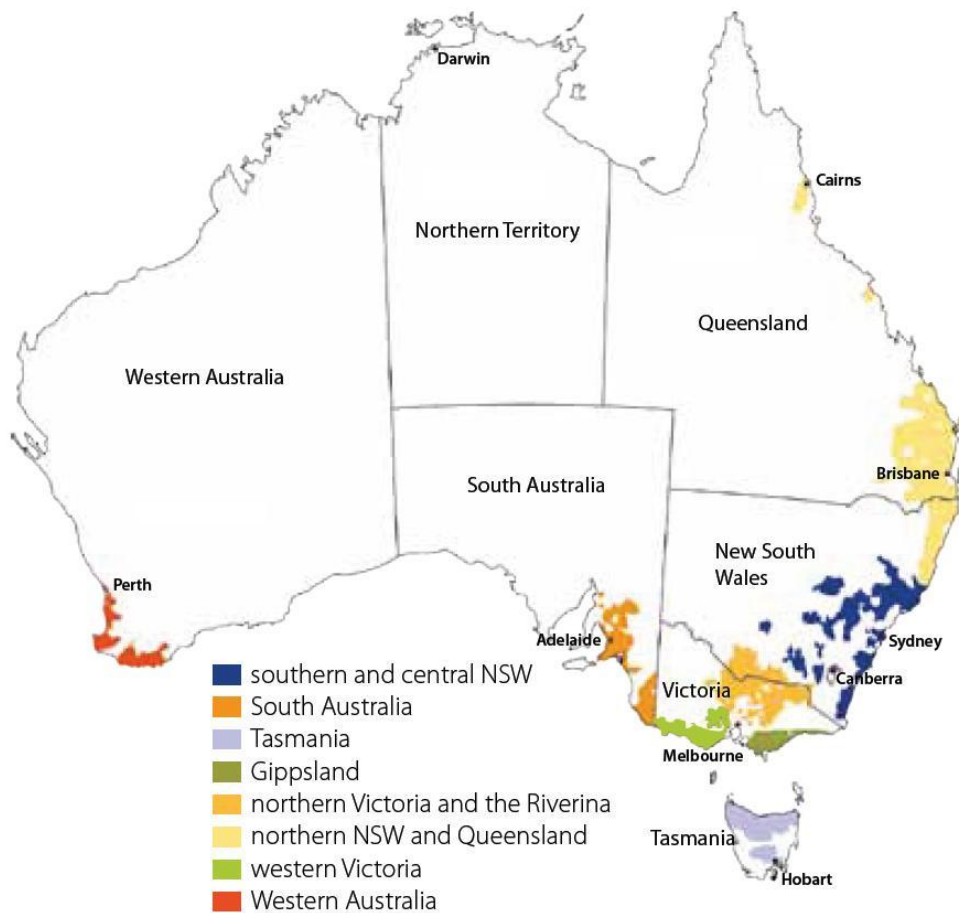


Chapter 2

Overview of Australia's dairy industry

2.1 Based on a farm gate value of production of \$3.4 billion in 2009–10, the dairy industry ranks as Australia's third largest agricultural industry.¹ Milk production is concentrated in the south-east region of the country. Victoria is the largest producer, accounting for 64 per cent of milk output.

Figure 2.1: Australia's dairy farming regions



Source: Surya Dharma, *Australian dairy: Financial performance of dairy producing farms, 2008–09 to 2010–11*, ABARES report prepared for Dairy Australia, June 2011, p. 1.

2.2 Of the 9.0–9.1 billion litres of milk expected to have been produced in 2010–11, 55 per cent was utilised domestically and 45 per cent was exported.² Drinking milk accounted for 2.29 billion litres—about 25 per cent of total production.³

1 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 9.

2 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 8.

2.3 While drinking milk represents the smaller share of total production compared to manufactured products produced for domestic consumption and export (such as cheeses, butter and whole milk powder), as this chapter will discuss, the relative importance of drinking milk to dairy producers in different regions varies significantly. Unsurprisingly, it has been the producers in the regions where drinking milk is overwhelmingly the main product produced that have been most vocal in arguing that the retail price cuts for milk threatens the sustainability of their segment of the industry.

Recent history

Farm gate prices

2.4 The past five years have seen highs and lows for the Australian dairy industry. In 2007, the overall position of the dairy industry appeared relatively strong. Despite the negative impact of the drought, international conditions were favourable. Dairy Australia believed the industry was enjoying 'the best world market conditions in decades' as a result of international dairy commodity prices reaching record levels in 2007.⁴

2.5 While farm gate prices had generally been increasing in all states since 2004–05, the strong position in 2007 led to a significant jump in farm gate prices. As shown by Table 2.1, the average Australian price rose from 33.2 cents per litre (cpl) to 49.6 cpl between 2006–07 and 2007–08.

2.6 As also demonstrated by Table 2.1, however, following the global financial crisis farm gate prices declined significantly.

3 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 30.

