around Australia, and it worries me that in 20 years time when my kids are old enough to go into the business—I already have one son in the business—our local jobs are all going to disappear. Our group has 111 stores. Some of those are full-on with Woolworths in major centres and they will survive, but there are a lot of stores down there in our group with less than 1,000 square metres and they are really struggling.

CHAIR—It is really all about market share, isn't it? In the United States they do limit market share. Do you think that would be something that we should consider in Australia to facilitate competition?

Mr Reynolds—I would love to see that. There has to be a balance of green sites going to the independents and also distance between stores. The Woolworths store got the green site that we were chasing and had spent several years trying to achieve. We got into a bidding war and, of course, we could not afford it. We had done our sums and told the landlord what we could afford, what we wanted to do, and Woolworths just outbid us. In the end we are situated in the same footprint that we had when we started the business 25 years ago.

CHAIR—A moment ago you spoke about the prospects for your son going into the business in 20 years time. What do you see in 20 years time? Do you see any small independent supermarket operators or is it all going to be two national chains and maybe even one national chain?

Mr Reynolds—I think there will be a few people hanging on, of course, but I definitely think that the opportunities will be limited. I have an older son, who is my butcher, who is in the business now. My next child is going through year 12 now, he can see how hard we work, and I think he will steer away because you are flogging a bit of a dead horse at the moment. In the last six years we have had little to no growth at all. Our expenses are going up but we have had no turnover growth at all.

CHAIR—Have the buying power and negotiating strength of Coles and Woolworths had an adverse impact on any of your arrangements with suppliers?

Mr Markham—Clearly, they have, with nearly 80 per cent share of the market. Fortunately, in South Australia, the independents have a higher share of the market, so we are probably in a better position than perhaps some of our interstate colleagues, because we can bargain collectively as the Foodland group. We check promotions every week. Sometimes we cannot promote certain products because we make too much of a loss. A lot of the products we promote now are at a loss anyway, so it is about minimising the loss. We have a lot of issues where pricing is going. It is great for the consumer, but what is the long-term effect on the market and will it eventually mean that there will only be two players? Then there will not be a choice and then they will have free rein to charge whatever—and that is our fear.

CHAIR—Do you consider that Coles and Woolworths are making up the cost of their price cuts elsewhere? Do you have any evidence of significant price adjustments of other goods in their stores?

Mr Markham—I have. I am aware that fuel can be offset against grocery prices. I have an ex-employee of Coles who told me that the mix would change, so I do not believe there is any doubt that that occurs. The independent retailer does not have that ability. He buys off a wholesaler. We do not have the distribution margin to play with and we do not have other businesses to offset losses in profit against.

Senator XENOPHON—I have a follow-up question to Senator Eggleston's question. As I understand it, Coles and Woolworths have told the markets that their supermarket margins are going to be maintained if not increased and their margins will not be reduced despite this deep price discounting. Do you have any evidence other than fuel that some of the other goods have been ratcheted up to make up for the price war on milk?

Mr Markham—It is anecdotal evidence and I have nothing to put before you today but market intelligence tells us that, yes, there is a ramping up in probably what you would call C-grade products, which are the ones that people probably do not check on price too much. We believe there would be some balancing out. Mind you, that is the way we run our businesses ourselves. You have to have a mix to get your bottom line. The more that we are forced into major specials and under-costs and matching milk and so forth the more we have to look elsewhere to offset that because, David was quite right, our costs are increasing all the time.

Senator XENOPHON—You are seeing the low costs at the moment, are you not? You sell your own home brand at $1.

Mr Reynolds—No, we do not sell our home brand at $1. We try not to bastardise our brand product, Foodland milk, which has stayed competitive. We have introduced another brand of milk to our stores to compete at $1 a litre. In our store, we have not gone one litre, two litres, three litres at $1 a litre, we have just maintained two litres at $2. We have that alongside our Foodland brand milk which, for the integrity of the dairy farmers, we have left at a competitive margin, we have not reduced our margin on that. On the new brand that we have brought in we are actually losing money.

Mr Markham—I will add to that. We are in a market where if we do not compete basically the chains will get market share. We have had to compete where possible and most of our retailers would have done that. Some would have competed on the Foodland brand. That is their prerogative; we do not give them a clear instruction. Some have done what David has done and used another brand, so they have the offer there. Some may have used the Foodland brand. Some in other areas may not have competed at all.

Senator XENOPHON—Have you lost market share?

Mr Markham—There are early signs that it is just starting to dip. Until prior to Christmas we had not. The latest data says there is starting to be a dip, but the major thing that our figures are telling us is that the branded product share is declining quite rapidly. That is a concern. I have notes on that to say that that affects the distributors, it affects the sponsorships and it affects a lot of other areas. The mix of branded milk does add to the industry and I believe it also does give the farmers that supply the branded milk a better farm gate price.

Senator XENOPHON—Thank you.

Senator O'BRIEN—If Foodland stores could buy their unbranded milk, if I can call it that, at the same price that Coles and Woolworths could buy it, would you have the same complaint?

Mr Markham—I am not aware of what Coles and Woolworths buy their milk for; obviously, that it is commercial-in-confidence. But from an operating point of view, as Dave mentioned, the margins on milk have now gone west. To operate a business now our stores are up for 12 per cent just to pay the wages. You have other operating costs and so forth, so certain products become unsustainable at low margins.

Senator —I am not sure what you answer to my question is. Does it make a difference whether you can buy it at the same price or not?

Mr Markham—It certainly helps us compete, there is no doubt about that. We would like to be able to compete on an equal footing with the buying power of Coles and Woolworths, but clearly that is not possible given the network that we are in.

Senator O'BRIEN—Is it because you have a wholesaler who sells to you that you cannot get it at the same price or is it because the manufacturer sells at a discounted price to Coles and Woolworths because of their buying power? I am not sure what you are saying.

Mr Reynolds—Coles and Woolworths buy direct from the manufacturer and we buy from a distributor. That is why for us there are extra people in the chain and the distributor is now struggling as well. I do not know what Coles and Woolworths are paying for their milk, but at the end of the day I would say that they have lost margin as well. At $1 a litre I would be very surprised if they are making any money, the same as us. The difference is the loss of margin comes straight out of my pocket whereas the loss of margin for Coles and Woolworths, even though it is coming out of the share market, the chains have $2 million or $3 million, even $30 million, to spend nationally. Once the independents slowly disappear then the chains can put their margins up because there will be no independents left. They could spend that kind of money to get market share.

Senator O'BRIEN—I thought your evidence was that there would be a decline not a complete disappearance of the independents which sounds a reasonable proposition.

Mr Markham—I will give you an example. Many of our businesses will survive because of our offer. We have smaller businesses. David's business is probably in the middle; it is a regional middle sized store. We have a number of stores in the metropolitan area that are smaller than David's. Nearly half our stores are in country areas. So we have a real mix of businesses.

My point on the sustainability question is that we have been hit on one product after the other. Long term the retailer will decide whether he can better invest his money in the share market or somewhere else rather than get the low return he is getting. Clearly, in the last couple of years the return has diminished.

Senator HURLEY—What has happened to your market share in South Australia in, say, the last five years?

Mr Markham—We have been on the fortunate end—through acquisitions, we have actually gained market share. We have gained a lot of that directly from Coles, through the acquisition of stores. So we have been able to grow. We are probably at the stage now where we have peaked with those acquisitions, so we are like-for-like. These are stores that have been sold to us.

Senator O'BRIEN—But what is your market share in South Australia?

Mr Markham—The independent market share is reported at 28 per cent. With many suppliers we have a higher market share. With milk we have over 30 per cent market share. So, as I mentioned in my initial remarks, we are probably in a better position than a lot of other independents.

Senator O'BRIEN—Is the scale of the individual businesses critically important in this ability-to-compete scenario—that is, if you have a bigger store, brighter premises, more stock to choose from? Is that critically important to the viability of individual businesses?

Mr Markham—It is not so much the store. We do have a number of multistore owners. So, collectively, if they have a number of stores, that gives them a bit of extra pulling power in the market. But, in the case of milk, we have a one-price policy to all our retailers in the Foodland Group, so a small store can buy at the same price as a big store.

Senator COLBECK—Mr Reynolds, you mentioned in your evidence that a local vendor has lost something of the order of 15 per cent of their business since this campaign has been running.

Mr Reynolds—Not total business—15 per cent from large shopping centres.

Senator COLBECK—So how would you characterise that 15 per cent?

Mr Reynolds—White milk going into shopping centres as a total. So, if there is a Coles or Woolworths, a snack bar, a Wendy's—wherever he distributes milk into that shopping centre, such as a Westfields. His volume is down 15 per cent because the small businesses are actually going into Coles and Woolworths to buy their milk.

Senator Williams—

Mr Reynolds—Yes. And I think you mentioned, when the last witness was here, that Woolworths sell Coca Cola cheaper than I can buy it for.

Senator COLBECK—So it is in that defined market, where he has been delivering product? I think I understand what you are talking about.

Mr Reynolds—He has lost 15 per cent of that business.

Mr Markham—I can add to that. In relation to what they call the convenience sector, which is everything below supermarkets—so it is your delis, your snack bars, your convenience outlets—the information I have from our major supplier is that that sector was down 16 per cent in February as a direct result of what is happening with the milk discounting. So the small business area will be suffering due to that.

Senator COLBECK—I am just trying to build a picture of that particular sector, because it appears that there is a fair bit of harvesting out of the supply chain of business by this campaign. I am trying to get a picture of that across the board, because I have come across some other impacts of that in discussions on this issue myself. So you purchase your milk as a group and then on-sell to—

Mr Reynolds—No.

Senator COLBECK—Each individual supermarket has its own relationship with a vendor?

Mr Reynolds—Yes.

Mr Markham—But in the case of our own private label we do negotiate a price.

Senator COLBECK—That is what I was trying to get to. Your branded product comes through a vendor process but your generic product, your Foodland label, still comes through the vendor.

Mr Reynolds—It still comes through the vendor. The price is negotiated as head office.

Senator COLBECK—Okay. So it is collectively sought and there would be a delivery fee that would be paid to the vendor as part of that access process.

Mr Markham—That is built into the price.

Senator COLBECK—I just wanted to get a sense of how that broader process works.

Mr Markham—This is the difference in where we receive our product. In South Australia the suppliers of the milk deliver direct to the chain's warehouse. There are 90 distributors in South Australia. As part of that distribution network they deliver to our stores. They deliver branded milk products and the private label product to us.

Mr Reynolds—They do not deliver to Woolworths and Coles.

Senator COLBECK—I think that is starting to become a bit prevalent around the country where that part of the business has actually been taken out of the vendor network over the last couple of years anyway, from my understanding. I do not know whether that has been at the request of Coles or the processors, but we will try and get to that as part of this.

Mr Reynolds—They lost 20 per cent of the volume when Woolworths distributed directly.

Senator COLBECK—That is not an unfamiliar story to me. That has had an impact on devaluing individual vendor businesses. These guys that have effectively purchased a business and have lost a chunk of it for whatever the driver. I have not determined which way that is yet, whether it has been the processor or the supermarkets, who have asked for a different delivery process, which has taken a chunk of value out of all of those businesses that were doing the delivery to supermarkets. That is a slightly different element to this but it is also, I think, one of the by-products of this process because that is the one of the first places, as we are seeing now, that value will be taken out of the supply chain. It will come out of the vendor businesses. Across the board in South Australia it is 16 per cent and you are talking about 15 per cent for your vendor in that shopping centre market.

Mr Reynolds—It is quite a funny coincidence. I had a meeting with him and Russell had a meeting with the main people and our figures have only a one per cent difference.

Mr Markham—The other thing is the shift from brand product to private label. We have seen that in our business quite significantly.

Senator COLBECK—What would you indicate the proportion is there? I think the numbers that I have seen are in the order of 20 to 30 per cent.

Mr Markham—It is not quite that high in our business but not all our retailers have price comps, so I guess it is a bit difficult to tell. You probably need to look at an individual store. I know David's figures do bear out quite a shift. It is somewhere between five and eight per cent of a drop in branded sales. Dave, you are a bit higher than that because you are next to Woolworths?

Mr Reynolds—Yes, that is correct.

Senator HURLEY—I am from South Australia so I know the Foodland business reasonably well, and indeed I happily shop at Foodland Norwood. My understanding is that one of the reasons Foodland is doing so well is that they stock a different range of products from Coles and Woolworths. People will go to Foodland, for example, to buy Fleurieu brand milk, Paris Creek butter and that kind of thing. If I am going there to buy that, I pick up my milk. Fortunately for me it does not matter if I spend an extra five or 10 cents a litre to buy that milk. If we were to go down the track of regulating prices that people pay for milk and possibly eggs and whatever Coles want to discount next, is that a good way for the industry to go from your point of view? Are you happy to have that happening?

Mr Markham—I am not sure whether we support full regulation. Independent retailers can compete in the case of Foodland Norwood. But I think milk is a different proposition and maybe it should be considered for milk.

Senator HURLEY—What other goods would you do it with, then—bread, eggs, what else?

Mr Markham—We need to let these things draw out. The egg thing has only just started, so we are not sure what the effect of that is going to be. I know there are already producers starting to shout about where is the product going to come from and are the eggs truly farm laid or free range and so forth. Certainly milk; I am not sure about other products. Something should be considered because I do not think milk producers will be there in the same form as they are now in a few years time if this continues.

Senator HURLEY—It could sound like you are just asking that the competition as it stands be enshrined, that Coles and Woolworths not be allowed to discount but you can.

Mr Reynolds—I think, getting away from the milk situation where there are other people involved—there is a huge Australian industry involved here—as a small independent we find it hard to compete because we do not have the dollars in our back pocket—

Senator HURLEY—But that has always been the case.

Mr Reynolds—It has, but the unfortunate thing is that as slowly as the independent disappears, and over the 25 years I have been in business it has, all of a sudden there is going to be no-one to keep them honest. That is what really concerns me.

Senator XENOPHON—What is your view of the effectiveness of the ACCC and current competition laws, firstly, and, secondly, do you think it should be regarded as price discrimination to sell the same product at a different price? Even though we are dealing with milk but one happens to be branded and one is not, it is effectively the same product. Should that be treated as price discrimination?

Mr Markham—I do not believe the ACCC has really done too much in that regard. We certainly do not see anything that has changed through the ACCC. Can you repeat the second part of your question?

Senator XENOPHON—Is it price discrimination to be selling branded milk and generic milk, or the home brand milk, for different prices when in effect it is the same product?

Mr Markham—I think that is the case for most private labels and branded products anyway. Branded products carry a marketing component, a brand value, which has always put them at a higher price than a private label. So, no, I do not believe so.

CHAIR—That concludes our questioning. Thank you for appearing today; it has been very useful evidence.

Proceedings suspended from 12.24 pm to 1.32 pm

BASHAM, Mr David Keith Bernard, President, South Australian Dairyfarmers Association

LYONS, Mr Kenneth Gordon, Chief Executive Officer, South Australian Dairyfarmers Association

STACEY, Mr James Conrad, Vice President, South Australian Dairyfarmers Association

CHAIR—I welcome the representatives from the South Australian Dairyfarmers Association to the inquiry and invite you to make an opening statement.

Mr Basham—I would like to thank the senators for making the time available for us. The South Australian dairy industry is made up of a little over 300 dairy farms, producing about 610 million litres. Of that, just under 20 per cent is sold in supermarkets. Our major concern is the growing market power and the lack of transparency in the sale of drinking milk through the supermarkets. As farmers, we believe milk is being sold for less than it costs to put that milk on the shelves in supermarkets but feel that the current situation is not able to examine that to actually prove that because of the lack of transparency in the system.

