

# Chapter 1

## Introduction

### The supermarkets' price decisions

1.1 On 26 January 2011, Coles announced as part of its 'Down Down' price promotion campaign that the price of Coles brand regular and low fat milk will be cut by as much as 33 per cent, to \$2 for a two litre bottle. The price cut in low fat milk to \$2 for a two litre bottle eliminated the premium that was previously charged.<sup>1</sup>

1.2 In its media release announcing the price changes, Coles stated:

Because we all buy milk, this price cut will offer significant savings for customers proving that quality food really does cost less at Coles. We are lowering the price of the family shopping basket because we know that is what our customers want the most.

1.3 Coles also stated:

Coles is not reducing the price it pays to its milk processors ... so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased. Coles is fully absorbing the price cut, bringing great value to customers whilst supporting Australian dairy farmers.<sup>2</sup>

1.4 Woolworths followed Coles' price cuts straight away, with other supermarkets such as ALDI, Franklins, some IGA stores and other retailers following soon after.<sup>3</sup> Coles' assessment of the impact of its decision on the dairy industry supply chain was not shared by other participants. Woolworths immediately questioned the sustainability of the move,<sup>4</sup> later informing the committee:

... this price move has effectively re-based the price of white of milk across Australia overnight, and for an unknown period into the future, which also

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1 The prices of Coles brand 3 litre bottles of milk were also reduced to \$3. Additionally, Coles consolidated the two generic brands of milk products it previously sold into one brand.

2 Coles, 'Because we all buy milk: Coles cuts the price to help shoppers save', *Media release*, 26 January 2011.

3 On 3 February 2011, Coles also announced reductions in the prices of other dairy products, namely Coles brand butter and cream. Coles, 'Coles cuts more prices across the store to help customers save – Butter, cream and olive oil "Down Down" and staying down!', *Media release*, 3 February 2011.

4 On 27 January 2011, Woolworths' spokesperson Claire Buchanan was reported to state 'this is certainly not a sustainable price level for milk and it will inevitably lead to pressure at the farm gate'. Paddy Hintz, 'Supermarket war between Coles and Woolworths cuts milk price', *Courier Mail*, 27 January 2011, [www.couriermail.com.au/lifestyle/supermarket-war-cuts-milk-price/story-e6frer4f-1225995314655](http://www.couriermail.com.au/lifestyle/supermarket-war-cuts-milk-price/story-e6frer4f-1225995314655) (accessed 22 February 2011).

potentially devalues the whole milk category in the eyes of the consumer. In effect, the consumer baseline for price is now at 1990s levels, but with 2011 input costs for all parts of the supply chain.<sup>5</sup>

1.5 The Australian Dairy Industry Council (ADIC) questioned whether the supermarkets would absorb the price cuts, submitting that the milk price cuts led by Coles and followed by other supermarkets will remove over \$70 million from supermarket margins each year, with Coles experiencing less than half of this decrease.<sup>6</sup> The ADIC suggested that, for the entire supply chain, the impact on revenue and margins could 'easily extend to hundreds of millions of dollars per annum', and that pressure will build 'on the more vulnerable members of that chain to accept lower prices'.<sup>7</sup>

### **Referral and conduct of this inquiry**

1.6 Various issues facing the dairy industry have received detailed consideration from Senate committees in recent years. Commencing in September 2009, this committee conducted an inquiry into issues facing the dairy industry. Its report, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, was tabled in May 2010. The third interim report of the former Senate Select Committee on Agricultural and Related Industries' inquiry into food production, tabled in November 2009, also focused on the dairy industry.

1.7 However, following industry concern about the supermarket price cuts, on 10 February 2011 the Senate resolved to refer the issue to the Economics References Committee for inquiry and report. The terms of reference are as follows:

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 on the Australian dairy industry, 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;

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5 Woolworths, *Submission 98*, p. 2.

6 Australian Dairy Industry Council, *Submission 96*, p. 10.

7 Australian Dairy Industry Council, *Submission 96*, pp. 11, 15.

- f) the need for any legislative amendments; and
- g) any other related matters.

### ***Submissions and public hearings***

1.8 The inquiry received a significant amount of interest from stakeholders, the media and the general public.

1.9 The committee advertised the inquiry in *The Australian* and on its website. It also wrote to relevant companies, organisations, academics and individuals to inform them of the inquiry. The committee also invited and received a number of supplementary submissions.

1.10 In total, the committee received 160 submissions and a further 22 supplementary submissions. Details about this material can be found in Appendix 1.