4 Dairy Australia, *Australian Dairy Industry in Focus 2008*, p. 3.

Table 2.1: Trends in typical factory paid prices

		2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 (p)	2010-11 (z)	2011-12 (z)
NSW	cpl	32.9	34.3	35.7	48.6	52.4	48.7	45-53	45-51*
	\$/kg MS	4.62	4.8	5.02	6.73	7.29	6.72	n/a	n/a
VIC	cpl	31.5	32.9	32	50	39.1	33.9	40-41	40-41
	\$/kg MS	4.23	4.44	4.32	6.68	5.14	4.49	5.40-5.50	5.40-5.50
QLD	cpl	35	36.6	38.8	51.8	57.2	55.8	52-60	#
	\$/kg MS	4.84	4.99	5.38	7.14	7.89	7.57	n/a	n/a
SA	cpl	30.1	32	32.6	48.6	44.6	34.6	40-41	40-41
	\$/kg MS	4.19	4.49	4.57	6.75	6.19	4.73	5.40-5.50	5.40-5.50
WA	cpl	27.3	29.1	32.4	41.4	49	42.4	38-42	35-41
	\$/kg MS	3.91	4.12	4.55	5.8	6.77	5.96	n/a	n/a
TAS	cpl	30.9	33.6	36.5	50.2	41.3	34.6	40-41	40-41
	\$/kg MS	4.05	4.39	4.79	6.63	5.4	4.46	5.40-5.50	5.40-5.50
Australia	cpl	31.5	33.1	33.2	49.6	42.4	37.3	n/a	n/a
	\$/kg MS	4.28	4.5	4.51	6.68	5.66	4.98	n/a	n/a

Notes:

p: Preliminary; z: Provisional estimate; n/a: not available. The 2010–11 and 2011–12 estimates for Queensland include data for the region classified as North NSW.

MS: refers to milk solids.

* Dairy Australia notes this estimate may be subject to variation due to different exposure to changes in liquid milk market access (affecting the percentage of milk at Tier 2 prices).

Dairy Australia predicts that there will be a reduction on 2010–11 prices for suppliers exposed to the changing processor liquid milk market.

Source: Dairy Australia, www.dairyaustralia.com.au/Our-Dairy-Industry/Industry-Statistics/Milk/Farmgate-Prices.aspx (accessed 8 August 2011—originally sourced from dairy manufacturers); Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 45.

2.7 Farm gate prices in some regions, however, have improved recently. For example, Murray Goulburn has stated that the final 2010–11 price final 'represented the second highest ever paid by the company'.⁵ The current outlook for overall farm

5 Murray Goulburn, 'Murray Goulburn Co-Operative (MG) announces final step-up in farmgate milk price for 2010/11 season', *Media release*, 6 July 2011.

gate prices is also positive. In May this year, Dairy Australia considered that the opening prices for 2011–12 should be stronger than the opening prices for the previous season;⁶ recent announcements and reports have largely supported this assessment for the larger dairy producing regions.⁷

2.8 For reasons that will be explored elsewhere in this report, farm gate prices in some regions such as Queensland, New South Wales and Western Australia may not be in as strong a position compared to the other states.

Production

2.9 Overall milk production has generally declined since 2002. Two competing forces involved in this long-term trend are the declining number of dairy producers but increasing average herd size.

2.10 The number of dairy farms in Australia has decreased by two-thirds over the last three decades from around 22 000 in 1980 to 7500 in mid-2010. Average herd size increased from 85 cows in 1980 to an estimated 220 in 2010.⁸ Over the past few decades, this increase in per farm productivity led to milk output generally increasing up to 2001–02, despite decreasing farm numbers. The number of farms and total milk production, however, has declined since that time.

2.11 Dairy Australia considers that falling farm numbers reflect 'a long-term trend observed in agriculture around the world, as reduced price support and changing business practices have encouraged a shift to larger, more efficient operating systems'.⁹ The recent report of a UK parliamentary committee supports this claim; although producer numbers have declined by a half over the last decade in the UK, milk production has only fallen by nine per cent because of larger herd sizes and more productive processes being used.¹⁰

2.12 Over the last decade, Australian milk production has also been affected by prolonged seasonal issues such as drought, which resulted in high production costs and low water allocations.¹¹ Other factors attributed to the decline in total production over the past decade include the flow on effects from deregulation in certain regions, the impact of the global financial crisis on farm gate returns in 2008–09 (and an associated rise in farm indebtedness), increased competition for land use in different

6 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 3.

7 For example, Murray Goulburn's opening price equates to a weighted average of \$4.90 per kilogram of milk solids, compared to the opening price of \$4.75 for 2010–11.

8 Dairy Australia, *Australian Dairy Industry in Focus 2010*, pp. 11–12.

9 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 12.

10 House of Commons Environment, Food and Rural Affairs Committee (UK), *EU proposals for the dairy sector and the future of the dairy industry*, eighth report of session 2010–12, 13 July 2011, vol. I, p. 6.