I will go through some of the headings in our submission. We feel that there is a failure by government to act. There was a Senate inquiry last year that delivered some findings. During that time some issues were raised and we feel that some of those have not been acted upon. This current act by Coles has highlighted the case for action on these things. It is not just the dairy industry that we feel is going to be affected; the egg industry is also being affected in a very similar manner, as we have seen today. I think we do need to act and the government needs to look at some of the things around the Trade Practices Act and the powers of the ACCC.

The second heading in our submission is ‘Short term gain (for consumers) but a long term pain (for consumers)’. We feel that competition is more than just cheap pricing. We feel that competition in a way also should allow choice. In the way that the pricing is forcing the market to move it will deliver less choice for the consumer—on the variety of products and the location where you can purchase the products. If you walk into any convenience store at the moment you will see that the milk cabinets are half full, because they do not have the turnover. I guess our long-term concern is that, once the supermarkets have strong market share, the milk price might not be as low as it is either for the consumer.

We call on the ACCC to investigate the latest discounting by Coles as a matter of urgency. We feel that there is probably predatory pricing there. We feel that the ACCC needs to investigate the pricing practices of Coles, including the guarantee that has been made to dairy farmers that they will not be adversely affected. We do not believe that to be the case. It needs to ensure that predatory pricing is not being practised. We also need to make sure that there are sustainable returns to Australian farmers, processors and other members of the supply chain.

Without action by the government the image of the entire dairy food chain is being damaged. I think it is very important that we act quickly. In the last few weeks there has been quite a dramatic shift in where milk is being sold. Supermarkets have gained quite a large share. I mentioned before that the convenient stores have been largely affected. I read in the *Sydney Morning Herald* this morning that it is not just having that effect but also affecting the image of milk. The story said how milk will not be the same—you will not be able to get a coffee with a froth on it, permeates have been added, the milk is watered down et cetera. Those are the sorts of things that were reported in the paper today. Milk is a fantastic food product and we do not want to devalue that in any way.

Finally, I think the ball is in the court of the senators. You can help resolve this issue. There are some changes that need to be made to the Trade Practices Act and to the ACCC powers to allow them to investigate predatory pricing. We need to mandate some information on the supply chain pricing so that the ACCC can see whether there is predatory pricing occurring.

I do not see this as just a dairy issue. I think it is going to affect all rural products across time. And I do not think it will be isolated to milk within the dairy industry; I think cheese, butter, cream et cetera will get tied into this over time as well. I ask the senators to consider this action and the possibilities to change.

CHAIR—Thank you very much. Coles have said that they are fully absorbing the price cut and there is no justification for a reduction in farm gate prices from processors now or in the medium term. On the other hand, a number of submissions have claimed that eventually Coles will decide not to absorb the price cut and will pressure processors to accept lower prices. If Coles is able to influence prices in this way to pay less to processors, what do you see is the future? Haven’t they already done this?

Mr Basham—Yes, I guess. Crystal balling, I see that the future will be interesting. There are two very separate markets in the industry: the domestic industry and the export industry. The only thing that is going to protect farmers going forward from the processors being forced to drop the price—because I am sure Coles will not continue to absorb that past the short- to medium-term—I think will be a shift of farmers to supply the exporters. Currently the export market is on a bit of a rise, so they might be able to deliver better returns, which may actually cause a shortage on the domestic side of things. Who knows what that may do? It may put enough pressure on Coles to lift that price; but it may not, too, because they are using it effectively as a loss leader.

CHAIR—Who are the export purchasers?

Mr Basham—There are several companies that supply the export markets. The main ones are Fonterra, Murray Goldman and Warrnambool Cheese and Butter.

CHAIR—To Japan?

Mr Basham—They supply milk powder, cheese et cetera into different world markets.

CHAIR—We are told that Coles introduced this strategy on the advice of some people from Tesco, the UK supermarket chain, as a means of increasing their market share. I am told that in the UK some of the supermarkets have introduced dedicated supplier arrangements, such as the Tesco Sustainable Dairy Group. It is claimed that these farmers are paid a higher farm gate price, which is reviewed by a consultancy to account for changes to the costs of production, rather than relying on market forces. I wonder if you are familiar with that arrangement by Tesco, and if you think it might work in Australia? Are these sorts of arrangements, in your opinion, likely to be beneficial to dairy farmers overall? Or do they just crowd out other cooperatives and processors, eventually leading to less competition?

Mr Basham—I am certainly aware of them. I see them, to a certain degree, as a 'divide and conquer' type strategy by our supermarkets. There are extra costs that these contracts which they develop with the farmers cause. They have certain stipulations about what they want et cetera which add extra costs into the whole system. I am not even sure whether those extra costs are covered by the extra price they are paid. They have higher welfare standards and they have higher quality standards et cetera; but we have a wonderful system here in Australia of both welfare and quality. We do not need to have these extras because we are producing a very good food product.

CHAIR—Are there any rumours about Coles considering this kind of Tesco arrangement?

Mr Basham—I certainly have not heard anything, but that does not mean it is not out there.

Senator McGAURAN—Are you able to tell we non-dairy farmers what the barriers are to switching from the domestic milk market to export?

Mr Basham—Basically, just the contracts that farmers have signed. The common contracts are for 12 months, two years or three years—or thereabouts. There are some that go out to five years. The other issue is that some of the clauses in those contracts say, even when that contract term comes to an end—the normal term is that the contract will end on 30 June—that a farmer still cannot leave for another three months, even though they become uncontracted. James may like to comment; he supplies one of the companies that have one of those contracts.

Mr Stacey—There is one major barrier to going from a domestic supply arrangement to an export supply arrangement in Queensland, New South Wales and Western Australia: the processing capability is purely for the domestic white milk and flavoured milk market. There is no avenue to get your milk processed for the export market. So those farmers are only able to have people there that will buy milk for the fresh milk market.

In Western Australia the industry has shrunk to the point where an export manufacturer will not put a plant in to take the amount of milk that is supplied in that state. Those guys only have one option, and that is to supply the domestic market. If there is no money in that domestic market they will discontinue milking cows.

Senator McGAURAN—So the barrier is absolute outside Victoria?

Mr Stacey—Yes. Even in South Australia National Foods are reviewing the operation of their two factories along the River Murray due to reduced milk production. Potentially, in South Australia, I have the opportunity to supply an export processor but at the moment I am getting paid more to be a domestic milk supplier. If I go to export supplier the closest factory is about four hours away and the next closest factory is about six hours away from my farm. In view of the potential for carbon taxes and increased costs to transport and freight it is unrealistic to expect an exporter to pick up milk from me and take it to their factory.

Senator McGAURAN—Just to finish that, the barriers there need not make it any higher but, to put another brick on it, there is no capital expenditure such as change of herds, vats or something?

Mr Stacey—People who traditionally supply the export market calve in spring or autumn and produce a lot of their milk through the spring when there is a lot of feed available. Whereas people that supply the domestic market have to supply milk 365 days a year at a pretty flat production curve. We have to incur costs of conserving fodder and purchasing in grain and other things to maintain a flat milk supply to those companies.

Senator McGAURAN—That is pretty absolute.

Mr Stacey—Yes.

Senator O'BRIEN—What is the current farm gate price of milk in South Australia? I would be very happy if you could give me a number of companies.

Mr Basham—It varies over the period of 12 months. For example Warrnambool Cheese and Butter, the company that I supply, have a lower price during the spring and a higher price during autumn. The ballpark figure is that, during the spring, we are being paid about 30c a litre and during the autumn it is going to be around 40c to 45c a litre.

Senator O'BRIEN—Because it costs you more?

Mr Basham—Yes, and they are trying to keep their curve flatter.

Senator O'BRIEN—Yes. They want a lot of milk in one season and very little in another.

Mr Basham—They do not want milk in the spring and during autumn there is a lot of capacity.

Senator O'BRIEN—To keep farmers supplying they pay a significant amount more.

Mr Basham—Yes, that is right, to try and flatten the curve out a little bit they do that.

Senator O'BRIEN—What about other processors?

Mr Stacey—I supply National Foods with a domestic milk supply. I am probably about two or three cents a litre ahead on that price for both periods. I get a lower price in the first half and a higher price in the second half of the year purely based on trying to have a flatter production curve.

Senator O'BRIEN—Assuming whoever collecting your milk is supplying to supermarkets, you are suggesting that they will have no choice but to offer less for your milk.

Mr Stacey—That is the only option they would have. Coles does not buy all the fresh milk and sell it all. The guarantee they are making is not truthful. They are making a statement which they cannot prove. They have not even put in a submission to this inquiry to try and back their statement, which I think is extremely rude of Coles to do that.

Senator O'BRIEN—Do not worry, we will explore that with them. In terms of where the price is in South Australia, what is the relationship between that price and the international price for milk product?

Mr Stacey—It is very close.

Mr Basham—They are closely linked. The international price is certainly very important, particularly when the international price is rising. That brings the other price along with it. Depending on the timing of when contracts are signed, et cetera, the price can also fall fairly quickly.

Senator O'BRIEN—As we have seen recently. Are dairy farmers happy with that relationship and how that works for their businesses?

Mr Basham—No, not really, because they see that the domestic market has those extra costs that James was talking about from needing a much flatter supply than the export market. So there are a lot of other costs involved in trying to actually supply that market. They do need higher returns than you get on the export market.

Senator O'BRIEN—Is there much collective bargaining between farmers and processors in South Australia?

Mr Basham—There are a couple of collective bargaining groups in South Australia. I was involved with one that started operating about five years ago and actually attracted one of the export players into the region around Adelaide. Prior to that, there were only domestic markets and those two companies were not competing very well and the price was actually lower than the export price. We were able to convince the other player. They did not pay us any more than they were paying Victorian suppliers, but that was more than we were being paid at the same time.

Senator O'BRIEN—Are the collective bargaining provisions of the act too restrictive, about right or not restrictive enough?

Mr Basham—Probably still a bit restrictive. They do not really give us enough power to actually influence. As I said, all we were able to do was get a third player to come to the region because we had a large enough quantity to make it attractive enough to them. We were not actually able to get any money out of the other companies at the time. Interestingly, once we had agreed to get the third player in, they all came back to the table offering us more money but we decided that the third player was more important than short-term money.

Senator O'BRIEN—I understand that. Of course, the question we would like you to answer is: if you are not satisfied with the provisions of the act now in relation to collective bargaining, what changes ought to be made to level out the playing field?

Mr Basham—It is a very hard one to actually try and get that balance right so the farmer is able to have some power. The farmers have costs on a daily basis that we need to cover. We cannot just decide that we do not like that price and walk away and go somewhere else because we need to go somewhere else tomorrow. That is the difficulty. Milk is a very fragile product, so we cannot actually store it for any period of time.

Senator O'BRIEN—It depends on how the market is. If there are a number of processors seeking more milk then your choices are good. If, as farmers in my state experienced early last year, there is more milk than there is demand, your choices are limited.

Mr Stacey—I have never been involved in a collective bargaining group and I get paid more than guys who are involved in a collective bargaining group. Things work differently for different people. Really, unless the dairy industry can collectively bargain as one unit, it may be beneficial to tinker around the edges but I do not think this is the solution to the problem we have got at the moment.

Senator O'BRIEN—What is the solution?

Mr Stacey—This morning I listened to the people from Norco speak and you senators asked them what the margins were for the processors selling it to the retailers. The Senate inquiry asked the ACCC to find those figures out by last September. That has not happened. If you had done your job, we would not be asking the same questions again. So we need the ACCC to have the ability and the powers so they can investigate things as they are asked for by the senators. There is obviously a lack of political will by both Liberal and Labor to follow through with recommendations from the Senate and actually get the ACCC to do what you have asked it to do. I do not know if it is a lack of capability of the ACCC and they need their powers improved or if it is a lack of political will to do it.

Mr Lyons—The absolute centrepiece to our submission today is that the dairy industry is not happy. It is very, very unhappy with the state of the domestic grocery market in this country. We are very unhappy with the power the duopoly has got and with that power continuing to grow.

In this inquiry, you will hear more and more about large supermarkets squeezing out competition. This organisation, representing the South Australian dairy industry, is coming to this inquiry with a major request: that you strengthen the Trade Practices Act provisions and, if necessary, ensure that the ACCC has all the powers that it needs. Number one, you need to get off the ACCC off its hands and into action. Someone else said this morning that we can finetune things; that we can do a few things. We are not going to solve everything here today for the dairy industry; we will not solve everything by toughening up these acts. All we want is a domestic grocery market that is competitive and free. We do not want re-regulation.

The key to it is that we understand globalisation and the fact that the supermarkets will continue to have home brand milk. We understand that discounting is something that supermarkets do. But we cannot understand why the Australian government continues after numerous Senate inquiries to do nothing about having a fair, healthy and competitive domestic market in this country. We understand the power of the supermarkets in lobbying. I go to Canberra all the time. I can walk into the Department of the Prime Minister and Cabinet and they will tell me who has more power, the supermarkets or the National Farmers Federation. Everybody knows.

All we are saying here is that this is the moment in time. We have Independents in power. We have the supermarkets, apart from Coles, coming out and saying that this is unsustainable. Senator Eggleston said, ‘What about discounting?’ Coles have said that it is not going to be passed back to you. That beggars belief. Every other submission from every other supermarket, National Foods and every other insider is telling you that it will not happen. Over $700 million year is going to be wiped off the income of this dairy industry. Half of the milk currently goes into the domestic market. Senator O’Brien, when you asked David, ‘Are dairy farmers happy?’ the answer is that we are very unhappy.

Senator O’BRIEN—I do not think that I quite put a question like that, but it is very clever of you to put it back to me that way. The purpose of us asking you questions is to tease out your views. I am thankful that you have given us that view and not hedged around the matter. They are the specifics that we are seeking. If you have something specific in any particular form of words, such as a change to the provision of the act, or some generality about a provision of the act and how it should be changed, this committee would gratefully receive it.

Mr Lyons—In terms of the extra powers for the ACCC, the best people to answer that question are the ACCC. I understand that the ACCC will be with you tomorrow. Once they are on the job and have the political flag to say, ‘Get on and do the job,’ they will soon come back and tell you, if they are fair dinkum, what they need to find the answers. Let us go to the specifics. I have sat here this morning and heard a number of people talk about predatory pricing. I have no idea whether Coles are using predatory pricing. But I tell you what: I have felt very uncomfortable over the last few weeks listening to people talking about and being suspicious about it. I want somebody to go out there and find out whether it is true. That is what I want.

Senator O’BRIEN—There are provisions in the act that we have thought meant things that the court have decided meant something else. It is not simply a case of us determining how the act will be interpreted, because there is a separation of powers in this country and how the parliament might have thought the act was constructed may not be how the courts interpret it.

Mr Lyons—I am not a lawyer. There are lawyers here today. But I do know this: there are a number of legal firms around the country working for various farm organisations pondering academically this sort of question about the powers here and there. The simplest way of doing it is to get on and do the job. Then you will work out what you need and what you have not got. That is my view.

Senator O’BRIEN—We will see what the ACCC says. Thank you.

