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SENATE

ECONOMICS REFERENCES COMMITTEE

Reference: Competition and pricing in the Australian dairy industry

THURSDAY, 4 FEBRUARY 2010

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**SENATE ECONOMICS
REFERENCES COMMITTEE
Thursday, 4 February 2010**

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

Substitute members: Senator O'Brien to replace Senator Pratt

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cameron, Cash, Colbeck, Jacinta Collins, Coonan, Cor-mann, Crossin, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Han-son-Young, Heffernan, Humphries, Hutchins, Johnston, Joyce, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronald-son, Ryan, Scullion, Siewert, Sterle, Troeth, Trood, Williams and Wortley

Senators in attendance: Senators Adams, Back, Colbeck, Eggleston, Milne and O'Brien

Terms of reference for the inquiry:

To inquire into and report on:

The current circumstances of the varying prices being paid to dairy farmers in different Australian states, including:

- (a) the economic effect on the dairy industry of announced reductions in prices to be paid to producers by milk processors;
- (b) the impact of the concentration of ownership of milk processing facilities on milk market conditions in the dairy industry;
- (c) the impact of the consolidation of the ownership of the market or drinking milk sector with the manufacturing milk sector on milk market conditions in the dairy industry;
- (d) the impact of the concentration of supermarket supply contracts on milk market conditions;
- (e) whether aspects of the Trade Practices Act 1974 are in need of review having regard to market conditions and industry sector concentration in this industry; and
- (f) any other related matters.

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Committee met at 6.04 pm**HADLER, Mr Rob, General Manager, Corporate Affairs, Coles****MARA, Mr Chris, Adviser, Government Affairs, Coles***Evidence was taken via teleconference—*

CHAIR (Senator Eggleston)—I declare open this fifth hearing of the Senate Economics References Committee into competition and pricing in the Australian dairy industry. On 10 September 2009 the Senate agreed to refer the matter of current varying prices being paid to dairy farmers in different Australian states to the committee for inquiry. The committee is due to report by 28 February 2010. These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be 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 the committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether or not it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, be made at any other time. A witness called to answer a question for the first time should state their full name and the capacity in which they appear and witnesses should speak clearly and into the microphone to assist Hansard record the proceedings.

I welcome Mr Rob Hadler and Mr Chris Mara of Coles. Would you like to make an opening statement at this teleconference?

Mr Hadler—Thank you, Senator Eggleston. It is good to talk to you again. Chris Mara is the government relations manager for Coles and he is far more experienced in the issue of milk buying and pricing in terms of our house brand products, so he will be answering most of the detailed questions from you today. I do not think we need to make any statement up-front. We are happy to take questions and leave it at that.

Senator O'BRIEN—I take it Coles is content for us to make findings on the evidence we have before us in relation to its role in dairy pricing and its impact on the dairy industry?

Mr Hadler—Sorry—what do you mean? I did not quite catch that.

Senator O'BRIEN—You have not made a submission; you are happy to take questions. What I am putting to you is: in the circumstances are we—I think we are—entitled to take it that you are content for us to make findings in this inquiry on the basis of the evidence we have before us and, to the extent that you answer questions, that is all you want to say?

Mr Hadler—Yes, and clearly, if you seek further information, we are prepared to provide that either on a public or commercial-in-confidence basis.

Senator O'BRIEN—We have half an hour to do that. Are you saying that, if we devise a series of questions on notice, you will answer them one way or the other in writing?

Mr Hadler—We are prepared to do that, yes.

Senator O'BRIEN—Thanks for that. I will leave it because we have such a short time and others have questions. I am content to pursue questions on notice.

Mr Hadler—Thank you.

Senator MILNE—Thank you, Mr Hadler and Mr Mara. I wanted to start off by asking you why you insist on a single supplier for your fresh milk. We have had so much evidence from dairy farmers that you have extraordinary power in the market because you only allow a contract for a single supplier. Why is that and why can't it be a much more open competition in terms of a number of suppliers?

Mr Mara—That is not quite true. We do not have a single supplier. We have state based suppliers.

CHAIR—Could you say that again—you have how many suppliers?

Mr Mara—We have state based suppliers and up until the takeover by National Foods of Dairy Farmers we had Dairy Farmers, National Foods, Fonterra and Parmalat as suppliers around the country in various locations. We do not have one supplier.

Mr Hadler—Could I just clarify that. The reality is that National Foods is our predominant supplier of house brand products across Australia but it is negotiated on a state basis and they are not the exclusive supplier. Parmalat and Fonterra in three other states also supply us with house brand product. Clearly our strategy in diversification across states is to try and get as much flexibility and competition into the supply of product to Coles as possible.

Mr Mara—Could I add that this is Coles brand milk. For the branded milk in the marketplace we have multiple suppliers in each state and even regionally within states.