11 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 17.

regions and rising uncertainty over future access to key resources due to regulatory and policy changes.¹²

2.13 Dairy Australia estimates final 2010–11 milk production will be close to 9.1 billion litres. A gradual increase to between 9.2 and 9.5 billion litres is projected to occur by 2013–14.¹³

Table 2.2: Milk production by state (million litres)

	NSW	VIC	QLD	SA	WA	TAS	Australia
1999–00	1,395	6,870	848	713	412	609	10,847
2000–01	1,326	6,784	760	699	388	590	10,546
2001–02	1,343	7,405	744	715	393	671	11,271
2002–03	1,302	6,584	720	733	404	585	10,328
2003–04	1,271	6,434	674	703	404	590	10,076
2004–05	1,218	6,613	619	679	398	600	10,127
2005–06*	1,197	6,651	597	646	377	622	10,089
2006–07*	1,105	6,297	534	655	350	642	9,583
2007–08*	1,049	6,102	485	606	319	662	9,223
2008–09*	1,065	6,135	512	628	340	708	9,388
2009–10* (p)	1,074	5,790	531	605	350	673	9,023

* From July 2005, data collection based on farm location.

Source: Dairy Australia, 'Milk' www.dairyaustralia.com.au/Our-Dairy-Industry/Industry-Statistics/Milk.aspx (accessed 8 August 2011), originally sourced from dairy manufacturers.

Regional issues

2.14 Further to these industry-wide trends, many of the individual regions which make up the Australian dairy industry have faced significant localised challenges in recent years.

2.15 In 2009, controversial contract re-negotiations took place between National Foods (now Lion Dairy & Drinks) and Tasmanian dairy farmers. National Foods offered farm gate prices that were significantly below the cost of production and then announced they would bargain only with individual farmers, resulting in significant

12 Australian Dairy Farmers, answer to question on notice, 8 March 2011 (received 28 March 2011), pp. 2–3.

13 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 5.

adverse publicity for National Foods before negotiations were re-entered into and finalised. These issues were considered in the committee's May 2010 report.¹⁴

2.16 Extreme weather events during the past 12 months have also impacted dairy farmers in many regions—with 12 per cent of farms affected and some facing difficult conditions as a result. The floods in Queensland, Cyclone Yasi and other weather events led to production being lost on 48 per cent of Queensland farms.¹⁵

2.17 The effects of the Queensland floods were outlined to the committee:

Mr Tessmann—... The flood issue ... 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.¹⁶

... 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

14 National Foods initially offered the Tasmanian Suppliers Collective Bargaining Group a farm gate price of 29 cpl (later increased to 33 cpl); an offer that was a significant decrease on the price of 49 cpl in place for the previous year. See Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2010, p. 69.

15 Dairy Australia, *Dairy 2011: Situation & Outlook*, May 2011, p. 47.

16 Mr Brian Tessmann, President, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, p. 81.

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.¹⁷

2.18 As Coles' announcement regarding the retail price cuts of its generic milk was made on 26 January 2011, in the aftermath of the Queensland floods, some Queensland farmers were particularly critical of Coles' decision:

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?'¹⁸

Profitability

2.19 In recent years, the average cash income for an Australian dairy farm has unsurprisingly reflected the overall operating conditions experienced in each season. In 2008–09, the average income received by a farm in a financial year was \$87 960. This declined to an estimated \$77 300 in 2009–10 before increasing to an estimated \$100 000 in 2011–11. Average profits shifted from \$6700 in 2008–09, to estimates of -\$1400 in 2009–10 and \$5000 for 2010–11. Further detail about these figures is provided in Table 2.3.

17 Mr Adrian Peake, Chief Executive Officer, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, p. 85.

18 Mr Adrian Peake, Chief Executive Officer, Queensland Dairyfarmers' Organisation, *Committee Hansard*, 8 March 2011, pp. 85–6.

**Table 2.3: Financial estimates—Australian dairy farms, by region
(average per farm)**

	Farm cash income			Farm business profit		
	2009–10 ^p (\$)	RSE	2010–11 ^z (\$)	2009–10 ^p (\$)	RSE	2010–11 ^z (\$)
Queensland and North Coast NSW	105 320	15	59 800	24 250	73	-38 400
Northern Victoria and the Riverina	40 770	89	75 500	- 23 060	143	-7 300
Tasmania	37 550	93	105 000	-51 870	86	6 800
Western Australia	170 280	15	145 900	79 280	29	31 600
South Australia	149 900	18	184 500	31 130	81	67 200
Gippsland	74 550	21	126 600	-2 850	659	39 000
Western Victoria	38 990	84	76 400	-40 890	61	-21 800
Southern and central NSW	228 610	10	154 500	138 120	20	34 500
Australia	77 300	n/a	100 000	6 700	n/a	5 000

Notes:

(1) p: Preliminary; z: Provisional estimate; n/a: not available.

(2) RSE refers to relative standard errors—the extent to which a survey estimate is likely to deviate from the true population expressed as a percentage of the estimate. The ABS considers that estimates with an RSE of 25% or greater are subject to high sampling error and should be used with caution. As the information in the table is based on preliminary data and projections, as well as a sample of farms, it is not surprising that the RSEs are relatively high.

Sources: Surya Dharma, *Australian dairy: Financial performance of dairy producing farms, 2008–09 to 2010–11*, ABARES report prepared for Dairy Australia, June 2011, p. 4; ABARES, *Australian farm survey results 2008–09 to 2010–11*, April 2011, p. 14.