Senator COLBECK—A lot of the stuff that I wanted to talk about has been covered. Thanks for your evidence. It has been not only forthright but very valuable. From a South Australian perspective, what elements of the dairy food chain are at most risk and at what stage of this process? A lot of this is predicated on the fact that this price becomes a sustained price. Coles have told us that it is down and staying down, so that is the assumption that we have to make. Where are the pressure points in that supply chain?

Mr Basham—There are several, and they will be triggered at different points. As mentioned before, the convenience store is one that is being hit immediately. That is probably the first point.

In the same timeframe, the vendors—the people delivering milk to those convenience stores—will come under pressure. The supermarkets have their own network of supply, so they do not use the vendor system. Those vendors lose a lot of business when milk is shifted away from a convenience store into the supermarkets. My longer view is that there are going to be some fairly severe effects in some of the regional centres around our country. Those vendors, if they have not got large volumes of milk to move, are not going to be able to justify taking milk to a smaller country town. So there may not be the ability for those country towns to have fresh milk. They might end up having just UHT milk and it would be very disappointing for that choice to be removed from those people.

The other one is us as dairy farmers. Promises are being made that it is not going to affect our price in the short term, but James made the point that they do not control the whole market. There has been a shift away from home brand products, which had meant higher margins. The processors are going to have that squeeze put on them with the shift from the brand products to the home brand products. There is going to be a squeeze there, and that is going to be passed back to the farmers. I certainly see that coming pretty strongly and pretty soon—probably in July, when those contracts are renewed.

Senator COLBECK—So the current cycle of contracts is coming up for renewal July this year?

Mr Basham—There is a large proportion of contracts up for renewal in July.

Senator COLBECK—You have indicated some of the impacts, with the impacts initially on the convenience stores—and we have already heard some evidence about that—followed by the vendor network. And we have heard some evidence about that, too. So you see those as the impacts to date?

Mr Basham—Those are probably the major ones. There have been a few others just through farmers making decisions for the future that maybe this is not an industry that they want to be in. A couple of people have decided to leave the industry, with this being the final straw.

Senator COLBECK—So you would say that there are already impacts being felt at farm gate, effectively, through people making a decision as to whether there is a future or not in the industry—

Mr Basham—That is right.

Senator COLBECK—based on what is happening at the moment.

Mr Basham—Yes. There are people out there making decisions. They look at what has been happening. They have been through drought and this is the final straw. They have decided that they are not going to put up with this and that they are out.

Senator COLBECK—So the claim that it is not impacting or will not impact on farmers does not really stack up in that context.

Mr Basham—Not at all.

Mr Lyons—That is one of the reasons that we want a result. The reality is that if you look at the retailers, the processors and the farmers, there are great success stories at all of those levels. They are all being innovative. They are all meeting the challenges of the new market. We could sit here and build up the dairy chain and be very positive about it. We think that there is a fundamental problem here that we are all trying to work around. It is going on and on. The sooner that it gets resolved the better. The problem is the lack of competition with these supermarkets. We want to get on and get this thing solved and get back into a positive frame of mind so that the three sectors can work constructively to make profit for themselves and the country.

I want to take this opportunity to say that in the press there is a feeling that the dairy industry is being a bit negative, that it wants re-regulation, that it cannot hack the pace of competition and that it is not forward looking. The dairy industry is none of those things; none of that is true. We are very capable of surviving, growing and being quite a successful area. We just want a fair playing field. That is all we are asking for.

To answer your question, we want to be positive. We want our young people to come on. There are wonderful opportunities, particular in the export market, for us as a dairy industry to grow and expand, as per our seafood and fishing industries. If this domestic market is going to so poorly pay us, we probably will not want to participate in it. That is the truth of the matter.

Senator COLBECK—You indicated earlier in your evidence that the product is being sold for less than it costs to put on the supermarket shelf. Do you have any direct costings on that that you can provide to the committee?

Mr Basham—No. That is the big issue: we cannot get good data on that, because of the supply chain not being willing to make that available. They are bound by confidentially agreements with the supermarkets about what they are selling the milk for. It is not within the reach of farmers to get hold of that information. That is what is making it so difficult for us. We do not know whether this is occurring. But we know what we get paid for milk, and we do not think that there is enough money left in the price for it to be putting on those shelves for anything but less than cost.

Senator COLBECK—So when Coles write to us and tell us that there is a lack of transparency between the processors and the dairy farmers, the reality is that the lack of transparency exists between the processors and supermarkets, not between—

Mr Basham—Definitely. We know the amount that we get paid. But we do not know the amount that they are being paid.

Senator XENOPHON—In terms of increasing efficiencies, the evidence that we heard from Foodland earlier was there were 730 dairy companies in South Australia before deregulation and there are 306 now.

Mr Basham—About that.

Senator XENOPHON—How much more efficient is the industry compared to 10 years ago?

Mr Basham—Dramatically. Interestingly, over that time cow numbers have barely changed. Basically, the same number of cows are being milked in South Australia as they were back then. The number of farmers has halved, so we each milk double the number of cows. Milk production per cow has continued to rise also, so there have been quite substantial efficiency gains.

Senator XENOPHON—So how much scope is there for additional efficiency?

Mr Basham—It is getting towards the top end. The ability for people to upgrade is less now. A lot of people have put large rotary dairies in et cetera. They get to a point where they start to become less efficient once you go over a certain number. People are reaching the limits of their investment on farm. It would require quite a significant further investment, and the industry is certainly not in the position of wanting to make that sort of investment.

Senator XENOPHON—Some questions will need to be put on notice. One of the issues here has been about the long-term viability of the industry. One of the issues has been that the home brand milks—the Coles and Woolworths brands—have increased from 25 per cent 10 years ago to much higher. What is it now, Mr Stacey?

Mr Stacey—Ten years ago, it was 25 per cent. About 12 months ago, they had about 50 per cent of the market.

Senator XENOPHON—And that has gone up further now.

Mr Stacey—The latest figures from Dairy Australia—and there was some information given previously that getting accurate data at the moment is difficult—is that they are heading for about 75 per cent.

Senator XENOPHON—Bear with me. So there has been a dramatic increase in terms of the home brand milk. Mr Lyons, I think that you were the former deputy head of AWB—you were in the good AWB.

Mr Lyons—I was. I left in 1986. I left when Max Moore-Wilton left. So it was well before the bad stuff. It would not have happened, I hope, had I been there.

Senator XENOPHON—It would not have happened if you were there. You were 2IC, weren't you?

Mr Lyons—That is right.

Senator XENOPHON—Have we reached a point of no return in the sense that now that 50, 60 or 70 per cent of the market is home brand market? Your survival depends on the branded milk. Now that consumers are used to home brand milk, have we reached a point of no return in terms of market share? In other words, will we ever get back that branded milk margin back?

Mr Basham—I certainly have that fear. In particular, the longer the discounting goes on the more people are going to be happy staying there. I hope there might me some who would drift back if the price returned, but I am sure there would be some who would stay there.

Senator XENOPHON—Do you have a view on that Mr Lyons?

Mr Lyons—I do. You mentioned the term ‘efficiency’, and I agree with what David has said. I think the dairy industry is quite an efficient industry and it keeps improving. I think the key to it is that the Australian situation is that we are not a low-cost country. Labour costs and a lot of costs here are high. This means that a lot of these industries, including the dairy industry, must go to value adding. Value adding is the answer. The tuna people went to value adding. The tuna people used to put 90 per cent of their tuna into cans for the supermarkets. Do they do that anymore? No. Australian tuna is not put into cans for supermarkets. Indonesian and Korean tuna is put into cans for Australia’s consumers in our supermarkets.

So I think one of the answers is that the dairy industry will get stronger, will get better, if it learns how to innovate, to value add and to export dairy product to countries that have the capacity to pay. I think David is right that globalisation is here. Supermarkets will import low-cost produce, including dairy produce, from other countries if it is in their economic interest.

Senator XENOPHON—Finally—and I will put some of these questions on notice—what will happen to fresh milk then?

Mr Lyons—It could disappear. I think that is unlikely, because enough Australians will want to have it and will be prepared to pay a price that will allow us to service that market.

Senator XENOPHON—But at the moment the market share between fresh milk and UHT milk is about 90/10—is that right?

Mr Lyons—It is. Australians are very used to fresh milk. Over time, it will be a gradual change. It will be a bit like cooking a lobster. If the supermarkets keep running down this track of cheap, cheap, cheap, cheap forever, Australian consumers could conceivably end up getting used to New Zealand UHT milk.

CHAIR—We have run out of time, so I thank you for appearing.

[2.14 pm]

GRIFFITH, Mr Gregory, Executive Officer, Dairy Farmers Milk Cooperative

ZANDSTRA, Mr Ian, Chairman, Dairy Farmers Milk Cooperative

CHAIR—Welcome. I invite you to make an opening statement.

Mr Zandstra—Thank you. We are the cooperative part now of the previous Dairy Farmers, which was a processing business and a cooperative which sold to National Foods about 2½ years ago. We represented 780 farms, from North Queensland, right through Queensland, New South Wales, through the Riverina to northern Victoria and into South Australia. We supply about one billion litres of milk and, in aggregate, we are probably the largest supplier—single supplier, you might say—of milk into domestic consumer businesses.

I have been involved in the dairy industry since my wife and I entered the industry with a ‘no start’—we started off with nothing—in 1982. I am a deadset dairy farmer; I was brought up by a share-farming migrant. I did have other opportunities in life but I always wanted to be a dairy farmer. I have got a university education, but my heart and my passion lie with dairying. I first got on cooperatives’ boards, small ones, in about 1984. I was on the Dairy Farmers processing board. That was a fairly major business, at one time the biggest dairy business in Australia in terms of value in 1998. I feel through that I have got a very good insight into the whole commerciality of the dairy game—being a farmer, of course; being on a processor board, in the marketing and processing side of the industry; and also now being chairman of a milk cooperative, with 780 farms supplying a lot of milk.

In my introductory statements I do not want to focus so much—though I am sure you will ask me these questions—on the numbers and the effect of channel shift and category shift and so on. I want to focus on the fact that what we are seeing here now is absolute market failure. We are seeing what we might have thought, two months or so ago, was a fairly reasonable domestic market in drinking milk. It still had its competitive landscape, and perhaps tensions, but the value seemed to be fairly shared to the different stakeholders in the industry.

Since then we have seen absolute market failure, with one large retailer abusing their market power, and from different degrees. One is their very strong buying point, being a national buyer of large scale and able to extract a very keen and competitive price—and even that process has the processors somewhat beholden to them. But, further to that, I believe they are selling it at cost and even loss leading and, through that, have destroyed value in the dairy category but, equally, are destroying the economic position of small Australian businesses. It is hard enough on the big processors but we have to think of the distributors, vendors, convenience stores, small corner stores and farmers and, with that, the damaging of consumer choice. That is probably enough for my opening statement. I think most of the other things are in our submission.

CHAIR—Thank you very much, Mr Zandstra. I am intrigued about where names with Zs come from. I can think of Poland or maybe somewhere in the Baltic states.

Mr Zandstra—No, but people do surmise that. I am a Dutchman.

CHAIR—Okay. Zuiderzee!

Mr Zandstra—Yes, that is right.

CHAIR—I am very interested in the role of the ACCC and the Trade Practices Act, now the Competition and Consumer Act. I wonder what you feel about the effectiveness of the ACCC in ensuring competition in the dairy industry and whether they should be more involved or less involved or more effectively using the legislation which they have at their disposal.

Mr Zandstra—I think the issue is the ACCC's ability to manage the excessive market power of the two large retailers. There is a fair bit of history to that and we all complain about the 70 to 80 per cent market share in grocery, but that has been ongoing for some time and I think if there was to be any curtailment of that it is probably too late. For ourselves, we feel that the ACCC should take a look at this. Through my background knowledge of processing I have got no doubt—and these are generic terms, of course—they are abusing their market power. This behaviour of Coles is meant to do harm. There is absolutely no doubt about that. They are buying very strongly, they are selling at cost, they are loss leading in regions, they are damaging milk value on the shelf and to a degree they are damaging the milk value of their partners, the processors who supply them and rely on branded milk to extract an average price from the market. So I think that is where the issue is. They are abusing their market power. There is predatory pricing, loss leading. They are all terms that came up in the Tasmanian inquiry. We can say we are not sure about those things, but I think the ACCC should look into that.

Equally, I have an inkling that Coles, in saying that there has been six months of preparation for this, have been to the ACCC and explained, you might say, this business model. It is a surmise of mine that they have had it ticked off, because they must have seriously and with due governance themselves considered all the concerns we have raised. So I think they have—

Senator XENOPHON—Is that a surmise or do you have information to that effect?

Mr Zandstra—I would not know that. I am just sensing that Coles are so confident about this that I believe they think they are working within the lines. On a general national basis they might be, but in the regions I think they are selling loss-leading milk. It is alright saying that it is all okay in the big cities where they have big volumes and big economies and are close to factories, although I think there is a serious question mark over that as well.

CHAIR—That is a very fascinating answer. We will be seeing the ACCC tomorrow in Sydney and we might just ask them about that.

Mr Zandstra—I think they have to be asked, because Samuels has come out and said, 'Look it is more than just the retailers in this—it is the processors and the farmers as well.' There are issues about whether the politicians have been spoken to as well. I know Coles are a big machine, a big business. We were rather astounded that Minister Ludwig came out very early touting the Coles line, saying, 'This will not affect farm gate pricing.' He had not, from what I understand, talked to any farmers about it. Minister Burke said he thought farm gate prices should go up. I have to ask myself: who has been spruiking in their ear? That is not an objective view of what the real outcome will be, as you have seen from many submissions.

CHAIR—That is an interesting dimension, too, which I think we should explore tomorrow with the ACCC.

Senator COLBECK—Coles have indicated to us that the global dairy commodity market sets the price of milk, not supermarket behaviour. Could you give us your perspective on what influence that does have? What additional elements are there to dairy pricing for supply into the drinking milk market?

Mr Zandstra—There is some rationale behind the Coles position, but there is more spin. I am digressing a bit here. I feel Coles have tried to cover the early concerns they would have anticipated from farmers with absolute spin and weave. This is one example of their spin—that they do not set the milk price. Clearly a lot of Australian milk is in the south and a lot of it is exported or commodity ingredient. The price for that is set by those players. With our southern milk, we base it on that to a degree, but we cannot base it simply on the commodity price.

Our farmers are aligned to supply milk to the drinking milk market every day. We have contracts with very strong alignment to National Foods—we call it ‘aligned to the shelf’. So it is pretty well flat line supply. It is committed, contracted supply. Obviously it is supply that has to go through the seasons—if they get tough or costs go up, there is still a strong commitment to supply. There is, perhaps, a premium above the average commodity price because we have found that, with dairy farmers, if we do not offer a premium then, as soon as the commodity goes through a strong period—there is pricing volatility—our farmers just leave. That is a great risk. This is the alignment to Coles or the alignment to the shelf—the alignment to drinking milk. Even in the south, our farmers have a price that is set by what the processor has to pay to supply the milk to the retailer. That is only in the south. In other areas, prices are clearly set by the need for milk in those localities and that is somewhat reflected by the cost of producing milk in those localities. To get the milk to the shelf, the processor has to pay the farmer to have the milk in that locality.

Senator COLBECK—My understanding is that you have been relatively proactive in this process and that you have had meetings with Coles. Is it correct that one of the Coles executives greeted you by saying, ‘Not another whingeing dairy farmer’?