Senator MILNE—I understand that. I was referring to the house brand products. You just said that National Foods is the predominant supplier across Australia but with various combinations around the various states. Nationally, what percentage of the fresh milk home branded product market is currently handled by National Foods?

Mr Mara—It would vary by state.

Senator MILNE—Can you give me some indication?

Mr Mara—Proportionally it would be about 65 per cent of the volume, if you included all the suppliers.

Senator MILNE—Can you tell me what it is in Tasmania?

Mr Mara—I would have to take that on notice.

Senator MILNE—Thank you, if you would. One of the issues, as you would appreciate, is that the farmers are arguing that, because of your one-contract policy as such, they are turned into price takers because the lower price is forced on them once the processors have got the contract. What if we changed the system so that the retail milk price was capped at a multiple of the farm gate price? So let's assume you had a cap of three times the farm gate price. How would you react to that?

Mr Mara—Firstly, the drinking milk that Coles sells represents less than five per cent of milk production. We do not purchase milk at the farm gate. We deal through the processors. We do not set the farm gate price, which is set, as you probably know, by a world commodity market price which is paid by the processors to the farm gate. We have very little influence on it, I suspect.

Senator MILNE—But the issue for me is: if the government of the day, whoever that might be, chose to regulate, as they have done in New York, to say that fresh milk and the various categories of fresh milk can only be sold at a retail price as a multiple of the farm gate price in each state, what impact would that have on Coles—any?

Mr Mara—I do not know the numbers that would be involved in that but, if Coles milk is sold at roughly \$1.20 per litre around the country, the farm gate price accounts for about 40 per cent to 45 per cent of that. The processor's share is roughly one-third and Coles share is about 22 per cent. If you were going to have it as a multiple, you would put prices up, I guess. That would be probably the first outcome you would notice.

Senator MILNE—It depends on the margins each way along the supply chain, I suppose, as to what your ultimate price would be. What steps in the processing chain do Coles take responsibility for when sourcing generic branded milk? Do you package or are you only a reseller?

Mr Mara—We are only a reseller. We purchase directly from the processors.

Senator MILNE—Can you tell me what is the price differential between what Coles pays the suppliers for its generic milk and the same supplier for branded milk, of exactly the same product?

Mr Mara—We have state based pricing for milk as you probably appreciate, because it is a fresh product. But typically the branded milk, depending on the brand—and they vary more than Coles prices—is probably between \$1.70 and \$1.80 per litre, depending on whether they are in a one-, two- or three-litre pack. Coles branded milk would be in the order of \$1.34 a litre. That price would vary depending on whether it is a one-, two- or three-litre pack.

Senator MILNE—Are they exactly the same product? Is there any difference in a generic brand, a house brand product in the fresh milk market in the same category? Let's say we are talking about full-cream milk. Have we got exactly the same product in the packet, whether it is branded or non-branded?

Mr Mara—I suspect that is probably best answered by the processors. We do not make the product. They may have some minor specification differences. I could not tell you that.

Senator MILNE—So as far as you are concerned the home brand product and the branded product are exactly the same and if there are additives added or anything changed, that is not something you know about or have specifications for?

Mr Mara—We may have specifications. I am not the buyer of the milk, but if there are different specifications that we have, we are happy to share them with you. But the processors will be able to give you that answer, not Coles.

CHAIR—Do you want to provide that to the committee on notice, if you have that information available?

Mr Mara—We are happy to.

CHAIR—Thank you.

Senator MILNE—Can you tell me how Coles determines the shelf space allocated to its generic brand products in comparison to that given to the branded products for the companies that supply generic milk and those that do not have a supply contract?

Mr Mara—That would be driven purely by consumer demand for it.

Senator MILNE—So you are saying people do not have arrangements for where on the shelf their product is?

Mr Mara—No more than any other category.

Senator MILNE—That is not what you just said a minute ago, no more than other categories. What does that mean? How do you decide which brand to put where on the shelf?

Mr Mara—The consumer determines the volume and the sorts of products that are on the shelf in the first place. In the dairy case with milk you would have the branded products together, typically allocated within their particular product ranges. Coles brand would be allocated its range as well but that is something that we determine probably every six months. We change that mix around on a regular basis.

Senator MILNE—So there are no other considerations, other than what happens on the day you decide? So somebody who does not have a supply contract but has a branded product would not find their milk in a less lucrative space on the shelf?

Mr Mara—Our job is to sell the milk. If it is a popular branded milk, why would we disadvantage one to another? It is not in our interests to do so.

Senator MILNE—I guess the issue is that what creates a popular supply of milk can be determined by where it is placed and how it is advertised.

Mr Mara—How it is promoted.

Senator MILNE—And how it is promoted. Can you tell me: do you ever use milk as a loss leader to attract customers to Coles?