2.20 The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) summarised their expectations for the final 2010–11 figures as follows:

In 2010–11, improved pasture growth and increased availability of irrigation water are expected to favourably affect dairy farm incomes in southern Australia. The financial performance of dairy farms is projected to improve in the southern dairying region of New South Wales and in Victoria, Tasmania and South Australia as a result of higher prices paid for milk used for manufactured dairy products, combined with a reduction in total cash costs as improved seasonal conditions reduce expenditure on purchased fodder and irrigation water purchases.¹⁹

¹⁹ Australian Bureau of Agricultural and Resource Economics and Sciences, *Australian farm survey results: 2008–09 to 2010–11*, April 2011, p. 16.

The structure of the industry and varying levels of exposure to retail prices

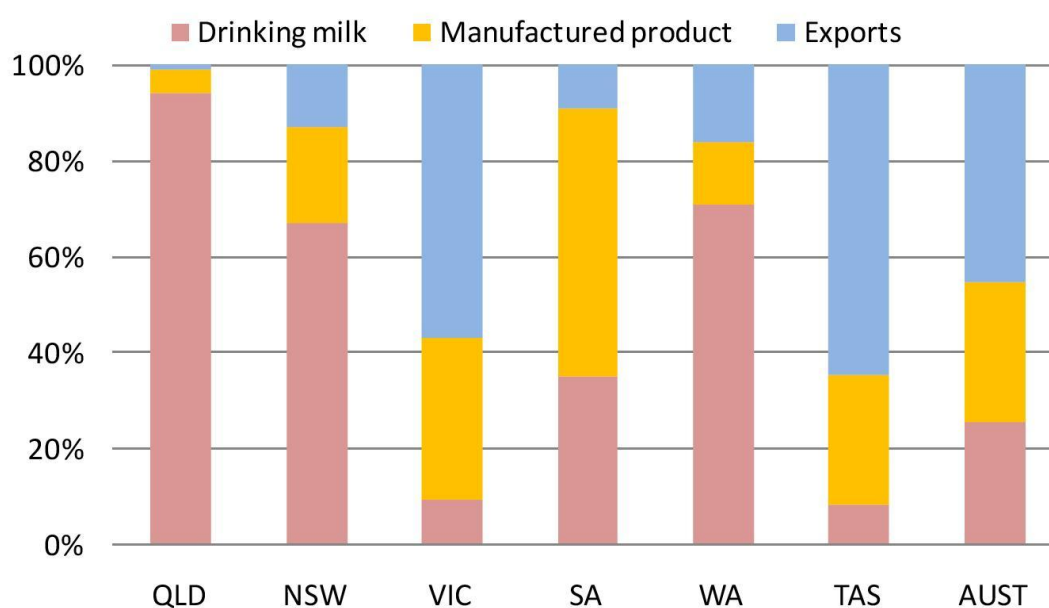
2.21 For drinking milk, there are four main elements in the dairy industry supply chain: production, processing, distribution and retail. This supply chain is shaped by some issues that are not faced by producers and processors of other food products because of the perishable nature of milk:

Compared to milk other beverages such as water, soft drink and beer do not require the same amount of supply chain investment as they are not perishable in the short term and do not require refrigerated storage. In addition, the production of milk is generated from a live farming system and simply cannot be turned 'on or off' or held in storage, as other manufactured drink products can be, including manufactured milk substitutes such as soy beverage.²⁰

Producers

2.22 As discussed in the committee's *Second Interim Report*, and as shown by Figure 2.2, there are two distinct dairy industries in Australia at the producer level.

Figure 2.2: Utilisation of milk by state (2009–10)



Source: Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 41.

2.23 In Tasmania, Victoria and South Australia, milk produced is primarily destined for the manufacturing milk market. Additionally, these states are highly export-focused. Producers in the states of Western Australia, Queensland and New South Wales largely supply drinking milk for domestic consumption in their respective regions.

20 Australian Dairy Farmers, *Submission 150*, p. 4.

2.24 The Australian Competition and Consumer Commission's (ACCC) 2008 inquiry into the competitiveness of retail prices for standard groceries observed that the key determinants of farm gate prices for raw milk are world dairy prices, domestic supply conditions and dairy farmer production costs.²¹ Accordingly, producers are exposed to volatility in the international price of milk and exchange rate movements.