Mr Zandstra—It was not in a meeting. I have had two meetings with Coles executives. I called John Durkan early in the piece, perhaps on the Friday—so three days after the turn of events. I got a call back from a Robert Hadler. He said, ‘I’m Robert Hadler.’ I said, ‘How are you, Robert?’ ‘Good, but gee I’ve been busy,’ he said. I said, ‘What with?’ He said, ‘We have just released our quarterly results’—I think it was. I said, ‘How did it go?’ He said: ‘Pretty good, but more is to come. We’ve got to improve on that.’ I said, ‘I don’t think you will improve if are losing money in a major category like milk.’ He said, ‘What are you, an investor?’ I said, ‘No, I’m a farmer.’ He said, ‘A farmer, a whinging dairy farmer—not another whinging farmer.’

Mr Griffith—Robert Hadler, corporate affairs.

Mr Zandstra—I do not know if I am allowed to name names here!

CHAIR—Everything you say here is covered by parliamentary privilege.

Mr Zandstra—Good.

Senator RYAN—Chair, can I raise point of order?

CHAIR—Yes, sure.

Senator RYAN—I just want to clarify for the record: I assume the committee will be contacting Mr Hadler, given his name has been mentioned and that he will have a right of reply. I am not alleging anything about what has been said, but someone's name has been mentioned.

Mr Zandstra—I would like to hear the right of reply when it comes forward.

CHAIR—That is a matter for the committee, but I do think it is a very good idea.

Mr Zandstra—I have been a bit low key about this, but it did happen. I told him what my grievance was, well and truly. He knows all about agriculture. He told me what experience he had had in agribusiness and so on. I left it at that. But it worried me. If Coles had been preparing for this for six months and knowing that there would be farmer angst, and knowing from their experiences in England that they really were thrashing up the supply chain—these are all UK supply chain guys—I believe Coles have not got a pro farmer culture. They need farmers and they need their produce. But we have seen this from them right across agriculture: they have talked baloney about eggs and they have tried it with beef.

Senator WILLIAMS—Pigs.

Mr Zandstra—Pigs—everything. To me this reflects that they know they are trying to get traffic through their front door. They are hitting these prime foods and they will do what they can, even sell them at cost, and they know there will be a farmer response. This is not England. They have come out with a lot of English spiel. Early on in the peace, as you know, they said, 'We don't set prices. It won't affect farm gate prices.' Later on, they said, 'It might affect contracts or something.' They prepared their spiel. For me it has been a pleasure to hear this baloney because with this harsh market behaviour they are carrying on with—and I have seen it elsewhere with businesses—it shows that they have had to bring in the spin doctors, who do not understand the commerce of things but are getting paid to be part of it and that they are doing their best to cover over the seriousness that this is having on the rest of the supply chain. With Coles this has been ongoing, quite frankly. It is the spin team, but I cannot say it is spinning out of control. Coles are still rather chuffed with how they have survived all this. They are calling it 'hysteria' and things like that. To me it reflects a real cultural problem.

Senator COLBECK—Have you met with the ACCC?

Mr Zandstra—We have met with the ACCC.

Senator COLBECK—What was the reaction?

Mr Zandstra—We met with the ACCC in the very early days. I think we had a really good meeting with them. I think they appreciate meeting with those at the grassroots level of the game. We were given about three points that were an outline of the parameters within which they can work. Clearly, their issue is evidence. I think they have been through all this before, though I would not say they gave us that impression, with the grocery inquiry et cetera. If we are to say that this sort of behaviour is predatory pricing, the key for them is evidence. We had a good hearing with them. It was good to have gone there.

Senator COLBECK—Are you aware of any impacts at farm gate to date? We did have some evidence this morning from other witnesses. Are you aware of anything outside of that?

Mr Zandstra—With our farmers we are contracted through until the end of June. We have already seen 10 to 15 per cent milk price drops through to National Foods in the last year. We are commercial guys. Who wants to stand in front of farmers and say, 'I have come out of the meeting and, guys, you have a milk price drop'? But we do understand the economic and commercial climate and most of it has been through the difficulty of the business that National Foods is in.

I saw it in Dairy Farmers. I saw it going downhill. It is pretty tough out there. For Coles to suggest that there is plenty of money in the milk game and that these processors and now these multinationals—they have pulled that diversion in—are making more than Coles is just another decoy. It is pretty tough out there in the drinking milk game. I saw it with Dairy Farmers. As I might have mentioned, our peak profit was 1998-99 and we never had anything like it for the next 10 years. Once deregulation came along and the shelf price went down, it all turned around in dairy. It is a tough game.

Senator COLBECK—What sort of percentage return on investment would you say was an average? Can you give a sense of what sorts of returns on investment were going through when you were involved in the dairy processing sector before National Foods took over?

Mr Zandstra—I was with Dairy Farmers and we were a cooperative. Generally the drinking milk business was not making any money because of its large percentage of private label, except in New South Wales because of the scale of the business—stronger brands, better economies. But when we came to the other areas, clearly one thing with drinking milk or any process, of course, is the scale economies. It is pretty tough but generally there was no money in it. My understanding now is that in most regions there is not a lot of money in drinking milk.

National Foods are a separate entity to us. We are in dispute with them, we negotiate with them. I can only refer to my Dairy Farmers history and knowledge. It is a damn tough game. I think Dairy Farmers, the cooperative's, days were numbered because it could never raise the capital to get the critical mass to reset the economies and the scale and all this sort of stuff.

I know nothing about the Fonterra business, but Fonterra made a few attempts to enter the dairy game and now they are saying, 'We're out of here,' in Western Australia. I firmly believe the comments of National Foods, not those of Coles. Things have to improve for them. But this is not a high EBIT margin game to be in at the moment.

Senator COLBECK—So when Coles tell us that the multinational dairy companies are making profits and they will be trying to draw savings out of those profits, or those margins, you do not believe that they exist to the extent that Coles are claiming are available for passing on to the consumer?

Mr Zandstra—No. I think this is another Coles diversion. I do not know how many days you are going to give me here! This is part of Richard Goyder paying too much for Coles, tailgating the private equity 'rip-off and run' merchants at the peak of the financial boom. It is his business what he paid. It was very expensive and he is trying to get some money back. That is normal corporate behaviour. They have effectively brought the private equity team in that were going to do the private equity job—and I think we all know what that does. He has brought them in to make this business make some money. They are going to use any excuse to extract value, and one of them is: 'Everyone else is making more money than we are.' They probably are, the price they paid. But I do not think National Foods is making a lot of money in dairy at the moment, and this will squeeze them further.

Another little example is that when Dairy Farmers was about a $1.2 billion business, with a lot of products and a lot of milk in a lot of places, Parmalat was half the size and made equal if not more profit, and the simple reasoning was that they were not in private label milk. They were not in the game. That is the effect of being in this game. Of course there is a lot of milk for the processors. They have got a lot of milk and farmers in localities. They need throughput. They bid for this. Part of it is the processor fault. But it is just the exposure of the market to these two big players, and one of them now is abusing that game.

Senator COLBECK—You characterised the squeeze on margin, particularly in that part of the market, and you indicated processor 'fault', if you like, at that level. Processors went into this market when the proportion of home brand milk was much smaller. They have costed it at marginal prize. They have been stuck with those pricing regimes and differentials through ongoing contracts just so that they can keep them, and the proportion of the home brand product versus the branded product has grown to the extent where it is equal to or outstripping them. Is that what is dragging margin out of the industry?

Mr Zandstra—Obviously for many years private label was absolutely loss making. I was on the Dairy Farmers board when it first started to occur. It was not done on the margin line; it was done at the request of retailers wanting some consumer shop choice. We are not against that. The more there the more buy, you might say. The shelf is about choice. Nobody can control the retail price of this product and, as we can see now with Coles, that absolutely happened 10 years ago. It was a pretty keen and loss-making wholesale price. The sales just boomed. Nobody expected the retail price point to be dropped that much compared to brand. I know when Dairy Farmers got the contract we just kept losing and losing money because much more was sold than was ever anticipated in the contract. But you had to meet the contract.

Senator COLBECK—So it was like a merry-go-round that became a monster and nobody could actually afford to get off it, get off it or find a way off it.

Mr Zandstra—Absolutely—you are on there with it. And then you have the farmers. They are contracted or cooperative. You need market. You have the factories. You just cannot get off it. I will give Andrew Reeves his due. He did say this year: 'We can't stay in this game at these prices.' I do believe Coles and I do think I know there was an increase in price probably to move it away from the margin line and to at least meet costs—cost recovery. But now of course if more milk sells at just cost recovery—

Senator COLBECK—It becomes self-perpetuating—

Mr Zandstra—It is the same thing at a better level. At least you are not losing money. But the whole value is being eroded. It is a pretty tough game.

Senator COLBECK—But, by the same token, if you are losing more of your branded business to that side of the business it actually has the same effect. You are not recovering as much of your marginal cost or your profit on this side, so it has the effect of making it a loss-making product again because you are losing value at the value end of the market.

Mr Zandstra—As I have said, this policy has been going to do harm. I do not know if it is short-termism or what, but these guys have been hired to reset the Coles spend. We do not want to be pawns in that. It is tough enough being pawns in the commercial game. Farmers do not have much power, but clearly we see we are pawns in the big financial game here. This has been done to do harm to their partners on the shelf, to the brands on the shelf, to the small brands who, to no degree, can offer a price that is anywhere near a dollar. Then all the competitive value on the shelf changes. You get category shift and you get channel shift into the retailers. Clearly they want that; they love the thought of that. It is not England, where at least the supermarket is not too far away. It will do a lot to consumer choice of milk and the offerings of dairy foods in different localities because milk might not drive the vendor's truck anymore. It is clearly meant to do harm.

Of course Coles said they are there to catch the convenience shopper. Now they are saying, 'That really wasn't what it was all about. We've got convenience stores too.' But most certainly they have dragged milk from other consumer buying places into the big supermarkets.

Senator HURLEY—I am interested in your conversation with the ACCC, Mr Zandstra, and I am inclined to agree with you about the relative market power of the big supermarkets at this stage. It might be possible to peg it back a little but not a lot. I think you are correct to ask how else we can address this. After your conversation with the ACCC did your opinion firm up about the direction that should be taken?

Mr Zandstra—No. We said to the ACCC that we would welcome an ACCC inquiry, and make a submission to an ACCC inquiry, and felt they should bloody well do one. Clearly, they should. I do not know by what process the ACCC is triggered into action. You politicians have to decide that. But we need an ACCC inquiry here, without any doubt.

Senator HURLEY—Did the ACCC say to you that in any way they were hamstrung in their regulations or ability to do such an inquiry?

Mr Zandstra—I think they went through some of that. I will try to recall. They explained the different regulatory avenues they had. The bigger issue was that we have to have evidence—that is the hard part. They did not suggest to any degree that they were ready to jump out of their seats and kick away an inquiry. Other industry personnel have approached the ACCC and perhaps have not got much confidence that it is ready for an inquiry. So I do not know who starts this process going.

Senator HURLEY—Several people have mentioned that. We have the ACCC as a witness so we can ask about that.

Senator RYAN—Mr Zandstra, let us move away from the ACCC issue. The committee are seeing them tomorrow. It has been covered already and there are issues that you have raised there, and I take your point. We do not always know what the ACCC is doing and when. It is an independent agency and in some ways that is for good reason because it is free to make these determinations free of us. I wanted to talk about your suggestion that you recommend the government require Coles, Woolworths, Aldi and Franklins chains to publish the contract terms and wholesale prices of their private label milk contracts with the processors in each state. I am not sure but is that required in any other sector that you are aware of?

Mr Zandstra—No, honestly I cannot say.

Senator RYAN—I was not sure whether you were drawing upon another idea for it.

Mr Zandstra—No. The issue here is that everyone is wondering: what really is the wholesale price? This revolves around Coles still selling this at a pretty tidy margin. We can imagine from the previous Tasmanian inquiry on the percentage margin that they said they had, and the amount of drop that they have had, and also the increase in the wholesale price, but I do not know where that line of margin is. I have looked at the National Foods presentation and they are saying about 54 per cent of the wholesale price is the cost of milk. I think they have let us in the door there because no-one wants to talk about these things, but I know from the Dairy Farmers Milk Cooperative that the average milk price is probably about 54c or 55c. We are looking at a dollar offer price.

Senator RYAN—My concern is obviously, as far as I know, that we do not require that in other parts of the economy. Government regulating or requiring publication of private contracts concerns me as a principle. The ACCC has quite extensive powers and I understand if it launched a formal investigation it would have the power to consider those issues and access those sorts of numbers. Are you saying that you think private contracts need to be publicly published regularly, and if so, why should it be applied here when we do not investigate private contracts in other parts of the retail food space, for example?

Mr Zandstra—This is going to be a long answer but let me say that the reason this is happening in milk is that it is exposed to this sort of hold-up situation. It is a staple; it is sold every day; it is produced every day; there is a cold chain there—National Foods and others, say.

Milk can easily be used for marketing reasons rather than value reasons and that is the issue here. We like to know what the value point is on the shelf, because it has clearly been used for marketing reasons here now. It is to generate traffic down to the back of the store and all these sorts of things and to get convenience trade. Pretty well, Coles have said they have forfeited their margin or are carrying the cost of this. Well what is that? Are they still there at margin? We can hardly say it is loss leading if we do find they are making some money on this—I clearly believe it is loss leading in certain areas. So we really have to know this relative to milk.

In reading through the Tasmanian inquiry, nobody really wants to open up about this retailer behaviour. There is intimidation here, without a doubt. When there were questions about loss leading, everyone skirted around it and said 'No, it doesn't happen.' 'Order betting?—no, that doesn't happen'. 'Third line forcing?—no, we wouldn't do that, us guys.' Nobody is game to talk about it. So let us see what is happening here because milk is exposed, it always has been, to this sort of behaviour. That is why there are more cooperatives in milk than in anything else. The farmer is in hold-up. He has to send it every day. He has a lot of lead time. He cannot say, 'I'll put it in the silo.' The processors now, at their scale in hold-up, have to get it through so let us get the cost lines right and see what the behaviour is. I believe there is unconscionable behaviour here too because—

Senator RYAN—If I could interrupt, Mr Zandstra—you have made a number of points about unconscionable behaviour, loss leading and predatory pricing. I do not think they are for politicians to judge. We set up the ACCC to look at this. If there is an issue around the ACCC using the powers it has—that is why I carved that out at the start of my question and we are speaking to them tomorrow—that is entirely reasonable to raise, given the amount of angst about this. What I am concerned about is the fact that we are not the place to judge whether the assertions you have made are happening. The courts are for that. The last thing you want is politicians making those judgments.

Mr Zandstra—Well, do we? It was the politicians who decided that the industry should have been deregulated 10 years ago.

Senator RYAN—With all—

Mr Zandstra—No, let me finish.

Senator O'BRIEN—That is not quite true.

Mr Zandstra—Righto, we will have a little bit of a fight. But let me finish. It is perhaps not quite true, okay. But it did happen. The economic premise was that we would move into a fair competitive market. That is the whole idea of having any market—that it is fair and competitive. Today we have market failure. We have an absolute failure of the market. It cannot be denied. I will go further and tell you what the next line of behaviour might be. It is going to hurt a lot of people if this value degradation shifts through the supply chain. At the end of the day, we are all in this together. We need a consumer, we need the seller, we need a processor, we need a distributor. We need everybody. The consumer needs milk. Quite honestly, I cannot do without my processor and I cannot do without my vendor and my distributor—we are in hold-up. If the value is squeezed, we are the ones to be squeezed at the end of the day. No one wants to say we are price takers. I do not want to say this, having been involved all this time in the industry and being chairman of a group of farmers. It is a tough thing to say. We have a collective bargaining group and we have other things. This process of market failure can have the effect of hurting a lot of people. Is that what deregulation was meant to do? I am not blaming the politicians, but the politicians have to look themselves in the eye and say, 'This could have to be addressed', ACCC or otherwise.