1.11 The committee held public hearings in Melbourne (8 March 2011 and 6 October 2011), Sydney (9 March 2011) and Canberra (10 and 29 March 2011). It heard from individual dairy farmers, national and state dairy farmer organisations, members of federal and state parliament, consumer advocates, academics, smaller supermarket chains and independent retailer groups, major milk processing companies, milk vendors, senior representatives of relevant government departments and agencies, and the two major supermarket chains—Coles and Woolworths. The witnesses who appeared at these hearings are listed in Appendix 2. The committee thanks those who participated in this inquiry.

### ***Reports***

1.12 The committee was asked to report by 15 April 2011. Initially, the committee requested a short extension to 20 April 2011, which the Senate approved on 21 March 2011.

1.13 However, to enable the significant amount of information received to be thoroughly considered, the committee tabled its *First Interim Report* on 20 April 2011, seeking a further extension in its reporting date to 1 October 2011. On 9 May 2011, the committee tabled its *Second Interim Report*. To enable a further public hearing to be conducted to examine developments in the dairy industry since the *Second Interim Report* was tabled, the committee requested a further extension of the final reporting date to 1 November 2011.

1.14 Various governments have undertaken to the Senate that they will table a formal response to reports of the Senate's standing or select committees which recommend action by the government within three months. As the committee was concerned that the Government had not tabled a formal response to its 2010 report *Milking it for all it's worth*, and as many of the issues addressed remained relevant, the *First Interim Report* called on the Government to do so. To date, the Government has not responded to *Milking it for all it's worth*, but it did respond to the *First Interim*

*Report* and outlined the reasons for its approach. A copy of that response can be found at Appendix 3.

1.15 The May 2011 *Second Interim Report* provided an overview of much of the evidence and proposals put to the committee. The report also provided a statement of the committee's intent regarding the direction of the remaining months of the inquiry and its final report:

The committee is of the opinion that no final conclusions can be made or recommendations given until it knows:

- (a) the duration of the 'Down Down' campaign and if it becomes permanent; and
- (b) the outcome of renegotiated contracts with the processors and impact on farm gate prices.

It will only be when the answers to these questions are known that the committee will be in a position to draw definitive conclusions about the impact of Coles' campaign and broader supermarket price decisions on the dairy industry.<sup>8</sup>

1.16 On the first issue—the duration of the 'Down Down' campaign—Coles advised the committee in March:

It is intended that our milk prices will stay down for at least six months, subject to cost increases by suppliers and, in the case of dairy products, commodity price increases impacting on farm gate prices.

We note that, if Coles did not honour its price representations made in respect of milk as part of our "Down Down" campaign, it may give rise to misleading and deceptive conduct under provisions in the Australian Consumer law intended to ensure representations are fully honoured.<sup>9</sup>

1.17 The final duration of the 'Down Down' campaign is ultimately a decision for Coles. At present, the price of the major supermarkets' private label milk remains at the post-26 January 2011 level of \$1 a litre for most products. The price cuts have therefore been in place for over eight months. On 25 July 2011, Coles announced that it would maintain its private label milk pricing 'for the foreseeable future'.<sup>10</sup>

1.18 Given Coles has maintained its pricing decisions in the short-term, and it looks likely they will be maintained at least in the medium-term, from this point forward the report will focus on the remaining key issue stated by the committee in May—namely the outcome of renegotiated contracts and impacts on farm gate prices—as the broader terms of reference for the inquiry noted earlier are also addressed.

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8 Senate Economics References Committee, *The impacts of supermarket price decisions on the dairy industry: Second Interim Report*, May 2011, p. 64.

9 Coles, *Submission 131*, p. 16.

10 Coles, 'Coles brand milk prices to stay Down Down', *Media release*, 25 July 2011.

## **Outline of the report**

1.19 This report consists of eight chapters which are briefly described below:

- Chapter 2 provides an overview of Australia's dairy industry including a discussion of the differing exposure to retail price movements.
- Chapter 3 discusses private label milk in Australia, including the growth in private label milk post-deregulation, current contract arrangements between the supermarkets and the processors, and product quality and specifications. The chapter also discusses in general the influence of the major supermarkets on the dairy industry.
- The impacts of the supermarkets' pricing decisions are examined in chapter 4, with a particular focus on changes in the volume and value of sales of both branded and private label milk since the price cuts commenced in late January 2011.
- Chapter 5 continues the examination of the effects of the pricing decisions by assessing the impact of the price cuts on farm gate prices.
- A number of issues relevant to the supermarkets' decisions possibly raised concerns under Australia's competition laws. Chapter 6 outlines the investigation undertaken by the Australian Competition and Consumer Commission into these matters, and related issues.
- Many aspects of Australia's competition law framework were also raised during this inquiry. These issues are discussed in chapter 7.
- Chapter 8 outlines some issues related to imbalances of bargaining power in the supply chain, and related matters such as calls for a strengthened code of conduct and a supermarket ombudsman.