Mr Mara—Not to my knowledge.

Senator COLBECK—Can you just go back. At the outset you gave Senator Milne a breakdown in costing allocations of the value of a generic product, as to what proportions went to certain elements of the market. Could you just run through those figures for me again, please?

Mr Mara—That was an approximation of what full-cream milk was sold at generally. I am happy to provide the committee with a breakdown on cents per litre as far as we understand the prices on a more precise level for one-, two- and three-litre packs of milk, if that is useful.

Senator COLBECK—No, you gave us a series of numbers a minute ago as to who got what proportion of the product in respect of the retail price. I was interested in getting you to clarify those rough numbers. That is all I want.

Mr Mara—The average price for Coles branded milk is around \$1.10 or \$1.20, depending on whether it is a one-, two- or three-litre pack. The farm gate price accounts for about 40 to 45 per cent of that shelf price, depending on who is the supplier.

Senator COLBECK—Forty to 45 per cent?

Mr Mara—Yes. The processor's share is about a third.

Senator COLBECK—Thirty per cent.

Mr Mara—And Coles share is 22 per cent or 23 per cent. That is Coles gross margin, if you like.

Senator COLBECK—Yes, I understand what you are saying.

Mr Mara—It will vary between those pack sizes.

Senator COLBECK—Fine; I can do my numbers on that later. Is milk one of the products that you are going to go to common pricing on?

Mr Mara—On a state basis, yes.

Senator COLBECK—It will not be national pricing?

Mr Mara—Because we have state based contracts with the suppliers.

Senator COLBECK—I understand that; I just wanted to clarify it. Going back to your comments about how the percentages work out, I want to get a differential between the pricing

and procurement mechanism for your generic brand, which is obviously a tender process that, as you have said, you run on a state based process. Are the offers based on supplying for the state or can it be broken down within that again, or is that a negotiated element of the contract?

Mr Mara—They are state based contracts for supply from within the state and sold within the state.

Senator COLBECK—So, to move into the market to supply you with that product, they would have to be able to supply you with your state-wide needs. They could not supply a proportion?

Mr Mara—For Coles branded milk, yes.

Senator COLBECK—But then you have the other branded alternatives as part of the process?

Mr Mara—Correct.

Senator COLBECK—So your retail price is based roughly on the percentages that you have given us, and obviously that varies with container size.

Mr Mara—The consumer price is obviously cheaper if you buy it in a three-litre pack.

Senator COLBECK—Yes, I understand that, because there are a range of efficiencies that work through with respect to the different packaging sizes and all that sort of stuff. That is not an issue. I am just going to some ABS figures that our secretariat has provided us and then to your evidence about the basis for your pricing.

If we look at, say, a product being sold in Melbourne for \$1.79 and a similar product being sold in Brisbane for \$1.59, the evidence that we have received—and it is quite clear from my understanding of the dairy industry—is that prices for supply in northern New South Wales and Queensland are certainly much higher than they are in the southern markets. Even if you take the Hobart price at \$1.85—and Canberra is within a cent and Darwin is obviously higher for other reasons—how does that align with the fact that it comes off a base of proportionality through to the farm gate?

Mr Mara—That is a fairly long question. Are you saying the price differences across the states—

Senator COLBECK—What I am effectively saying is: you are telling me that your price is based on, roughly, 45 per cent of the milk price to farm gate, 30 per cent to the processors, 22 to 23 per cent—rough figures—as your gross margin, and that covers all of your costs. It is not your profit; it is your gross margin. I understand that. But we know that if you look at Tasmania at the moment—and I know you have to take an average across the year—the farmers are getting somewhere in the vicinity of 31c or 32c a litre and that converts to a price of \$1.85 in Hobart and yet in Brisbane it is \$1.59 and we know that farmers are getting paid something like 50c up there.

Mr Mara—We have contracts, obviously, for two to three years, and whatever the farm gate price is is beyond our control, so we will base our margin off the processor's price that we pay for. So our gross margin in the mid-20s, if you like, is based on our buy price, which will be a fixed price from the contract. The only time that contract price has a step-up, if you like, is if the raw input costs, such as farm gate price or resin or diesel, have gone up significantly.

Senator COLBECK—So you have, effectively, rise and fall clauses within the contract to deal with?

Mr Mara—Rise contracts, not fall ones.

Senator COLBECK—Yes. I worked in the construction industry. We had rise and fall clauses and I never experienced a fall, I would have to say, in my contracts.

Mr Mara—Two years ago during the drought Coles actually, out of contract negotiations, did provide a drop in prices to accommodate the drought prices that were impacting in 2007—I think it was. We did that at the request of the dairy farmers.

Senator COLBECK—You provided a drop in price?

Mr Mara—Yes, of around 5c a litre.