Senator RYAN—If I could respond, firstly. The previous regulatory system rested on some pretty unconstitutional foundations, which were that farmers were not selling milk interstate. No one in Australia can prohibit that, and not politicians even if we wanted to. It is a founding part of our constitution. Regulation, I would put to you, dissolved because there were many interests that said, ‘Hey, we are not going to keep behaving this way.’ There is no legal way for us to go back to that world. It was unconstitutional in the first place.

My next point is that as well as politicians not judging this—and this is what the ACCC and courts are for—I have a different perspective on deregulation to you because the status quo is not that we have regulation but that we let people produce and sell freely. Other than the publication of the contract terms and conditions and other than the ACCC being geared up to look at this, and I do not have an issue with the latter, are you proposing any other legislative solution to address this issue that is for parliament to consider?

Mr Zandstra—First, I am not a re-regulationist. I was a deregulator as a farmer and for farm efficiencies and those sorts of things. I am suggesting that the overall commercial benefits of deregulation have been badly bruised by this current behaviour. I do not think we can go back. I want a normal operating market where the cost of producing milk on farms sustains the milk pool and the farm pool and then the value lines go through to the shelf. That has been damaged by Coles. That is how I see it. I am not a re-regulator, but this is not a normal market.

Senator RYAN—Sorry, I did not mean to suggest that. I was trying to put it in a regulation context.

Mr Zandstra—I know that. We were bantering about whether we should or should not and what happened.

Senator RYAN—I accept that the farm gate price fluctuates; in Victoria particularly it fluctuates based on the export price given where our volumes go. If Coles kept up its dollar-a-litre retail offer or however it is framed—and we have not seen flow-through yet in most of the evidence that has come before us because contracts have not expired—and the price remains the same, do you still have an issue with that? It seems to me the issue here is a fear that it will flow through to the farm gate. I am asking a hypothetical question because, if the price stays where it is today and the price cut at the retail level does not flow through to the farm gate, do you still have an issue with what Coles, Woolworths and Aldi are doing?

Mr Zandstra—From a farmer’s point of view you could say things would be stable, but there is so much value damage that you have to ask: could there ever be an increase in farm gate pricing? We have come down 10 or 15 per cent from two or three years ago. Those prices were driven by shortages of milk, drought and high farm gate costs due to oil, fertiliser and other such things. Clearly there was a driver to increase milk prices. If the whole value chain is damaged like this, I wonder if there will be room, despite what Coles says about the ups and downs of it all, for farm gate pricing to secure reasonable milk volumes. That is my perspective. The margin between retailer and farmer is going to have a squeeze because of the channel shift, category shift and other such things.

Senator RYAN—I have one last question, and I have asked this of previous witnesses. Is dairy farming as it is at the moment sustainable in all parts of Australia where it is being undertaken or are we still going through the post-deregulation phase, which was a very difficult transition? Have we completed that difficult transition phase? If you do not feel in a position to answer that, I am happy, but I am asking a number of witnesses that question.

Mr Zandstra—There is a transition that will always go on in dairy farming—that is, the generational issue. We saw a major drop-off in farm numbers after deregulation because things were pretty tough. That is 10 years ago and those farmers who stayed are 10 years older now. The cost of entering dairy farming is so high. Forget about the cost of land; it is just the cost of capital, cows and all those things. That is at risk. Can the industry restructure around that? I think in North Queensland we are really seeing some problems with older farmers and very strong concerns about milk pricing. The major concern in South-East Queensland and maybe even New South Wales is the swinging of the retailer contracts: if National Foods does not have them or loses them, it does not need the milk from those farmers. There are those sorts of transitional pressures.

I think the bigger issue is the cost of producing milk. I know at deregulation we were doing our numbers on our farm. I am pretty mean and lean by heritage and we were producing milk at about 22c a litre. That was operating costs, and I think the farm gate price got down to 29c. There was a fair bit of debt and they were tough times. My sharefarmer now is a good operator and he is producing more milk on a bigger farm, and the operating costs are 44c a litre. So costs have doubled in 10 years. The economies of scale do not come home in dairying very easily. Every step is a major capital cost. Why do you take these steps? To stay in the game. You need scale in your business or the economies do not come home at all. There is virtually no decrease in labour per cow as you increase numbers—it is about 100 cows per person. There are also capital costs, with the complexity of farming.

The farmers who are on the ground are keen, and they love farming, but they are going to have to work hard to stay in the game. When that generational shift is on, it is a real problem. I think you asked the previous witnesses whether there are any more of these productivity or efficiency steps to be had. I think even DA research shows productivity improvements in dairying are slowing down. There is really nowhere to go. I think we took some major steps with deregulation—the farmers who stayed in the game reset their businesses. There are some major challenges here, especially in some regions.

Senator XENOPHON—Would you support an explicit anti-price discrimination clause? Further to that, would you regard it as price discrimination to sell effectively the same product but a branded product compared to a home brand product, and do you think there ought not to be price discrimination in terms of that?

Mr Zandstra—Can you explain that, Senator?

Senator XENOPHON—Is it price discrimination and should it be unlawful to discriminate against something that is home brand compared to branded, and there is a very different price between the two? There is one line of argument saying it is unfair; there is another line saying that is what you pay for when you buy a brand. Do you see that as a potential mechanism for some fairness in the marketplace?

Mr Zandstra—We want to attract the consumer, and we know the consumer needs choice. Some of this choice is on price points. Brands have decreased but they are still good for processing businesses and good for retailers. The branded sector used to provide the most margin for both processor and retailer, but it has shrunk to buggery. I think the big issue here now is the discrimination of the price points between these two products. One is on the shelf at a 33 per cent discount to its previous price. I think we were living with, and I hope the processor was, the effect of offering choice to consumers and the varying percentage buys. The point now is that that has been destroyed. The real issue is, should an entity like this be allowed to sell for these pure marketing reasons at a price which sacrifices its category margin? Businesses do not do that. I think we are all dreading the day when the next lot of contracts have to be offered to provide margin—

Senator XENOPHON—And Woolworths has acknowledged this.

Mr Zandstra—Absolutely. This is what happened in England—it was down, down, down. The second point I would like to make is this. Coles are saying now it is not permanent, and I had to get my dictionary out to see what the differences was between ‘down, down’, ‘staying down’ and ‘permanently down’. What if they do lift the price later to extract margin, to get margin back in this massive category? The dairy shelf is probably the biggest category in grocery. They are really using milk in this game. If they do seek margin again, then I think it is unconscionable that they have the milk and the money, having done a lot of damage to others. Let us not forget the consumers here, as well.

Senator XENOPHON—This is my final question, because I think we are out of time.

CHAIR—We are out of time.

Senator XENOPHON—I will ask very quickly. You may want to take this on notice. I asked this question of SA dairy farmers: have we reached a point of no return in the sense that the market share of home brand has increased from 25 to 50 per cent since this latest price war? Is it the case that, even if there is a clawing back of this, consumers will not go back to branded milk, which is where the margins have been for dairy farmers?

Mr Zandstra—I think you would have to ask National Foods and other processors. Their brands are vital. Brands are where innovation and development for consumer choice comes into play. I am worried about what you say. I think it is 65 per cent. There are fears it will be 75 or 80 per cent. Clearly, private label has to have a reset of price in the wholesale prices world. I do not know what the shelf price should be—it should be higher. What is milk really worth? It is a staple, valuable, nutritious, daily needs product. All this has gone wrong completely. Clearly there has to be a decent shelf price, which is the retailer’s call, and obviously a higher wholesale price to the processor. We the farmers might not get much out of that but we will know the average value of milk to the processor is perhaps where it should be for good business. Currently that has all been wound down because more milk is being sold at cost.

Senator O’BRIEN—Mr Zandstra, I was on the Senate inquiry that considered the proposition from the dairy industry that the industry be deregulated. My recollection is that it had its genesis in United Dairyfarmers of Victoria proposing to shift milk into New South Wales and to beat the price regulation model in New South Wales, which led to a proposal from the dairy industry to the government of the day and therefore to the parliament that there be a model struck for deregulation, including the 11c a litre levy to fund restructure or exit. At that time, the committee noted that one of the potential problems would be an attempt by the retail sector to capture the margin. So we are going back a decade, but that is what the Senate committee thought at the time when deregulation was proposed by industry people and ultimately embraced by the federal government, the federal parliament and then the state parliaments.

So that it is the history rotation and where we are now. A solution to that capture—and I am pleased to hear you are not a re-regulationist—would seem to me to be to somehow balance the equation. I have asked a number of questions about the collective bargaining provisions and empowering dairy farmers, who I would concede are in a different position from other farmers because they have a very immobile capital investment and a product which is absolutely perishable and therefore, as you say, not able to be put in a silo or easily converted to a storable commodity on their part. Is that the way that we should go? Should we better empower the dairy farmers to stick up for themselves in the environment that has been created?

Mr Zandstra—We have good collective bargaining groups and good people in the different groups.

Senator O'BRIEN—Although some have been knocked back by the ACCC.

Mr Zandstra—I am not aware of that, but they are around, aren't they? We have ACCC authorisation to bargain with National Foods for back-to-back pricing and special arrangements for milk value and terms. It is good that farmers have structures to present their case in a unified way, but you cannot get what is not there. Farmers are still very commercial people. We have a good relationship with National Foods. We have our issues. We are in mediation now. We see difficulties with both price and volume of off-take going forward, but we have to sit around the commercial table and make commercial terms. But we cannot get what is not there.

Equally, I think our prime argument would be that we must at least get a price that is viable to sustain farmers on farms for the milk that the market needs. We would like more and more and more and more, but what do you get with that? You get more and more and more milk. There is a pure commercial balance here. Clearly, nobody can make too much out of milk, because it is a consumer staple. If it was that dear we would send more. There are some very strong economic lines in milk. It is at risk of being damaged by this process. I think farmers are doing a good job now. There are not many cooperatives around anymore. They are doing a good job for their cause, with good information. I think we need more transparency of this wholesale price. To me it is pure economics, and the pure economic bucket has been tipped out.

Senator O'BRIEN—It seems to me that if, on one hand, you have a big player who says, 'We're going to buy milk and we're not happy to pay any more than we're paying now'—which is the Tesco model; I am not saying that that is exactly what is going to happen—and, on the other hand, costs are going up, there is the irresistible force and the immovable object. It sounds like the farmers are going to be the movable object in the equation. How do we balance that? If there is no balancing it, then that is your answer.

Mr Zandstra—This is an economic committee, and we all know about duopolies, monopolies and perfect competition. At the bottom of this we have perfect competition—many farmers responding commercially to the price and costs, many small sellers in corner stores and convenience stores and many vendors. Then we get to the two big ones: two duopolies in processing. And then we get to the two big ones at the top, which are virtually acting as one. If we think about economics and the balance of the economic power or pure economic correct reasoning, there is an absolute imbalance here. The perfect competitors are getting stood over by the duopolies and the other strong players.

CHAIR—Thank you very much, Mr Zandstra. We will have to leave it there.

Mr Zandstra—Thank you very much for the opportunity.

Proceedings suspended from 3.07 pm to 3.20 pm

[3.20 pm]

McINNES, Mr Ross, Vice-President, Queensland Dairyfarmers Organisation Ltd

PEAKE, Mr Robert Adrian Bowen, Executive Officer, Queensland Dairyfarmers Organisation Ltd

TESSMANN, Mr Brian Arnold, President, Queensland Dairyfarmers Organisation Ltd

CHAIR—I welcome the Queensland Dairyfarmers Organisation Ltd and invite you to make an opening statement.

Mr Tessmann—I would like to thank the committee for the opportunity to address you this afternoon. I hope that you have had the opportunity to read our submission that we made to this inquiry. We would like to lodge a supplementary submission later this month on the recommendations that we are still following up and getting advice on. We have had a few other disasters and issues in our state just lately which have increased the workload on us, so it would be good if we are able to lodge a supplementary submission.

On 25 January we were horrified when we received the news that Coles were going to implement a cutthroat discount milk pricing system. We were particularly aggrieved on the timing of it, following on from severe flood impacts in Queensland. We have also been really concerned that Coles have misled the industry, consumers and government with a number of public statements they have made.

In their press release on 26 January—Australia Day—Coles claimed that farm gate prices had increased over the last year, but it is indeed a fact that prices for farmers in Victoria and New South Wales have actually decreased by 10 per cent, and in Queensland they decreased by 15 per cent last year—including the milk that goes into Coles branded bottles.

Secondly, they have also claimed that the Coles discount prices would not affect farmers. The fact is that this week many farmers in Queensland will have already been notified that their cheque for this coming month will be significantly reduced, which is a direct result of the Coles discounting.

Coles have also claimed that farm gate prices are driven by the world market, but in states such as Queensland, where 95 per cent of the milk is consumed domestically, it has little to do with the world price. But it is affected by the contract negotiations between processors and retailers through the value chain, and by what is yielded from the marketplace.

This cutthroat discounting by Coles has already had an impact on the value of domestic milk and will affect the whole value chain, including the vendor, the small stores, distributors, processors and particularly the dairy farmers. The current situation is not sustainable, and it must change quickly or the whole viability of the industry in Queensland will be seriously undermined.

CHAIR—Thank you. Yes, we did know about your floods and cyclones, and I wondered how they did affect your industry?

Mr Tessmann—It has had quite a significant impact, particularly the floods. The cyclone has certainly affected the guys in North Queensland; probably not as seriously as Cyclone Larry, but it certainly created quite a number of issues for them—particularly loss of power and what flows on from that. The flood issue, though, in central and southern Queensland, has had quite a serious impact on the industry. I would estimate certainly over 90 and probably over 95 per cent of farmers have had some sort of impact from it; some very seriously with inundation, cows swept away and loss of crops—those sorts of issues—and there is loss of infrastructure with washed out laneways and roads. There is a really significant impact on those farms, and they will be left recovering from it for some time.

CHAIR—Is there anything in the contracts that provides for mitigation of milk supplies, or that you do not have to deliver if there is something like a natural disaster of the kind you have had? Are there penalties, for example?

Mr Tessmann—Certainly in some supply systems there are penalties. You have basically a requirement to supply a certain amount of milk and if you do not supply that in the month you have a penalty which is applied to you if you do not keep up that supply. That has been an issue through the floods when a lot of farmers, naturally, have not been able to keep up their supply. There has been a certain amount of understanding, though, from the processors to that issue.

CHAIR—But some people have been penalised?

Mr Tessmann—What we are told by the processor at this stage is that they are showing leniency to people on that issue for at least a short period of time. What I have heard is that it will possibly be no longer than the end of February, but that is what we are being told at this stage.

CHAIR—Who holds the contracts for the supply of private label milk for Coles and Woolworths in Queensland? Could you let us know?

Mr Tessmann—The Woolworths one, as far as I understand, is held by Parmalat and the Coles one is held by National Foods.

CHAIR—What about other grocery retailers such as IGAs?

Mr Tessmann—I think they are held by various others but between those two chiefly. Although Norco is also involved in some of them as well.