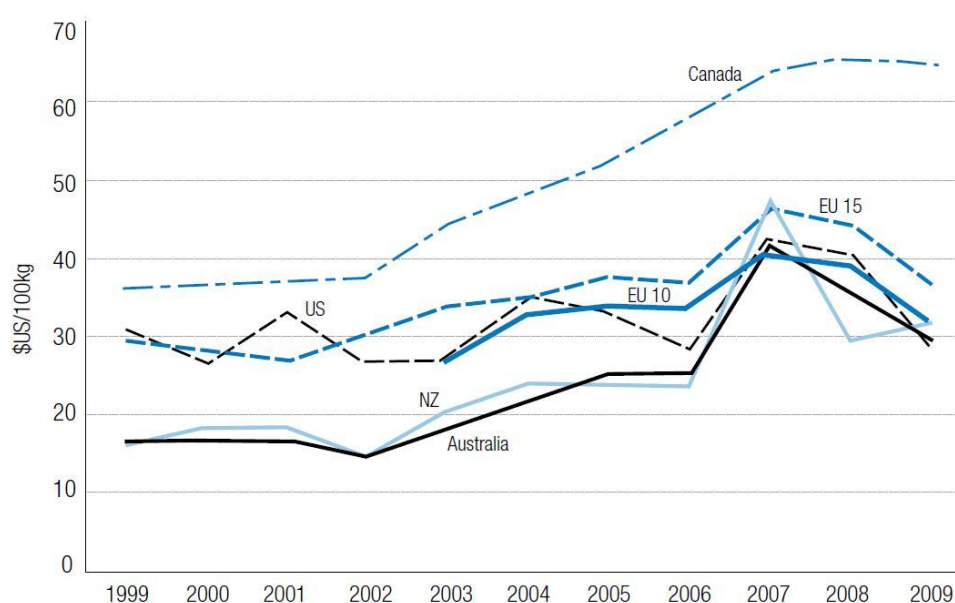
2.25 The entire effect of international prices on Australian farm gate prices, however, is more difficult to encapsulate. Both this inquiry and the committee's previous dairy inquiry heard evidence that the Australian farm gate prices are based on an international commodity price and are not significantly affected by domestic conditions. However, these arguments were rejected by other witnesses. The committee's 2010 report noted such claims were 'hard to reconcile with the differences in farm gate prices across the country'.²²

2.26 Divergences in international prices were also noted, with the committee's 2010 report suggesting that 'it may be more useful to think of the global price (after allowing for transport costs) as setting both bounds on the price that farmers will accept in the medium term for their milk and that processors will pay' although 'in practice, it is unlikely to be economic for processors to import raw milk'.²³

21 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 230.

22 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, pp. 33–4.

23 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, 13 May 2010, p. 35. However, during this inquiry the committee heard evidence that some fresh milk is imported from New Zealand which is used in some specialised milks: Mr Christopher Phillips, General Manager, Trade and Strategy, Dairy Australia, *Committee Hansard*, 8 March 2011, p. 14.

Figure 2.3: International farm gate milk prices (US\$/100kg)

Source: Dairy Australia, *Dairy 2010 Situation and Outlook*, May 2010, p. 10.

2.27 Although the price paid in the manufacturing states in south-east Australia still acts as a benchmark, producers in the drinking milk states of Western Australia, Queensland and New South Wales are less directly impacted by international factors. Instead:

... farm gate prices are more influenced by contract negotiations between processors and retailers, regional milk production levels, location of regional milk production pools and processing plants, the distance milk can be viably transported both in terms of cost, maintenance of quality and the location of markets.²⁴

2.28 Therefore, a premium price is paid to these producers to secure supply and to avoid high transport costs.²⁵ The cost associated with freighting milk long distances is significant—evidence provided to the committee estimated the cost of transporting milk from Victoria to Queensland at being between 12 and 14 cents a litre.²⁶ However, the required year round milk supply generally imposes higher production costs as supplementary inputs need to be sourced during the winter months.²⁷ Supply and demand also has to be closely matched in these areas because of the absence of manufacturing operations:

24 Queensland Dairyfarmers' Organisation, *Submission 94*, p. 13.

25 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 230.

26 Mr Christopher Phillips, General Manager, Trade and Strategy, Dairy Australia, *Committee Hansard*, 8 March 2011, p. 11.

27 Freshlogic, *Northern dairy industry regional industry outlook update: June 2011*, p. 11.

This is a challenge for both farmers and processors, as either over or under supply represents significant issues for the regional market, producing a flat supply curve is costly for farmers, while coping with seasonal peaks and troughs imposes costs on the processing sector.²⁸

2.29 This distinction is particularly important when considering issues such as the retail price cuts led by Coles. These sorts of domestic market shocks are much more likely to affect farmers in the drinking milk states compared to the manufacturing states. The Australian Dairy Industry Council (ADIC) highlighted this when providing its early assessment of the possible impact of Coles' decision:

Farm suppliers in Victoria and Tasmania appear to be less at risk. They may have to bear some of the impact on returns and margins for their companies who are engaged in production and sale of branded milk for route trade or domestic UHT milk.

Farmers in Queensland, Northern NSW and Western Australia are more at risk. In these states, local milk production is utilised primarily for drinking milk. Therefore, farm gate price drivers in these regions reflect the balance between local demand for drinking milk and security of supply.²⁹

2.30 That the different characteristics of the manufacturing and drinking milk regions is not always recognised was a point of frustration for some submitters:

Despite Coles' claims of recent increases in farm gate prices of 22 percent in Victoria, the reality is that milk prices to farmers have dropped by more than 10 percent in New South Wales and 15 percent in Queensland in the last twelve months in these key drinking milk production states. This includes farmers who supply milk which goes into Coles' private label (home brand) milk. To cite Victoria as an example is disingenuous when its key market is export oriented.³⁰

Processors

2.31 Processors collect raw milk from farms and transform it into dairy products, such as drinking milk, yoghurt, whole milk powder, UHT milk, butter and cheese.