Senator COLBECK—I understand that you are taking this based on what has been delivered to you by the processors, and this is what we are trying to get some understanding of, but my understanding of dairy is that it is much more economical to produce milk in the southern states, for a whole range of reasons, than it is in the northern states, and there is traditionally a higher price per unit of milk in the northern states than there is in the southern states. So again, what are the forces that are driving \$1.59 in Brisbane—where, as far as the production part of the market, it is a high cost—versus \$1.85 in Hobart where it is certainly at the low-cost end of production?

Mr Hadler—We do not see the processor's production costs, so it is not possible for us to comment on the price differentials arising from processing within each of the states. I think from our perspective the major difference in state prices could be attributed to the different timing of contract negotiations which applies for us at different times in different states. But we are happy to look at that further for you, if you would like additional information.

Mr Mara—This may help your understanding. It is just anecdotal, but obviously Victoria and Tasmania produce far more milk than they use—for drinking milk, anyway—whereas in states like Queensland and New South Wales the production levels of milk typically, not always, matches roughly what their drinking milk is, with a little bit extra. They have not got that big swing or reliance on the export that Victoria and Tasmania would have.

Senator COLBECK—I understand all that. What I am trying to get to the bottom of is why the retail price of milk in Hobart, where it is at the end of Australia where it is most economical to produce milk at farm gate, is 25c, 26c higher than it is in Brisbane where it is more expensive to grow milk. Those two things just do not align to me.

Mr Mara—As Rob said, we have not got what the processor's costs are, but we would be maintaining the same margin in both states.

Senator COLBECK—So we need to be looking at the processors to find out where the rest of the money is going—basically that is what you are saying? So you get it delivered at a price. You have a—

Mr Mara—Gross margin we can work on.

Senator COLBECK—gross margin and you work on it from there.

Mr Mara—Correct.

Senator COLBECK—Is there a difference in the pricing? You put out a tender for your generic milk. With respect to the branded product that comes in from the various suppliers, what is the procurement process for that? That is a separate process. So is there a tender process or is it an offer that they will supply at a certain price? What is the difference between the two processes?

Mr Mara—There are a number of suppliers of branded products in each state and within each state, some of which would be suppliers coming to us and saying, 'Place our milk in your stores,' and we do so. If it is sold, they get more space; if it does not sell, they get less space. That is in very bald terms. For the major suppliers, we may have contracts for their branded milk and it would be on a price basis.

Senator COLBECK—So you would negotiate a price for their product and it would go onto your shelves on that basis, whereas the Coles branded product is a tender for supply.

Mr Mara—Correct—and price.

Senator COLBECK—With respect to branding of that product and consumers knowing where it comes from, from what I have observed, the labels basically give your name and address as supplier. Do you have any thoughts on ensuring that consumers know where it really comes from?

Mr Mara—I can only speak for Coles branded milk. In our contracts it stipulates that milk comes from intrastate, so if it is Tasmanian milk it is from Tasmania, and in Victoria it is from Victoria.

Senator COLBECK—That is not what I am asking. I am asking: who has supplied the product? In Tasmania it is National Foods who supplies your branded product—the processor. So where is it coming from so that a consumer can understand its provenance? At the moment the only provenance on there is that it is Coles milk.

Mr Mara—The labelling laws require us to have our name on it, of course, in terms of who the owner of the product or the producer of it is. I do not know what the labelling requirements are for other sourcing material, other than the ingredients. Maybe that is something we can sort—

Senator COLBECK—Something else we can explore. Thank you.

Senator BACK—Gentlemen, I have a couple of quick questions. Can you give us an idea—perhaps in, say, Tasmania and Western Australia—of how many processors would be participating in the tender process to supply you with your Coles branded milk?

Mr Mara—It varies in the states. WA typically has three or four processors—Harvey's, Fonterra, National Foods and another one whose name escapes me.

Senator BACK—Would you be sourcing from all of those or not all of them?

Mr Mara—We would source their brand, yes. But for our house brand contract we would have—in WA at least—Fonterra supply it.

Senator BACK—I think you mentioned that less than five per cent of the product is drinking milk as such.

Mr Mara—That is Coles, sorry.

Senator BACK—At Coles. Could you give me some idea of what the turnover of that stock would be on a weekly basis? Would you turn that same space over three, four, five, six, seven times a week?

Mr Mara—I am not sure of those numbers, but it would be deliveries daily and replenishment daily.

Senator BACK—You mentioned that your gross margin is about 22 per cent. Would that include transport of the product from the processor to your stores and in?

Mr Mara—Those costs would be in the gross margin, yes.

Senator BACK—So they are in your proportion of the gross margin, not in the processor's.

Mr Mara—I would have to check on that for you. I am not certain of that fact.