CHAIR—Do you think it is likely that the processors will cut the price of their branded milk in an attempt to maintain market share in Queensland?

Mr Tessmann—It is difficult to judge that but I think that is certainly a possibility. It is important for them to keep customers buying their brands.

Mr Peake—If I could add to that, Senator, in the last few weeks some of the processors have actually increased their expenditure in advertising. They are seeking to retain their market share of their proprietary branded sales. There has been some discounting as well. There is a combination of both currently.

CHAIR—There has been a submission that producers should be able to have tradeable and dual supply contracts and thereby trade their contracts between processors either in long- or short-term tranches in milk volumes. What do you think of that as a proposal?

Mr Peake—It is an important issue, particularly in Queensland at the moment where we have two major processors. It is one of the issues that we have identified in our Northern Dairy Industry strategic plan. When you have a major change in a retail contract for a supermarket store brand product it can have a major impact in the supply chain in moving a major volume of milk from one processor to another. The issue for us, which has just happened recently, was that Woolworths changed contracts with its processors and it created an issue in terms of how that milk volume then transitions at the farm base. That is an issue. It is certainly one of the key priorities in our Northern Dairy Industry strategic plan to try and work out better mechanisms for transitioning that milk without it ending up being a downward pressure on farm gate price.

CHAIR—That is very interesting. What about the role of the ACCC, for example? What might it have in approvals for contracts with dairy producers? Do you think there is any role for the ACCC there?

Mr Peake—It is an area that we would like to explore more. In terms of the current negotiation processes our value chain has a number of difficulties. At the farm sector the farm investment, which was mentioned previously, the asset is immovable. The farmers have actually got the highest level of investment, the highest level of risk and the lowest return in the value chain. Those producers at that level in the value chain need longer term security in their price formats or contracts. At the other end of the value chain the difficulty we have is that we have retailers negotiating with processors on shorter term arrangements. That creates a real imbalance in the value chain. That has created a number of difficulties. If there were a means by which the farm sector could provide input legally into negotiations between the top two tiers of the value chain and, if that were able to assist in transparency and improving the sustainability of the whole value chain, then we would welcome that opportunity.

CHAIR—Thank you.

Senator COLBECK—You mention a few times in your documentation the Down and staying down price promotion that is being run by Coles at the moment. That leads to an inference that this price is going to be sustained into the longer term. What does that effectively mean for the dairy industry in Queensland?

Mr Peake—The question that you have raised is at the core of the issue that we have right now in our industry. The announcement on Australia Day of this major discount has actually devalued drinking milk right across the nation. As you know the other retailers came out to match the price. One retailer actually went further and discounted milk to $2.89 for three litres, so about 96.4c a litre. It has actually devalued the drinking milk category. Further to that we have the issue that, since deregulation, milk is continually being used as a marketing agent by the major supermarkets.

Fresh drinking milk is used as a marketing agent in a number of ways. This latest discount strategy from Coles is about getting more customers away from its competitors and through the Coles store door. Milk is also used as a multiplier in terms of enticing consumers to purchase other products while they are in the store and it is also used as a store customer locator in terms of where they place milk in the store to maximise the potential of other purchases as people walk through the store. That is a major strategy from using milk as a marketing agent. The other problem we have is that at the same time, the retailers are actually using this massive discount to grow their own market share of their own supermarket brand. The supermarkets are no longer just retailers of product. They are actually owners of brands. There is a major issue in that as well which requires further investigation.

The difficulty we have as an industry is that—and the details are in our submission—if you go back to 2000, the differential between the two pools of milk, proprietary brands versus supermarket brands, was roughly 18c a litre. The differential across all sales through the supermarket was about $44 million. Ten years later at the end of last financial year, that difference has blown out by about 71c a litre or across the value chain about $414 million. That is a big chunk of money in terms of the domestic dairy industry value chain. That is money that is not going back into the value chain. This latest discount by Coles has actually pushed that differential out even further. That gives them an absolute price advantage in terms of growing their own brand market share and it puts greater pressure on the proprietary brands and that is going to put greater pressure back through the value chain on, obviously, the farm gate.

In states like Queensland where 95 per cent of our milk goes into the domestic market and we do not have other alternatives in terms of markets, we are left in a really difficult situation. The principal problem that we have right at the moment, and it has been an ongoing problem for the last decade, is that the retailers continually use milk as a marketing agent. Because of its unique nature—as a perishable, every day inelastic, high quality, nutritious, dietary staple of our community—the average consumer consumes 102.4 litres a year, so consumers are buying it two, three or four times a week. It is an absolute classic case of a product that they can use as a marketing agent. That is the real difficulty for us in our industry. Because retailers use it as a marketing agent it has devalued the product. If the actual retailers were to say, ‘Okay we want to use it as a marketing agent, but we’ll pay you the market value that’s being chewed up by the discount,’ then that would be okay because the industry would get that back through the industry value chain.

To explain it in another way it has been reported that Coles are spending $6-odd million on this current campaign but that is not the true cost. The true cost is the actual discount and how much that is going to take out of the dairy industry value chain. That is the true cost of the advertising that is going on but it is just that the retailers are not paying for it; it is the industry value chain that is going to end up paying for it. It might not be right now. As I said, they are taking it out of their internal margins but you cannot take hundreds of millions of dollars out of the dairy industry value chain and not have an impact. It just does not work; it does not add up.

Senator COLBECK—You indicated before that suppliers in Queensland will receive notification in the immediate future, if they have not already started to receive them, in relation to a reduction in their cheques next month because of transfer from branded product to generic product. Do you have a sense of what percentage of transfer there has been in that market, from the branded to the generic product, which then drives down that return to dairy farmers?

Mr Peake—I will start with the answer and then hand it to Brian, because he will be able to give you a farm example right here, right now. The issue we have at the moment with the way that Coles promoted the discount to Australian consumers, to government and to industry was that it was not going to have an impact on the farm gate price. The fact of the matter is that in Queensland we have more than 180 farms that supply one processor, and part of their payment is directly linked to that processor's proprietary brand sales. So, as Coles has implemented this cut-throat discount, those proprietary brand sales have fallen as Coles has increased its market share of sales. You all know that Wesfarmers stated that their sales had increased by 15 to 20 per cent of their Coles branded sales. That was two weeks ago. That has had a direct impact. What happens with those farmers is that, because their share of their milk cheque for proprietary brand sales has gone down, they are going to get a lower payment. So for Coles to promote that they are not impacting on farm gate prices is actually incorrect; there is a direct link and a direct impact—and it is happening right now.

Mr Tessmann—Parmalat farmers, who are not suppling milk to Coles in Queensland, are being impacted. With the PDA, Pauls Daily Access, system with Parmalat you get paid your tier 1 each month—your higher priced milk—as a percentage of what is basically your PDA quota. There are two figures that are important in calculating the payment: the actual sales figures and then what they have sold outside the area to bolster up another milk pool in Central Queensland. In February last year the initial figure of sales percentage was 84.23 per cent, which was then bolstered up to 88.8 with what they were selling just outside the region. In November it was 84.59. That is the bolstered-up figure; the original figure was 82.85. But when you come to February 2011 the initial figure is 77.9, so the amount that they get paid their better price for has come down significantly. The bolstered-up figure is 80.89. That shows already a significant drop off, even since September. Particularly when you compare month on month with a year ago—because months do vary, normally—that is a significant fall, down from the base figure in south-east Queensland of 84.23 to 77.94. To a dairy farmer that is a significant drop in his income for that month.

Mr Peake—I think what needs to be stressed as well, and what needs to be put into context, is that during this period Parmalat has spent an awful lot of money on marketing—linked to their flood donation program, but it has also been about promoting and trying to retain the market share of their branded products. So, even in that environment, where they have invested a lot of money in promotion, there has still been a significant reduction in those proprietary branded sales. We are actually looking to track that impact, and we will have better information later this month. Obviously, in relation to the figures for January in Queensland, that is not a good month to look at because of the impacts of flood. We had communities that were totally without milk. We actually had some protests at some retail centres that had no milk, which is a good sign of what happens when you do not have fresh milk in a community. But we are going to track those figures as we move forward this month.

Mr McInnes—This is really only the first stage. This is the direct impact, but once you take into account the processors' drop in profitability from this process, their ability to keep paying the price they have been will be affected. So it is really a two-stage process of downward pressure on prices to dairy farmers.

Senator COLBECK—I just want to go back to the question Senator Eggleston was asking in relation to the floods. For those who were directly affected, particularly by loss of power and things like that, which was fairly widespread in a lot of those south-eastern regions and perhaps up in the north too with some of the impacts of the cyclone, what are the longer term effects and how long are they going to take to play out, particularly animal health, mastitis and those sorts of things that do take some time to work their way through the system? What impact does a reduction in income through fluctuations in the market have on the industry's capacity to manage that?

Mr Peake—Since the disasters we have actually been collecting a lot of information from producers. Right at the worst of the floods we contacted all of our farmers by phone or whatever means we could to check on their welfare, what impacts were on-farm and what we needed to do emergency wise. More than 98 per cent of our industry is in natural disaster declared areas. So it has been a huge impact. Currently we have got 582 farms in Queensland and, to put that into perspective, that is actually a reduction since 2000 from 1,545.

Senator WILLIAMS—That was 1,545 down to 500?

Mr Peake—Yes, 582 at the current time.

Senator WILLIAMS—So you have lost two-thirds?

Mr Peake—Yes.

Senator WILLIAMS—What about total milk production?

Mr Peake—It was 848 million litres at 1999-2000. Last financial year it was 530 million litres. I will give you an update on the other bit of it in a minute. In terms of the impact on-farm from an economic point of view, milk production was lost and milk was dumped because a lot of farms were isolated by floodwaters and tankers could not pick up milk. We had a lot of lost production because of animal health issues, feed issues et cetera. There were also impacts on infrastructure on-farm. We have forecast for this year that the cost is going to be more than $100 million on our industry in terms of damage incurred and lost milk production. In terms of the impact on production, it is hard to model the recovery component or the end tail of the impact but we are expecting a loss of 50 million to 60 million litres of milk out our industry and possibly in excess of 60 farms.

Senator XENOPHON—Sixty farms going under?

Mr Peake—Yes. At the present time we have lost farms already and we have probably got, off the top of my head, about 14 farms in the process of exiting. The morale of our industry had already taken a massive blow. As I said, 98 per cent of our industry's farms are in disaster declared areas. After that announcement on Australia Day, I can tell you all our people phoned. We had people working around the clock on phones seven days a week. I can tell you it is the worst I have seen the morale since the worst of the drought, and we had a decade of drought. We have young farmers who took over their parents' farm during that drought and they were still positive about the future. They pushed through that and stayed in the industry. Those same young people are now saying, 'If this is what is going to go on in our domestic dairy industry, what is the future for us?' I can give you a list of a dozen names off the top of my head of farmers that are in the process of selling up and exiting right now.

Senator XENOPHON—Who is going to buy them?

Mr Peake—Good question. That is an absolutely pertinent question. A lot of dairy farms right at the moment cannot be sold as dairy farms. It is a really difficult issue.

Senator XENOPHON—Have you spoken directly to Coles about this?

Mr Peake—We actually were to meet with Coles. I spoke to them on 25 January and made the request that they not put the press release out, but it was too late. It was sent out as an embargoed press release. We are currently finalising the impact statement of Cyclone Yasi on Far North Queensland. I hope to have that finalised this week and I actually then want to engage with all the retailers about the impact on our industry.

Senator XENOPHON—I think there is a representative from Coles here today. You might want to have a chat with him.

Mr Peake—Yes. I was going to drop off a business card on the way out.

Senator O'BRIEN—This morning we were told about the differential price that farmers receive for the milk they supply, depending on its destination. We have been told that supplying the same tanker load of milk to the processor leads to two components of the final cheque, and you are confirming it. Can you give us more detail? What is the price differential? How much less do farmers receive for the milk that is ultimately sold as unbranded milk to the main supermarkets, to IGA or to whoever?

Mr Tessmann—That varies from processor to processor. Ross, would you have the figure for the current difference between National Foods tier 1 and tier 2?

Mr McInnes—Ours will vary. We will be on about 51c with component adjustments and everything else. As far as I can remember, our extra milk, which does not have a spot in a bottle at the moment, will vary from 20c to 40c.

Senator O'BRIEN—You are getting 50c for stuff that does not go into the—

Mr McInnes—That does. But even that is blended between branded and unbranded as well.

Senator O'BRIEN—So there isn't a price differential. I am trying to understand the evidence that has been given. If your cheque is going to be lower because more of it is going into the—

Mr Tessmann—It varies. National Foods give two prices, and one is for what they figure they require. That may be a blend of branded and unbranded. Everything over that liquid sale is their tier 2, and that is significantly less. Parmalat base theirs directly on the branded sale. Their tier 1 is just the branded sales, and that is why it varies from month to month. It will drop off if you have a bad month or a slow month. December is always low with Christmas, because they do not sell as much milk, and we expect significantly less. So that is directly related to sales. Tier 2 is less, but is not quite as low as the National Foods one.

Senator O'BRIEN—And tier 2 is the milk that goes into—

Mr Tessmann—With Parmalat it would be milk that goes into the store brands as well as into yoghurt and things like that. That is the small amount of manufacturing there.

Senator O'BRIEN—Parmalat has a price for their own brand, and then tier 2 is, for example, the Coles brand plus other proprietary brands—store brands, perhaps, is the best way of putting it—plus manufacturing milk.

Mr Tessmann—Yes, plus the manufacturing milk.

Senator O'BRIEN—So it is the manufacturing milk and the store brand at one price point.

Mr Tessmann—Yes. With Parmalat it is their proprietary branded milk and a blend of store brand plus manufacturing, whereas with National Foods, though their tier 1 is a blend of branded and store brand, their tier 2 is manufacturing milk. It is not quite the same. Parmalat figures are different—because their tier 2 is a blend of those other ones, their tier 2 is more like around 44c on average.

Senator O'BRIEN—It is 51c and—sorry, what is tier 1?

Mr Tessmann—Parmalat have still got their tier 1 price higher for their proprietary branded product—it sits between 56c and 58c. Tier 2 is a blend and sits somewhere between 43c and 45c.

Senator O'BRIEN—So there is actually, for Parmalat, a substantial fall in the price for the milk that goes into the store brand milk.

Mr Tessmann—Yes. That is right.

Senator O'BRIEN—And the difference is more than 10c a litre.

Mr Tessmann—That is correct.

Mr McInnes—One of the assertions by Coles in all their releases has been that somehow there was an arrangement with the processor that that was supposed to go down to the farmers. My milk will go into Coles and Brian's will not, but he is affected. He is the collateral damage out to the side that basically there has been no recognition of from anything Coles have presented.

Senator O'BRIEN—The consequence is that the price points of the current contract do not change in Queensland at the moment. With Parmalat, it means that your cheque will go down because of a transfer between the two components of the cheque—between the branded and the unbranded.

Mr Tessmann—The two prices will be the same, yes.

Senator O'BRIEN—When is the current contract up for renegotiation?

Mr Tessmann—With Parmalat it varies. Some will be up for renegotiation at the end of this year and others will not be until the end of next year. But National Foods will certainly go through negotiations first.

Mr McInnes—We start in July. We supply milk through Dairy Farmers Milk Cooperative, so it is in Ian's presentation. That is where my milk goes to.

Senator O'BRIEN—Is Dairy Farmers going to be the first test of how this new retail market works at a farm gate level?