2.32 The following table gives a snapshot of the processing sector as at 2009–10; however, it represents the entire milk market (and so includes milk that is not used as drinking milk and processors that are not involved in drinking milk).

28 Queensland Dairyfarmers' Organisation, *Submission 94*, p. 14.

29 Australian Dairy Industry Council, *Submission 96*, p. 12.

30 Australian Dairy Industry Council, *Submission 96*, p. 4.

Table 2.4: Estimated share of total milk production by processor (2009–10)

Processor	Australia		Vic	SA	Tas	Qld	NSW	WA
	million litres	% of total						
Murray Goulburn	3,200	35.5	3,000	100	0	0	100	0
Fonterra	2,000	22.2	1,310	30	470	0	100	50
National Foods/ Dairy Farmers	1,682	18.6	291	319	150	261	611	51
WCB	800	8.9	700	100	0	0	0	0
Parmalat	480	5.3	215	0	0	215	50	0
Others	861	9.5	275	56	53	54	213	209
Total	9,023	100	5,790	605	673	530	1,074	350

Source: National Foods, *Submission 97*, p. 14. Based on information published by Dairy Australia and National Foods' estimates.

Market concentration

2.33 As Table 2.4 indicates, the milk processing sector is relatively concentrated, with the Murray Goulburn Co-operative the largest processor. Murray Goulburn is also a significant exporter—of its total revenue of \$2.24 billion in 2009–10, \$1.16 billion was from exports.

2.34 The most significant recent consolidation in the sector was the acquisition of Dairy Farmers by National Foods during 2008–09. The ACCC decided not to oppose the acquisition on the condition that certain assets were divested. A proposal for further consolidation—Murray Goulburn's proposed acquisition of Warrnambool Cheese and Butter Factory Company (WCB)—was considered by the ACCC in the first half of 2010, but did not eventuate.³¹ Dairy Australia, however, suggests there is 'ongoing interest' in the ownership of WCB:

... in view of the fact that the 15% limit on individual shareholder ownership will lift in mid-May 2011. WCB now has two large dairy groups with significant shareholdings—Bega Cheese holding 15% and Murray Goulburn 10%.³²

2.35 An interesting outcome of the concentration of the processing sector is the price leadership role effectively held by Murray Goulburn in south-east Australia. As shown by Table 2.4, Murray-Goulburn processes the majority of milk in Victoria

31 On 22 February 2010, the ACCC commenced a review of the proposed acquisition. The ACCC released a Statement of Issues in April which raised certain preliminary competition concerns with the proposed transaction. On 2 June 2010 Murray Goulburn announced that it would not proceed with the acquisition and the ACCC consequently ceased its review.

32 Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 38.

which, in turn, is where the majority of Australian milk production takes place. This issue was examined in more detail in *Milking it for all it's worth*, with the committee noting:

National Foods appeared to set their prices based on those set by Fonterra, who in turn had based their prices on those set by Murray Goulburn.³³

2.36 The ACCC, however, observed that such an outcome:

... is something that you would see across a range of industries given some of the market dynamics. I would not see it as a form of collusion but there is no doubt that it is the result of the market structure...³⁴

2.37 The Sapere Consulting Group similarly commented:

While it appears that MG [Murray Goulburn] occupies a position of price leadership, the available evidence suggests that MG occupies a position of what is known in the economics literature as 'barometric price leadership', where the price leader commands adherence by rivals to the price set because its price reflects market conditions with tolerable promptness. That is, the 'barometer' firm is considered to be reliable and tolerably accurate in its pricing decisions, and therefore others tend to copy it.³⁵

2.38 Another relevant feature is the number of processors in each region. In the larger producing and manufacturing states, such as Victoria, there are more processors operating. The drinking milk processing sector is more concentrated than the overall processing market, with National Foods and Parmalat being the major participants. Smaller processors with regional brands continue to operate in some regions.³⁶ Fonterra, which had about three per cent of the national market share for drinking milk, has now virtually left the market by selling its Brownes milk business in Western Australia to Archer Capital. The sale was completed in March 2011.³⁷

2.39 Also in Western Australia, the Challenge Dairy co-operative went into voluntary administration towards the end of 2010 owing substantial amounts of

33 Senate Economics References Committee, *Milking it for all it's worth—competition and pricing in the Australian dairy industry*, May 2010, p. 35.

34 Mr Mark Pearson, Executive General Manager, Regulatory Affairs, Australian Competition and Consumer Commission, *Committee Hansard*, Inquiry into competition and pricing in the Australian dairy industry, 18 January 2010, p. 80.

35 Mr Stephen Bartos and Dr Alistair Davey (Sapere Research Group), *An overview of the Australian dairy industry*, March 2011, p. 11; provided by Coles, answer to question on notice, 29 March 2011 (received 19 April 2011).