CHAIR—If you could take that on notice, that would be good.

Senator BACK—You did mention that five per cent is drinking milk. Can you give me a rough breakdown of other milk products and perhaps what the percentages of the remaining 95 per cent would be?

Mr Mara—About a fifth of the production is drinking milk sold in supermarkets and in the route trade.

Senator BACK—About 20 per cent?

Mr Mara—About a fifth. Coles share of that is about a fifth—five per cent.

Senator BACK—Okay.

Mr Mara—Of that fifth, about half will be sold through the supermarket trade—so that is ourselves, our main competitor, ALDI and the IGA networks—and the other half would be in the route trade and food services.

Senator BACK—Thank you.

Senator MILNE—I want to ask about the tender process that you use to get your state supply contracts, because you have said it is a state supply contract for the Coles generic brand milk. Can you describe the tender process: how it works; why you would argue that it is competitive and transparent or whether you acknowledge it is not. Tell me how that tender process is undertaken; how often it is renewed; what are the time frames; and the terms involved in that tender process?

Mr Mara—Typically, the contracts are two to three years. It is open to all parties who want to supply us within that state. In Tasmania, Fonterra and National Foods are the only ones probably capable of supplying the volume that we need in that state. In the other states, like Western Australia, there would be four or five suppliers who could supply us for our house brand contracts. I could not tell you what happens in WA or Tasmania—I am not the buyer—but I can probably take on notice those others details that you have asked for.

Senator MILNE—I am happy to put it on notice. But just to follow that up, given that in Tasmania you have only got two parties—Fonterra and National Foods—capable of supplying the volume that you are talking about that you require, doesn't that lead to an extraordinary amount of market power in that state in terms of being able to drive down the price to the processor and then in turn the supplier?

Mr Mara—Can I just bring you back to the original statement that, as you probably know, Tasmania produces something in the order of 600-plus million or 700 million litres of milk, and we would be buying, I suspect, less than 10 per cent of that total. For our house brand, I suspect it is probably slightly more than half of that 10 per cent. The price is set as an international commodity price, which the processor pays and negotiates with the farm gate, and we buy it off the processor and basically put our gross margin on top of that.

Senator MILNE—Of course there is a lot of debate as to whether the international commodity price is relevant in the fresh milk market. I will not go there now, because we are running out of time, but I would really appreciate it if you could take on notice and send to us as detailed a description as you can of how your tender process operates, the time frames around it, and so on, and the terms associated with it. That would be very much appreciated.

Mr Hadler—We can certainly provide you, on the public record, with details of the tender process. The terms of each of the contracts that we have are clearly commercial-in-confidence between the parties. We would be willing to look at providing that to the committee on a commercial-in-confidence basis. We have provided information to the ACCC and, subject to consultation with them, we would be happy to provide you with the same material.

CHAIR—Okay, you can do that. You can provide that on a commercial-in-confidence basis and it can be confidential.

Senator MILNE—Can you include in that whether you have uniform conditions for your tendering process for each state?

Mr Hadler—Yes, we will do that.

Senator MILNE—Thank you.

CHAIR—That concludes this segment, so we thank Coles for appearing before the committee tonight. Thank you very much.

Mr Hadler—Thank you, Senators. It is a pleasure to talk to you again.

[6.40 pm]

CUMMINGS, Mr John, National Association of Retail Grocers of Australia

HENRICK, Mr Ken, Chief Executive Officer, National Association of Retail Grocers of Australia

van RIJSWIJK, Mr Gerard, Senior Policy Adviser, National Association of Retail Grocers of Australia

CHAIR—We welcome NARGA to the inquiry. Do you wish to comment on the capacity in which you appear and to make an opening statement?

Mr Cummings—Yes, Chair, I will. I am the chairman of the National Association of Retail Grocers and I also happen to be a poor, dumb retailer from Perth, Western Australia. So I own my own supermarkets and I have done for 20 years. I have been buying milk for 20 years and I understand the market reasonably well. The prices that we quote today will be Western Australian prices but they will give you a flavour of how the milk market works.

In my opening statement I would like to draw people's attention to the *Financial Review* on Tuesday that showed in a report from National Foods that they have got the Woolworths contract and the Woolworths contract takes about 40 per cent of the company's total milk production. So some of the figures that I have heard do not add up.

Senator MILNE—Right.

Mr Cummings—I think it is also fair to say that there is not one processor in Australia that could still remain in business if they had the contract for both companies' house brand milk. In every state they are shared.

Senator MILNE—Would you mind saying that again?