Mr McInnes—Apart from the farmers that supply Parmalat at the moment that are being affected as of today.

Senator O'BRIEN—That is not a contract effect if they have already contracted a differential.

Mr McInnes—Sorry, yes. Ours will be the first ones in July.

Senator XENOPHON—As to the mix between tier 1 and tier 2, is that fixed by contract or can there be a variation of that?

Mr Tessmann—With Parmalat, yes. Premium, the collective bargaining group, verifies that the sales figures are right. It varies from month to month, and always has, according to the sales in that month. That is what the system is; it is a variable system.

Senator XENOPHON—So there is no great certainty. The variability means it is much less certain for the industry.

Mr Tessmann—Yes, that is right. If Parmalat has disastrous sales, that will come back and hit those farmers right away.

Senator O'BRIEN—When was that contract struck? How old is that arrangement?

Mr Tessmann—It would be 2½ years ago now when that arrangement was put in place.

Senator O'BRIEN—So it was struck when the international price was higher anyway?

Mr Tessmann—Yes.

Senator O'BRIEN—Not that Queensland necessarily spins directly off that.

Mr Tessmann—No.

Senator O'BRIEN—It seems to be a factor which has got something to do with that, plus taking into account additional production costs.

Mr McInnes—At the time when those contracts were taken up, all the feedback from the farm services staff of the processors in Queensland suggested that with the current climatic conditions it was going to be very unlikely that production would rebound. The prices went up accordingly because everyone, including us, thought we were in a demand situation. The seasons turned around—we went from drought to an excellent summer—and production rebounded. It is still reflecting what the market outlook was two or three years ago.

Mr Tessmann—By rebounding, I think it went from a deficit where Queensland was seriously looking at having long periods of importing milk, not just for a short period in autumn, to a situation where, in springtime and for a fair period of the year, Queensland had a surplus of milk which then had to be dealt with.

Senator O'BRIEN—Parmalat for some time was contracting as far south as Port Macquarie to get milk for its processing, as I understand it. I do not have a detailed knowledge of the market in Queensland. I was just reflecting on the pre-deregulation arrangement in states like Queensland, which was that there was a price for market milk, drinking milk, that was regulated and there was an unregulated lower price for manufacturing milk. That seems to be how Parmalat struck their arrangement. But then you folded into that a component of market milk because Parmalat had contracted a lower price for it.

Mr Tessmann—Parmalat followed that system. Basically what was going on with regulation was just that they—

Senator O'BRIEN—Except for the part of the market milk that they priced at manufacturing milk price because they had struck a deal to sell it lower than marketing prices.

Mr Tessmann—That is right. They set their tier 1 on their branded milk, not on the total milk.

Senator O'BRIEN—And National Foods have not got around to that yet?

Mr McInnes—No, they are still in deliberations. It is going to arbitration, as far as I am aware.

Senator O'BRIEN—It is going to arbitration?

Mr McInnes—The arrangements between DFMC and National Foods, yes. I understand that that is in process. We have ADF, anticipated full demand, for tier 1 and then there is tier 2 milk which is treated separately. Tier 2 is basically your tier 1 milk. They all like to have a different name for the same thing.

Senator O'BRIEN—The different ways of describing it is interesting. Are you expecting to be asked to differentiate between the two components of market milk when you contract? How do you think dairy farmers in Queensland currently contracted to National Foods will react if that is the proposal from National Foods?

Mr McInnes—At the moment tier 1 does not differentiate between branded and unbranded.

Senator O'BRIEN—I know that, but they do have Parmalat.

Mr McInnes—Yes, that will be interesting.

Senator O'BRIEN—How do you think dairy farmers in Queensland who are currently contracted to National Foods will react if that is the proposal?

Mr McInnes—I believe there should be more transparency because we would like to know what the processor believes is the farm gate value of the milk that is going into those contracts.

Senator O'BRIEN—What sort of impact will that 12c differential—which sounds like what it is now at Parmalat—for that proportion of market milk that is sold to Coles, Woolworths, IGA or whoever in their store brand have on the incomes of National Foods' dairy farmers? Do you have any idea?

Mr Tessmann—That 12c obviously shifts a farm from a situation of making a profit to making a substantial loss. So if they are forced into a situation where the milk they have now is pushed into that second level then obviously—

Senator O'BRIEN—Is that how it works for Parmalat? Does the category 1 milk subsidise the other components? Do you make a loss on the milk you have to sell at about 44c?

Mr McInnes—That is probably a question for the processor.

Mr Tessmann—Yes.

Senator O'BRIEN—No, you are getting a cheque for your milk, and you are getting 56c to 58c for your category 1 milk, which goes to the Parmalat brand of market milk. The rest of your milk you are selling at about 44c or so—some of which goes to manufacturing yoghurt et cetera and some of which goes to store brand milk. I am asking the question: do you make a loss on that lower priced milk and subsidise it by making a better profit on the higher value milk?

Mr Tessmann—Yes, that is how it works. In springtime or in a really good season you may be able to make a small amount of profit on that lower priced milk, but for all year round and year in, year out you make a loss on that and live on your PDA milk, that tier one milk. That is where your profit is. There is nothing in the other milk, no.

Mr Peake—The difficulty is that, as the transition occurs with this cutthroat discounting from proprietary branded processor brand sales to more supermarket sales, that is where the unviability issue comes in.

Senator WILLIAMS—So the more the brand sales the more your income from the higher priced milk transfers down to the lower priced milk and the more who will go broke.

Senator O'BRIEN—The low profitability will eventually be to your loss.

Mr Peake—I will go back to my original point. You cannot take a couple of hundred million dollars out of an industry value chain and not expect it to have an impact.

Mr McInnes—To me, it is a bit like a seesaw. You might have had an average price for milk in the middle and when it was only so wide it probably worked reasonably well. When it drops down to a dollar, to not make loss out of the whole thing you can imagine where your branded sales have to be. The differential is too much, so that is where you get your market failure.

Senator WILLIAMS—Looking at the costs of running the business as well, we have oil over $100 a barrel, so the freight is going to be more. If you have to freight fodder in during the dry time, it is going to be more. We know where the price of electricity is going, and if we have a carbon tax we know it is going to go higher. We do not know by how much. There are other factors that surely have to be weighed in the future of the industry—not only the downward pressure on that second lower priced milk but also the additional costs that are coming upon your industry.

Mr Peake—Absolutely. If you look at the potential ramifications for our domestic milk supply industry in Australia, you will start to see non-viability in some of our regions in Queensland, you will start to see a collapse of investment and asset isolation, you will start to see cold chain breakdown because the viability is not there and the only alternative is to drag milk further, the carbon footprint of the industry will increase not decrease. But that comes at an extra cost, and that is the issue. We have a table in our submission with the landed cost comparison. To cart milk from northern Victoria to Queensland, which also involves all sorts of problems in terms of milk quality—

Senator WILLIAMS—Downgrading of quality.

Mr Peake—and all of those issues—even if it was to happen, it will increase the cost by 17c to 20c a litre. So just from an economic point of view, it does not stack up, let alone all the other issues on top of it.

Senator WILLIAMS—What about one other important issue: the more money that is taken out of your regional community means less money will be spent in your local towns and businesses and fewer jobs. It is about the sustainability of your local economy. Wouldn’t that be a major factor as well?

Mr Peake—Absolutely, it is a reverse multiplier effect. When you start to take this money out of the value chain, particularly at these regional levels, you get that reverse multiplier. It has a knock-on effect throughout the value chain and it will affect investment, viability and employment, and it will isolate assets. There is no question about that.

Senator XENOPHON—Coles says it will not affect the value chain. Woolworths in their submission last night said that the lower prices can be expected to flow back to processors and farmers as new supply and pricing agreements are negotiated over coming months and years. But you are saying, further to the line of questioning from Senator O’Brien, that because of the variability clause in the Parmalat contracts, we are already seeing the impact of this price war.

Mr Peake—Right now.

Senator XENOPHON—And it quite profound.

Mr Peake—Absolutely. For them to promote in their press release that they are not impacting on farmers is wrong.

Senator XENOPHON—Even before the renegotiation, it is already impacting.

Mr Peake—Yes.

Senator XENOPHON—Okay.

Senator WILLIAMS—So Coles are right?

Mr Peake—I have to say: it is tantamount to false advertising. There are inaccuracies in their statements in their first press release on Australia Day.

Senator RYAN—It is indirect—in the sense that it is not directly from Coles price policy; it is indirect as a result of the flow-on effects through the market.

Mr Peake—There is a direct impact there through the transition of sales.

Senator WILLIAMS—The contract.

Mr Peake—Absolutely. If it is a mistake and they did not understand it, it is a mistake. But our organisation have put out press releases correcting those issues. We have made no bones about it. I have not seen the statements corrected by Coles. I will just leave it at that.

CHAIR—Regrettably we are out of time.

Senator XENOPHON—I might put a question on notice, Chair.

CHAIR—If you wish to.

Mr Peake—I am happy to provide more information and answer any other questions on notice.

CHAIR—Perhaps the questions on notice could emailed and you could email the answers back fairly quickly, so we are armed with the information. We thank you very much for your appearance today.

Mr Peake—Thank you for the opportunity.

[4.04 pm]

DAVIS, Mr Francis, Chairman, Warrnambool Cheese and Butter

LORD, Mr David, Chief Executive Officer and Managing Director, Warrnambool Cheese and Butter

CHAIR—Welcome. Thank you for appearing, Mr Lord. Is Mr Davis going to be with you?

Mr Lord—Mr Davis is observing today. He is here but he is observing.

Mr Davis—I thought we did not need to bother the committee with two of us, but I would not mind sitting up here.

CHAIR—You can sit there by all means. We had you down with two witnesses, that is all. You may add something if you wish. Mr Lord, would you like to make an opening statement?

Mr Lord—The contribution that WBC can make to the inquiry is largely in three areas. I think we can talk with some level of authority on the potential impact of this current level of price discounting on Victorian farm gate prices, we can talk with some authority on the potential impact on processor proprietary brands and we can make a general comment on how we perceive the impact of a value chain for liquid milk representing $1 per litre.

WBC understands that the current discounting of fresh milk in the retail sector is a competitive tactic used by supermarket retailers to compete and to grow profitability and market share. We understand that price discounting on staple items is a means of attracting more consumers into stores. We understand that it is all part of the competitive process that goes on between retail competitors. Most of all, I think we understand that supermarket retailers are vying to be perceived by consumers as the most aggressive on price and, therefore, the retail chain that represents the best value for money. We understand all that and accept that that is part of a competitive environment.

We think that the current price discounting is unlikely to be a substantial influencer of farm gate prices in Victoria. The majority of Victorian production is acquired by cooperative, principled, export oriented processors for conversion into dairy products for the international commodity markets. Prices achieved domestically for these products tend to be aligned to export prices, due to the global nature of trading in dairy commodities. Because of the desire of these processors to maximise milk prices for their cooperative members, they tend to be farm gate price leaders in the market for raw milk and the farm gate prices they pay are more likely to reflect the returns derived from the international dairy markets than those derived from the domestic market. As a result, smaller, export oriented processors and domestic market facing processors alike are required to meet these market prices in order to effectively compete for raw milk supply in the Victorian market. I think the short way to express all that is: if in Victoria farm gate prices are influenced by international factors then whatever occurs in the retail sector is unlikely to have a significant influence on that.

We certainly believe that the current price discounting of fresh milk products—and the fact that it applies to private-label brands or supermarket brands exclusively—has the potential to have a significant impact on processor brands. Retail prices for processor proprietary brands have remained unchanged and as a result are no longer price competitive against private labels or supermarket brands. If retailers elect not to reduce their margins on proprietary brands to the same extent that they appear to have compromised margins on private labels then this can only lead to a dramatic decline in market share for proprietary brands and whatever subsequent financial impact may flow from that.

It is certainly WCB's view that, with reference to a market for domestic drinking milk, a value chain of $1 per litre would not appear sufficient to deliver an adequate return to all stakeholders involved in the production and distribution of a litre of milk. The issue we believe is further compounded where a disparity in negotiating power exists between stakeholders. When this occurs, it is highly likely that an inequitable sharing of the limited value that exists in the value chain will be the outcome. I know that might be stating the obvious, but that is I suppose market forces at work. It seems to us to be quite likely that there will be a number of stakeholders in the chain who will be dissatisfied with their returns from a limited value chain of $1, and they are likely to make decisions in relation to their continued participation in that value chain based on that.

It is probably not entirely appropriate for us to make comment about regional areas because we certainly do not operate to any large extent outside Victoria, but I think as a guiding principle in regions of Australia where milk production is entirely destined for the processing of consumer products for the local market, then price compensation for stakeholders in that value chain should ultimately be reflective of the actual cost of production in that region. It may, again, be an obvious statement, but where this does not occur then milk production is unlikely to be sustained in those regions at a level that is consistent with demand.

I am happy to take any questions to clarify that, but that is largely the position of WCB in relation to this.

Senator COLBECK—Can you tell me what your exposure is to the drinking milk market, and what proportion of that might be in generic brand?

Mr Lord—WCB is a company that is predominantly export focussed, but we do have a consumer products division. It is a smaller part of our operations, but important nonetheless. We market our own proprietary brands of milk in the domestic market, predominantly in Victoria. At this point in time I believe that our production of private labels is restricted to a very small volume of product that we produce for Woolworths, which is mainly flavoured milk. We are not a prominent player in that marketplace.

Senator COLBECK—Flavoured milk sits where in the overall pricing range? Would that be towards the higher end in value terms?

Mr Lord—Certainly it is a more expensive product to produce, so it is higher value, yes.

Senator COLBECK—So you do not have any particular exposure directly to $1 per litre milk—apart from the fact that it competes with your branded product?

Mr Lord—Yes, exactly.

Senator COLBECK—What has been the impact of the current campaign on your branded product?

Mr Lord—At this point in time we are watching it very closely, and there has been a minor impact. We continue to watch that closely, but we would expect that there is the potential for that impact to be much greater over time.

Senator COLBECK—Depending on how long it is sustained?

Mr Lord—Yes, depending on how long it is sustained, but I think that where products are price-uncompetitive in the market then it stands to reason that they are likely to be negatively impacted over time.

Senator COLBECK—I suppose it depends on what you call uncompetitive, though. A heavily discounted loss-leading price is, as you have quite rightly said, a market mechanism that is used. It depends on how sustained it is as to other implications, potentially. It is hard to say that other products are necessarily uncompetitive when that is being used as a market movement tool.

Mr Lord—I think you can only assess competitiveness at a point in time, and at this point in time we would regard our products as being—in a purely pricing sense—uncompetitive because they sit on shelf at a significantly higher price than $1 per litre.

Senator COLBECK—Do you pay any premium over and above your market milk price, given that you are an export focused business, for the product that goes into your drinking milk product?

Mr Lord—We do not. We have an announced pricing structure and we procure milk on that basis within the parameters of that pricing structure. We do not differentiate by the final destination for that milk, whether it is going to skim milk powder or cheese or liquid milk.

Senator COLBECK—So how do you select the product that goes into it? Do you have a process that determines by milk quality, bacteria count or those sorts of things and you select a supply based on that, or is it basically just completely random that product will go into a particular supply stream?

Mr Lord—We have very strict quality standards and we apply those standards to all milk that we acquire, regardless of whether it is going into the skim milk powder plant or the cheese plant or the liquid milk plant. We do not differentiate in any way.