36 Dairy Australia, *Australian Dairy Industry in Focus 2010*, p. 26.

37 Fonterra Australia, *Submission 81*, p. 2; Freehills, 'Freehills advises Archer Capital on the acquisition of Brownes dairy and juice business', www.freehills.com.au/7029.aspx (accessed 9 April 2011).

money to farmers.³⁸ Challenge Dairy's assets were purchased by another Western Australian processor, Harvey Fresh.

2.40 As a result, in the drinking milk regions the choice of processors for dairy farmers is more limited. In its most recent application to the ACCC seeking authorisation of collective bargaining arrangements, Australian Dairy Farmers noted:

... in many dairy farming areas of Australia there is often only one dairy company facility, which can leave little or no choice about where individual dairy farmers can market their milk.

This places individual dairy farmer businesses at a significant disadvantage in the market place for milk, leaving them with virtually no bargaining power and making them the ultimate price takers.

Farmers in this position take what the local processor is prepared to offer for the terms and conditions of milk supply. These terms and conditions include price, volume, quality, access to the dairy farm, seasonality of supply and other factors that are incorporated into supply agreements between the individual dairy farmer and the processor.³⁹

Distribution

2.41 Milk is demanded by consumers throughout Australia, not just in the regions where it is produced. Given the limited areas of the country where dairying takes place, this means that many population centres are a significant distance from dairy regions. The fresh and perishable nature of milk as a product also has implications for its handling and transport:

Milk is a 'live biological system' containing an ecosystem of beneficial and nonbeneficial micro organisms that are not eliminated by standard pasteurisation. If milk is allowed to warm to above 5 degrees Celsius, the delicate balance of micro organism can change resulting in flavour taints, physical changes, microbiological spoilage and potential rejection by consumers. The deterioration of unpasteurised fresh milk is sudden and immediate. Pasteurised fresh white milk ordinarily has a shelf life of between 12 to 15 days. A daily consumer would generally begin to consume fresh white milk which is less than 5 days old (from the time of milking).⁴⁰

38 The ABC reported in late December 2010 that 47 dairy farmers in south west WA were owed over \$4 million for unpaid milk: ABC Rural, 'Christmas payments to Challenge dairy farmers', 22 December 2010, www.abc.net.au/rural/wa/content/2010/12/s3099694.htm (accessed 23 February 2011).

39 Australian Dairy Farmers, *Application for revocation of a non-merger authorisation and substitution of a new authorisation*, authorisation A91263. p. 2 www.accc.gov.au/content/trimFile.phtml?trimFileTitle=D11+360556.pdf&trimFileFromVersionId=1001407&trimFileName=D11+360556.pdf (accessed 11 August 2011).

40 National Foods, *Submission 97*, p. 8.

2.42 These factors combine to require a reasonably complicated distribution system called 'a cold chain'. National Foods explained the cold chain process:

A large number of Federal and State laws apply to cold chains, including the Food Standards Code which is administered by State-based regulatory bodies such as the New South Wales Food Authority and Dairy Food Safety Victoria. The laws apply to on-farm handling, transportation to and from processors, onsite storage, distribution centres and retail outlets.

... Cold chain compliance begins at the farm where milk is required to be cooled to 4 degrees Celsius within 3 hours of milking. Typically, milk is collected 3 to 5 times each and every week and delivered to the processor. The trucks collecting the milk are insulated vehicles which require substantial capital investment. Once the milk has been transported to the processor, it is stored in holding storage facilities which can only hold a limited amount of production. The milk is then processed, packaged and dispatched to retailers as fresh white milk within about 24 hours.⁴¹

2.43 National Foods also pointed out:

Dairy processors which do not participate in the drinking milk market do not incur the substantial costs associated with operating a cold chain.⁴²

2.44 Another aspect of the distribution process in the dairy supply chain are the milk vendors who are either contracted or franchised to a processor to distribute milk and other products to a number of retailers or end-users, such as supermarkets (both major and independent), petrol and convenience chains, schools and hospitals. Evidence given to the committee estimated that there are approximately 745 milk distributors in Australia employing around 2200 staff.⁴³

Retail

2.45 About 25 per cent of Australian milk production is used for drinking milk. Drinking milk is sold to customers through two broad 'channels'—the supermarket or grocery channel and the non-grocery channel. The supermarket channel consists of grocery retailers and is dominated by Coles and Woolworths. The non-grocery channel includes of a variety of retailers and users of milk products, such as convenience stores, takeaway food shops, cafés, hospitals and aged care centres.