Mr Cummings—There is no company that could take on both contracts. They share it. In Western Australia, National Foods have Woolworths and Fonterra have Coles. If Fonterra took on both, they would go broke; if Nationals took on both, they would go broke. I do not believe there is any question about that. If we talk about pricing, looking at Western Australia—two litres of house brand milk, both in Coles and Woolworths, and they are state-wide prices—for some reason their house brand milks are exactly the same price, which is surprising when they seem to work on a formula which is a margin-orientated one. Two litres of house brand milk in Western Australia is \$2.42. I believe the contract price would be somewhere around \$1.70. If we take their hi-lo milk, the retail price is \$2.77 for two litres of milk, and two litres of milk is the largest package, and my information would be that house brand milk would be about 80 per cent of what they sell.

Senator COLBECK—So \$2.77 is the—

Mr Cummings—Hi-lo; \$2.42 is the full cream.

Senator COLBECK—It is \$2.42?

Mr Cummings—Yes. That is the retail price as at last Friday. They obviously come from different cows. The hi-lo cows must be more expensive to maintain!

Senator O'BRIEN—Yes, well, it's the mountains!

Mr Cummings—If we look at that, I would estimate—and this is on pricing that I pay for milk myself, and I will get to some of those comparisons—that their contract price would be somewhere around \$1.70. I see that farmers in Western Australia get about 42c a litre, to 85c—let's say—for two litres. So if we look at that, their gross margin on hi-lo—that is both the major chains, and it would be me if I chose to sell house brand milk as well because I could access house brand milk at around the same price—would be 40 per cent.

Senator COLBECK—For the retailer.

Mr Cummings—For the retail. On full-cream milk the gross margin would be 35 per cent. Before deregulation we made—

Senator COLBECK—So a gross margin of 40 per cent on hi-lo.

Mr Cummings—On hi-lo; 35 per cent on full cream, because they would pay slightly less than the \$1.70 for the contract price. If you looked at available gross margin through that price chain as it went up, taking \$2.77 as the retail, the retailer makes \$1.07 gross margin or 82 per cent of the available gross profit in the chain. The cost of production of that two litres of milk from one of the processors over there would be estimated at \$1.50, so they would make 20c, or 15 per cent of the available gross profit, and the farmer would make 4c, or three per cent of the available gross profit.

That aligns with some research that was done in Oxford that showed the majority of the available gross margin in the chain is taken up by the retailer today and not by the processor or the farmer. There have been some long-term effects from this. We believe it has brought about the waterbedding effect in the dairy industry, and that has worked in two ways: I pay more than the contract price for house brand milk to Fonterra and to National Foods. They have to charge me more so that they can, at the end of the day, make money. I am, in effect, subsidising the supply of house brand milk to those people. Also, if you look at dairy products, if you are a consumer of other dairy products, if we go back 18 months, we would consistently have one-kilo yoghurt on special at \$1.99. We have not seen a price below \$3.99 for the last 12 months. The prospect of me buying cheap ice-cream left my business about a year and a half ago. So I would contend not only that a processor has to make money in other areas but that I believe we are seeing this waterbed effect in other dairy products.

The ACCC in their grocery inquiry recognised that the chains charged slotting fees—that is, if you want to slot your product on their shelf, you pay them. So, on the prospect that they do not charge slotting fees for a category like milk, I do not see it personally, but the ACCC must know the answer to that one. In regard to the value of milk, if the grocery market in Australia is about

\$80 billion a year, and fresh milk, drinking milk, is about five per cent of a supermarket's turnover, we are looking at \$3.2 billion worth of retail grocery sales of milk. If the two majors have 80 per cent, that is \$2.56 billion. If they have been able to lift their gross margin by 15 per cent since deregulation in the sale of fresh milk, they have added some \$256 million to their bottom line profit, or \$384 million if it is 15 per cent. So it is a lot of money that we are talking about here.

I am the first to admit that deregulation has delivered extra margin to retailers. As independent retailers, we tend to spend our money on branded milk and we spend with local suppliers, and we always have—parochialism and all the rest of it. That happens around Australia. You will find now with branded milk in Western Australia—and I will stay with two litres because that is the major container that is sold—Brownes milk retails at \$3.42 for two litres in a Coles supermarket where they sell their two-litre house brand for \$2.47. That 33 per cent difference does not occur in any other generic product that we sell. While I am saying that, Heinz baked beans are \$1.57 retail; house brand baked beans are \$1.15. Two kilos of CSR sugar is \$3.47; house brand sugar is \$3.15. You do not have this huge break, and I think that has skewed the market to it. If that is not addressed, the dairy industry will not be addressed, and that is the reality. So we see people going to those areas.

I will continue going down there: Pura they sell for \$3.47 versus \$2.47 and Harvey Fresh they sell for \$3.51 versus \$2.47. In our business we sell Brownes milk for \$2.35 versus their price of \$3.13; we sell Pura milk for \$2.69 versus their price of \$3.47; and we sell Harvey Fresh milk at \$2.49 versus their price of \$3.15. Why does that happen? Because the processors have come to us and they have said: 'Look, we just can't live on house brand alone. If you blokes don't help us out, we won't have a brand in a few years.' So they are discounting the milk to us.