Senator COLBECK—That is fine. I am aware that there are different scales within some of the pricing mechanisms for steps outside various bacterial counts. When my parents were in the game to supply town milk, it was at the top end of the range of quality of production. Obviously there are circumstances—we have just heard about weather in Queensland—that impacts, and you would see that here too. There is potential weather and circumstantial events that impact on a farmer’s capacity to supply within that range. You would obviously understand that.

Mr Lord—Yes.

Senator COLBECK—While everyone does their best to achieve that, there are things that just do occur.

Mr Lord—That is exactly right and we provide price incentives for quality. Lower cell counts, for example, are rewarded with price increments, and there are volume bonuses—suppliers that produce more are rewarded for that—but that is in a transparent, announced pricing structure.

Senator COLBECK—I understand that. I just was not sure whether any specific element of your product went specifically into the drinking milk market. Some do it that way, others do not.

Mr Lord—Yes, some do.

Senator COLBECK—And some just have a general off-take, obviously, as you do. You have said that in your view the $1 a litre does not provide a sufficient dividend in the supply chain to cover off all players in the value chain. How do you get off the merry-go-round? This is something that we have discussed earlier in the day. If the industry decides that it cannot supply into the market at that sort of price, how do you get off the merry-go-round if there is potentially somebody else out there who is prepared to say, 'I will supply it'? That is the market. I understand that. If your view is that there is not sufficient value in the supply chain to do that, you obviously have made a decision not to get into that market as a business because you have some minor volume in flavoured, but that is a different product again. How do you get off the merry-go-round?

Mr Lord—My statement there is based on the assumption that if the value chain for a litre of milk that is supplied into the domestic market for liquid milk is $1—and I do not know if it is $1 or not at the moment, because we are not producing private label—

Senator COLBECK—All we know is that they sell it at retail for $1.

Mr Lord—We know it is selling for $1. We do not know whether that is the entire value chain and we understand that a retailer may choose to buy products at a particular price and sell them below that price. I do not know that the current value chain is $1. But, if it were, from our seat in the circle we perceive that there are the three stakeholders need to be satisfied with that $1—primary producers, processors like us and retailers—and it would seem to us that $1 would be insufficient to provide them all with an adequate return, assuming they all want an adequate return. If one does not, then my argument does not hold as much credibility. We understand that retailers can make that choice. They can decide to do that, as processors can. Processors can decide to operate on a reduced margin as well, if that is what they choose to do. It is not something that we have chosen to do at this point in time.

Senator COLBECK—How much shy do you think it is, if $1 is the number, of a reasonable return?

Mr Lord—I do not know that I can answer that question because I think that would require me to put a number on—

Senator COLBECK—Processing costs.

Mr Lord—Processing costs are one thing which are commercially sensitive to us.

Senator COLBECK—I am happy to test you on it!

Mr Lord—I am sure you are and will continue to do so! It would also require me to put a number that represents an adequate return on a producer and I do not know what that is because producers have varying degrees of cost.

Senator COLBECK—The producer cost, with respect, is not much of a secret because the dairy farmers are pretty happy to put it out there. We know that there are a range of prices that have been provided to us in our papers. They vary from mid- to high-30s in Tasmania and Victoria has a cost of production of about 40c. Far North Queensland goes to 50c to mid-50c. Northern New South Wales is about 50 or a tad above and it varies across the other states. Western Australia is 42. That stuff is not so much of a secret. I accept your perspective that there is not so much a pressure from this whole argument on Victoria and Tasmania because they sort of fit within that 40c price range.

My view is that anyone who has a cost of production much over 40c—if this price is sustained into the long term—is in strife as far as the sustainability of their business is concerned. So you are talking about New South Wales, Far North Queensland and parts of Western Australia and those areas that have a higher cost of production over 40c. They are the ones that end up being in strife. I am genuinely—and I am pretty sure the committee is—trying to get a sense of what the value of the bits are. Coles has said to us that the black box is between the processor and the farmer, and yet we quite obviously know what those numbers are, but what nobody knows is the numbers between the processors and the supermarkets. That is information that this whole argument really rises and falls on. The only thing that we have is something like your statement that says, ‘If $1 per litre is the price, it is not sustainable for everyone in the supply chain.’ We do not get any sense of how that gets broken up.

Mr Lord—I think the point I made a moment ago that for milk produced in regional areas as a guiding principle, where the destination for that milk is the local domestic market, if consumers in those regional markets want fresh milk daily then the price compensation that producers or the stakeholders in that value chain need is a price that is reflective of the actual cost of production. I think that is entirely consistent with what you have been saying. The cost of production varies up and down the east coast and all over Australia. The Victorian cost is the lowest and the cost of production increases as you move further up the eastern seaboard. If we are going to satisfy the stakeholders regardless of what the value chain is worth, we need to be getting to a point where the cost of production is recognised within compensation mechanisms at some point.

Senator COLBECK—But we know and it was clearly highlighted to this committee last year as a result of the impacts of the global financial crisis that, when the price at the top end of the supply chain goes down, it ricochets right down through the system and comes out at the dairy farm. Mr Zandstra was here earlier saying they did not want to go down the track of farmers being price takers, but we all know the answer to that. That is as it is. Inevitably, if $1 a litre retail becomes the norm, then anyone who has a cost of production much over 40c is in real strife under this regime. As you quite clearly said, out of $1 a litre there is not value for everybody in the supply chain. And the dairy farmer as the ultimate price taker has to bear the cost.

Mr Lord—It would appear to us that if the value chain is $1 a litre, there would not be enough in that $1 to deliver an adequate return to the stakeholders. That is not to say that one stakeholder or more will not choose to accept a return that is lower than others might expect as being reasonable.

Senator COLBECK—I am sure the dairy farmers are not going to be prepared to accept a share less than—

Mr Lord—Dairy farmers may not be; retailers may be. This goes to the heart of it; it is the cut and thrust of a free market. Ultimately, if a producer is not being compensated adequately for what he produces in a region where the cost of production is x, he makes the decision on whether or not he continues.

Senator COLBECK—Effectively so does everyone else down the supply chain. Your business has made a decision not to get into the market for this particular product, and people will reflect on how wise that decision might be or otherwise.

Mr Lord—Exactly, and you have to wear the ramifications of that decision. We are in a position where, if returns from the domestic market are not sufficient or if returns from the international markets exceed the domestic markets, we have the opportunity to some extent to balance that off. We can divert milk for conversion to products sold on the international markets in preference to conversion to products sold on the domestic market. We are in a position to be able to do that. Other processors who are entirely domestically focussed do not have that option. When you talk to them, if you have not already, they will have something to say about that.

Senator RYAN—As a parochial Victorian, I recommend that everyone visits the western end of the Great Ocean Road and visits Cheese World, which has a fine range of your products. I want to explore this issue of exposure to the export market. It is a particular aspect of Victorian producers. How influential in setting an effective national price for milk, taking into account the need to supply drinking milk in regional areas where it cannot necessarily be transported in or out, is the export price that Victorian producers receive? How influential in setting effective national prices, with all the regional variations, is the export price that allows you to divert production into overseas markets if the returns there are better?

Mr Lord—The price that we ultimately end up paying our producers in the market at the farm gate is an outcome of the returns that competitive processors in the Victorian market earn from the international market. Victoria is the state that represents the lowest cost of production, we think. That then, I suppose, becomes the basis for our national pricing in that, if the Victorian cost is 40c and the cost of freight to another part of the country is 10c, then as a rule of thumb the price paid in that particular region should be 10c higher because that would reflect the cost of freight. It would be economically more feasible to source it locally as a processor than to bring it from Victoria.

Senator RYAN—That is helpful, thank you. Obviously regional markets, which currently supply, effectively, drinking milk only, which is true in some parts of Australia other than Victoria, are much more exposed to the drinking milk price; their capacity to access export facilities such as yours would basically be almost zero, I would imagine—you are not going to source milk from other parts of Australia?

Mr Lord—No.

Senator O'BRIEN—I am just looking at Dairy Australia's state-by-state production figures going back to 1999-2000 and up to 2009-10. Victoria has seen a reduction in production of about 11½ per cent over that period, although it remains by far the largest dairy-producing state. The only state that with an increase in volume is Tasmania. About 4½ per cent of your volume loss was between 2008-09 and 2009-10, which may be drought. I am not sure. Can you give us some sort of explanation for the decline in production volume?

Mr Lord—The single biggest contributor to the decline in production would have been the drought experienced by that region through that period. That led to a significant reduction in the amount of milk produced.

Senator O'BRIEN—So how did that affect production capacity? Presumably, with such a decline in volume of production, production capacity was in excess of that required. Has there been a rationalisation of production capacity or are we yet to experience that? Should we be expecting that to happen?

Mr Lord—Producers who are producing less do so when their herds reduce in size. We know that, through the drought, herds were reduced significantly in size in some areas.

Senator O'BRIEN—I meant processing capacity.

Mr Lord—All the processing capacity still exists.

Senator O'BRIEN—So there has not been a reduction in processing capacity. If the volume builds up, subject to finding a market, the capacity is there.

Mr Lord—Absolutely.

Senator O'BRIEN—So there is not any prospect that, if volume builds up, it will have to go to another state—subject to available price, for example?

Mr Lord—No, I do not think there is any doubt that, if production rebounded in Victoria to previous levels, the processing capacity to deal with that would still be there.

Senator O'BRIEN—How does the dollar value affect the economics of export production at the moment?

Mr Lord—Positive price signals tend to lead to improved production levels and producers have been given some pretty positive price signals in the last 12 months.

Senator O'BRIEN—So the decline in international price which seemed to mirror the global financial crisis has reversed?

Mr Lord—Yes.

Senator O'BRIEN—And the price signals are indicative of an upward trend in the international price for export product?

Mr Lord—Yes.

Senator O'BRIEN—Traditionally that has driven an increase in farm gate milk prices in my state of Tasmania and in Victoria, just looking at the figures—and indeed everywhere else.

Mr Lord—That is correct.

Senator O'BRIEN—If the international signals are that prices will go up, but the domestic circumstance indicates that, for some states, prices will either remain the same or go down, what do you foresee happening with the dairy industry around Australia? Are we going to see a further contraction north of the Victorian border and continued growth south of it?

Mr Lord—Those positive price signals from the international market will largely impact on Victoria, where such a high proportion of production is destined for conversion to products that are sold on the international market.

Senator O'BRIEN—I think Tasmania actually has a higher proportion of its production going international than does Victoria.

Mr Lord—Yes. That free market is working very well. There are positive price signals from the international market that are feeding through as higher farm gate prices for Victorian producers. Our suppliers are enjoying significantly better prices today than they were this time last year.

Senator O'BRIEN—If there is a squeeze on the value of your market milk, your drinking milk, it is likely you will convert that into export product or manufactured milk product. Is that how I should read it?

Mr Lord—We have the capacity to do that for a proportion of our product, but we have an investment in our consumer products division and we have an investment in our market milk processing factories. We are obviously reluctant to walk away from that investment and not utilise it.

Senator O'BRIEN—Are you confident that there will remain a profitable market for you in that sector?

Mr Lord—At this point in time, yes. I think it is way too premature to be saying that what is happening in the market for domestic drinking milk now is somehow going to destroy the market completely over time. What we are seeing now is a new dynamic at play in this marketplace and we are watching the impact on our branded business. We are assessing what levers we have to push or pull to try and protect that business.

Senator O'BRIEN—Would it change if, for example, we see as the next step a much bigger move by the major supermarkets into butter and cheese guaranteeing their branded product will sell for no more than $6 a kilo for cheese and butter? How do you think those sorts of moves would affect your section of the dairy industry?

Mr Lord—As I said at the outset, we understand that there are certain competitive tactics and competitive strategies that can be employed by retailers and one of them is to offer high-volume staple items at very low prices.

Senator O'BRIEN—You suggested that perhaps it was not sustainable unless one of three elements of the chain was prepared to accept little or no profit.

Mr Lord—I think that is exactly right.

Senator O'BRIEN—Assuming that there is no profit at about $6 a kilo for cheese and butter plus $1 a litre for milk, are those three components of the dairy industry sustainable for a major supermarket chain? I do not know what portion of their business would be affected.

Mr Lord—If you are talking about a situation where all the stakeholders—the producers, the processors and the retailers—are unhappy with their return from that particular value chain, then I cannot see it continuing. But it may continue if the producer is happy and the processor is happy and the retailer is not happy but is prepared to accept that for other competitive reasons.

Senator O'BRIEN—If the major retailers were prepared to accept that—and we know that the dollar-a-litre supermarket brand milk has an effect on the volume of other milk sold and, therefore, we could expect the same effect on cheese and butter—how would it affect businesses like yours?

Mr Lord—Where companies rely on the proprietary brands that they have developed and invested in to deliver sustainable margins for that company and the market share for those brand holders declines, then clearly that has an adverse impact on the business, and that is not what any proprietary manufacturer wants.

Senator O'BRIEN—How does a business respond?

Mr Lord—I think the business has to look at alternative actions it can take to try and differentiate its products from private labels, to try and add value in some way and convince consumers that they should be purchasing proprietary branded products. I should add, though, that in commodity markets that is exceedingly difficult.

Senator O'BRIEN—So the easy option is to try and get your inputs cheaper, isn't it?

Mr Lord—For the processor?

Senator O'BRIEN—Yes.

Mr Lord—As I said before, in the value chain there are some stakeholders with more negotiating power than others. That is a fact of life; it is the law of the jungle. I expect where none of the stakeholders are happy with their level of returns, the stakeholder that has the weakest negotiating position is the one who is going to be the least happy.

Senator O'BRIEN—That is an interesting way of putting it.

Mr Davis—If I can just comment on that, I think David is exactly right. If you look at the three groups of stakeholders, you have got your farmers and your processors and your supermarkets at the top end. Right now I think the farmer is getting 40c a litre in Victoria and that is probably for the first time in some years, except for that extreme year in 2008 when global prices went very high. Most of the time he has been getting a return not above the cost of production. I am sure Dairy Australia gave you chapter and verse about this this morning and you do not need it from me again. This is probably the first time the farmers have got back to something approaching that. I know Victorian farm debt has been rising rapidly in the last 10 years, so that alone tells me that they are not getting as much as they should be getting out of the value chain. Quantifying it is another matter. If I had to put a figure on it I would probably say they should have got 5c more, but there was not 5c more there because prices in both export and domestic markets were not high enough to support that.

Processors I think generally are pretty efficient, simply because the cost of milk keeps them at that level of efficiency. If they do not deliver a price to their suppliers they do not get the milk because it can go to another supplier, and that can happen.

Then you get to the supermarkets. I do not know what supermarket margins are. I do not know much about supermarket margins but, clearly, they have brought that price down. If they are not going to visit it down to the processors and then to the farmers then they have got to absorb it. You would need to ask them whether they are prepared to absorb that. I am sure they are prepared to absorb it in the short term. I am not so sure they are prepared to absorb it when the next round of contract negotiations comes up. That would be the question I would be asking.

I would just say, with David, that a dollar does not sound like enough for the amount of the work that goes into producing a litre of milk when you see that a litre of water is $1.25—or it was yesterday when I looked. It is much easier to produce.

CHAIR—Other people have made that observation, that water is more expensive than milk.

Mr Davis—I am sure they have.

CHAIR—We have reached the end of our time, unless somebody has some very pertinent and urgent matters to raise. As that is not the case I will conclude this hearing. The committee will resume hearings on this issue in Sydney tomorrow morning.

Committee adjourned at 4.43 pm