2.46 Dairy Australia estimates that 13 per cent of national milk production is sold in supermarkets as drinking milk.⁴⁴ Coles has stated that its total milk sales (private and branded milk) make up less than four per cent of national milk production⁴⁵—

41 National Foods, *Submission 97*, p. 8.

42 National Foods, *Submission 97*, p. 14.

43 Amalgamated Milk Vendors Association, *Submission 91*, p. 1.

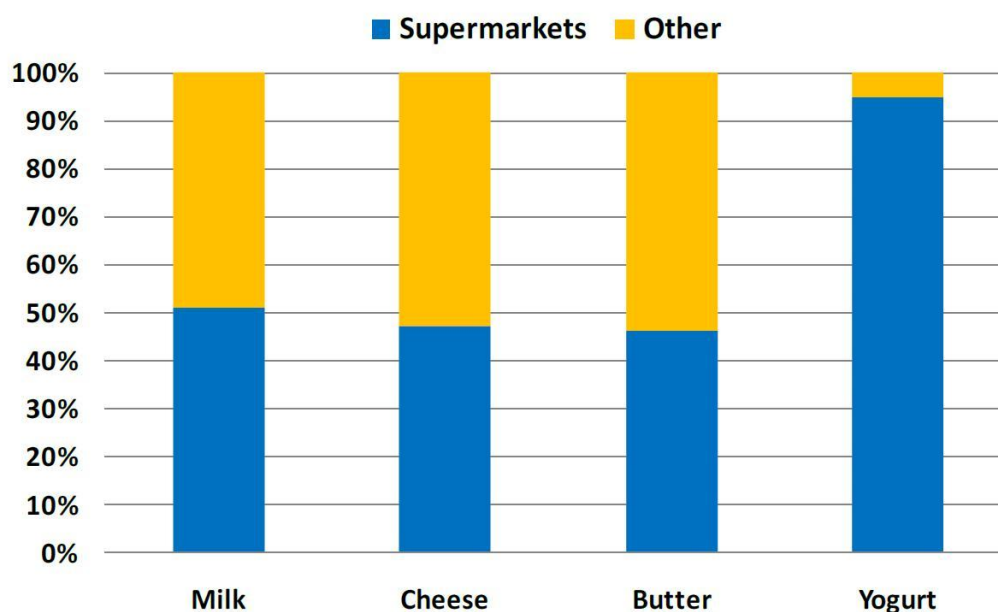
44 Dairy Australia, *Dairy 2011 Situation and Outlook*, February 2011, p. 6.

45 Coles, *Submission 131*, p. 12.

although this would represent a more significant share of the drinking milk market. When asked about their share of that market, Coles advised it was approximately 17 per cent.⁴⁶

2.47 Figure 2.4 provides Dairy Australia's estimates of the breakdown of dairy product sales in each channel. Drinking milk sales via the supermarket channel were estimated to represent 51 per cent of the total in 2009–10.

Figure 2.4: Dairy products sales by channel (2009–10)

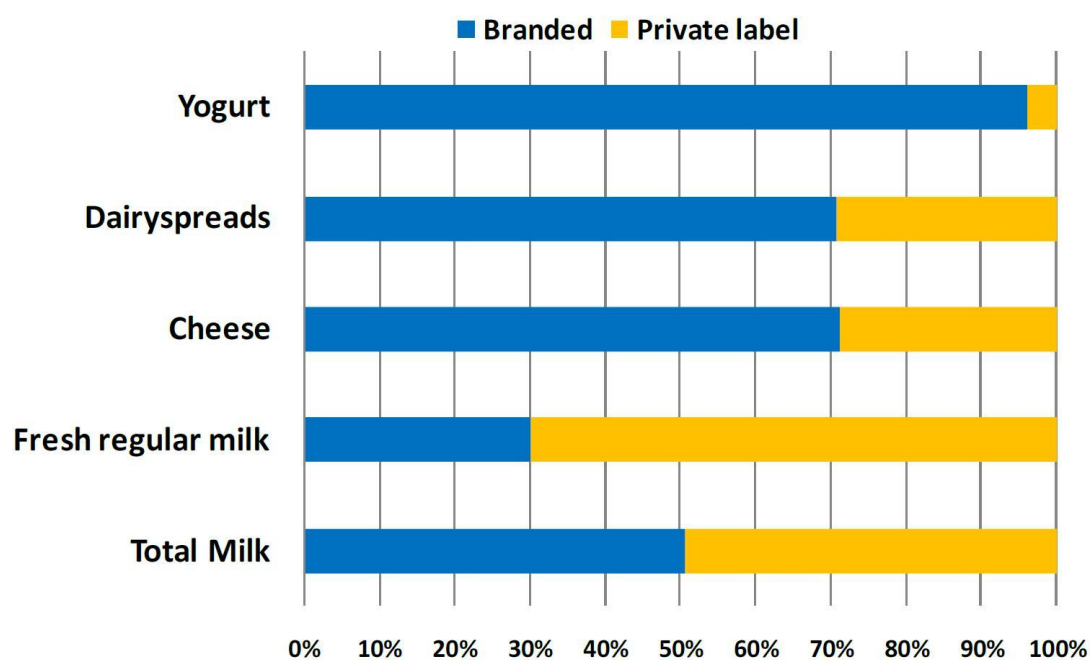


Source: Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 30.

2.48 In recent years, the supermarkets' own-brand or private label products have generally been increasing their share of total sales. While some dairy product categories have resisted the shift to private labels, it is clear that drinking milk, particularly regular full cream milk, has proved susceptible.

⁴⁶ Coles, answer to question on notice, 29 March 2011 (received 19 April 2011), p. 6.

Figure 2.5: Shares within the supermarket channel (December 2010)



Source: Dairy Australia, *Dairy 2011: Situation and Outlook*, May 2011, p. 31.