I have no intention of giving the wholesale prices of those because, if I did, I know exactly what would happen: one of those suppliers would get a credit note from one of those retailers tomorrow, saying, 'You owe me this amount of millions of dollars, because you're selling this product to John Cummings for that price and we want access to it.' That is the commercial reality of what we are dealing with.

Senator COLBECK—You obviously heard the conversation I was having with Coles a moment ago about the base price for milk and what the relationships were. Can you give us any insight into why there would be such a significant differential in the base price of milk? It is \$1.59 in Brisbane versus \$1.85 in Hobart. Where did the basis come from?

Mr Cummings—Sometimes I cannot understand it, but I can only assume that competitive forces are doing it.

Senator COLBECK—So it is either someone else in the market that is driving the price down—

Mr Cummings—Retailing is all about charging what you can get for it.

Senator COLBECK—or there are local or regional or state—

Mr Cummings—It could be in the northern parts of New South Wales—Norco have a niche in there—that it is being supplied to the independent sector. Therefore, I have to price my house brand around what that is. My great-grandfather was one of the founding blokes from Norco, so I know that brand a little bit. If you look at that, it is still strong up there—still a parochial brand—and Fonterra still sell it to independents, but I doubt whether the majors would stock the brand. So that would be an influence, I would imagine.

If it were not for Harvey Fresh in Western Australia, I think you would see a totally different dynamic milk market there. There are only three major processors over in Western Australia, and again I must say they are only Fonterra, National and Harvey Fresh, and I do not believe—

Senator COLBECK—Perth is a very similar price to Brisbane, at \$1.60. So there are price points within various markets of what they will bear, but then there are also other competitive elements that might be playing a part that changes the overall focus.

Mr Cummings—Long term, if brands are not around, I do not know where the milk market ends up. I just do not understand it.

Senator COLBECK—When National Foods were allowed to purchase one of their major competitors, Dairy Farmers, that effectively took a huge slice of price competition out of the market and provided one company with a significant element of strength in the overall market.

Mr van Rijswijk—Some of those prices you are looking at could be average prices and therefore reflect a mix between branded milk and private label milk.

Senator COLBECK—They are ABS numbers.

Mr van Rijswijk—So, as that ratio changes from state to state, you get a price variation. If there is a higher concentration of branded milk in a state, then your average will go up. If there is a lower concentration of branded milk, the average will go down. That would explain the difference between, say, Queensland and Tasmania.

Senator COLBECK—But given that they talk about state based pricing—

Mr van Rijswijk—Yes, but there is quite a differential between branded milk and generic milk.

Senator COLBECK—I understand that.

Mr van Rijswijk—If that particular state has a high proportion of branded milk, then the average is affected quite substantially.

Senator COLBECK—We might do some more detailed research into that.

Senator MILNE—As you are aware, this whole committee inquiry began because farmers are being offered farm gate prices below the cost of production and they simply cannot sustain their businesses. You have just said if there is only branded milk, they are out the back door, essentially.

Mr Cummings—Yes.

Senator MILNE—I am interested in what you think the solutions are. There are a couple of issues. One is the New York option of saying the retail price of milk can only be a certain margin from the farm gate price. That way, you actually lock in whatever that retail price is and you get a farm gate price that is reasonable. The other alternative is to prevent the sale of a home brand on the basis that it is anticompetitive in the Australian context.

Mr Cummings—That is not an easy question to answer.

Senator MILNE—I am just asking for your view of those options.

Mr Cummings—I believe that unless we get to either reintroducing anti price discrimination laws into the Trade Practices Act, which would mean like terms for like customers, or having a floor price for milk, we will not get any transparency in the chain. In Western Australia, as I said, we are selling Harvey Fresh milk retail for \$2.49. Prior to deregulation in 2000, we were selling Peters and Brownes milk for \$2.29 for two litres. That is 20c in 10 years. If you give me a challenge to sell milk as cheaply as the bloke next door, I will do everything in my power to buy it so I can do that, and that is the unfortunate thing that has happened.

This pressure has been put down, and who gets it? The bloke who is least able to get the ultimate pressure. I believe, personally and passionately, that somewhere along the line we have to make a decision as to whether we want to continue to have fresh drinking milk in Western Australia or whether we are going to be happy to have powder bought from Brazil, taken up to China, rehydrated and shipped down there for me to put on my cornflakes in the morning.

Senator MILNE—That is very much where we are coming from here: to try to deliver a sustainable future for people on the land, producing milk in a way that is ecologically sustainable and financially sustainable for them.

To come back to the notion of either a floor price or whatever, in Western Australia do you think that there has been an adequate assessment by the ACCC of the impact of mergers? I am aware that, when Peters were taken out in Western Australia, you lost a processor—

Mr Cummings—Sure.

Senator MILNE—which meant that the same volume of milk was no longer going to be processed, so that drives down the price in the fresh milk market. When the ACCC looked at that, was there any assessment of what the overall impact of that was going to be in terms of farm gate or anything like that?

Mr Cummings—Not to our knowledge, and I personally believe—and we have stated this publicly—that during the grocery inquiry there was an opportunity that was missed. A lot of farming groups were expecting there to be some transparency in the supply chain coming out of the end of it, and I think that transparency is available. Let's look at it from a consumer's point of view. Let's say in an ideal word we set a wholesale floor price for milk in Western Australia of \$2.20 for two litres and we all bought it at that price. We would sell it to consumers for \$2.69. It

would be less than the price for branded milk today. The processor would be getting a margin and the farmer would be getting a margin.

Senator MILNE—So is your proposed solution to this a floor price?

Mr Cummings—That is the only way that I could see it going forward, because until you do that we as businesspeople will chase the cheapest price.

Senator MILNE—Of course.

Mr Cummings—I am not having a shot at Coles or Woolies, but you have to remember: the bloke who buys the milk cannot go to his boss and say, ‘Hey, guess what? I just negotiated a contract up by 20c.’ He would lose his job.

Senator MILNE—What about the idea of them not being allowed to have generic brands because of the market power they have? Look at a state like Tasmania, where you only have two companies capable of supplying to two supermarkets. There is no negotiating power for farmers at all. Once the processor locks in a price, they just screw down the price at the farm gate. Is there an argument to say that, because of their market power and their share of the market and the lack of competition in the Australian dairy industry, state by state they cannot use that to produce generic milk?

Mr Cummings—I think if everybody was buying at the same price—

Senator MILNE—It would not matter.

Mr Cummings—there would not be the need to have it. You could still decide that you wanted to have your own brand milk if you wanted to, and Harvey Fresh is an example. They produce and own three different brands. Harvey Fresh is their major one, and then they have a Murray Fresh and another one, but they do different things. I think the need for a house brand might go away, but people could still have it. The problem is, as I said previously, that there is not a processor who can afford to just sell generic milk.

Senator MILNE—No, that is right.

Mr van Rijswijk—The price is artificially low.

Senator MILNE—Yes, that is right.

Mr Cummings—Absolutely. It is too low, and we are all chasing that price. Come hell or high water, if my competitors are going to be selling two litres of full-cream milk for \$2.42, how dumb do I look?

Senator MILNE—No, I appreciate that. Are there any other suggestions you have in terms of legislative change?

Mr van Rijswijk—I think the milk industry is symptomatic of a much wider problem. The milk industry is at the end of the process, where the price has been pushed down so low the

problem is obvious. But this is starting to happen in other sectors as well, and the people that suffer are the people—

Senator MILNE—Producing.

Mr van Rijswijk—at the farm end of the process, be it fruit, vegetables or whatever. Milk is showing us what the long-term future is, if the basic framework within which we operate does not change, and the problem with the framework is that we do not have section 49 of the Trade Practices Act any more. There is no price discrimination law, as exists in the UK, the EU, the US, Canada and other jurisdictions. At the time that Hilmer recommended that section 49 be repealed, he said, ‘We do not need it because section 46 can do it.’ We know what happened to section 46: it was gutted by the Boral case and since then no action has been taken under section 46. It is completely useless.

What price discrimination legislation says—if you look in the other jurisdictions—is, ‘You cannot sell this product to one customer at one price and to another customer at a different price, provided the volumes are the same.’ But by the same token, what you also cannot do is to say, ‘I’m a big gorilla, and therefore my volume is much bigger, and therefore I can push the price down,’ because you can only discount to the effect that the true cost differential is different between one supplier and the other. So the ability of actually pushing down the price as low as happened in generic milk disappears with a section 49 in the act. That solves a problem in the milk industry and it solves a problem across a wide range of industries.

Senator BACK—The economies of scale are not infinite. You cannot just go on pushing them—

Senator MILNE—So your recommendation would be to restore section 49, on the basis that section 46 is not effective post the Boral case?

Mr Henrick—There has not been a case taken under section 46 in eight years.

Senator MILNE—That is very helpful—to have a specific suggestion—so I really appreciate that. Do you have any other specific suggestions?

Mr Henrick—Just an observation. Every senator on this committee could do the exercise themselves, but there are lots of other sectors of industry in this country which have been concentrated as a result of the National Competition Policy, to the point where competition is virtually non-existent—the banks, the airlines, the telecommunications and so on. The fundamental flaw has been that the ACCC says that they are there to protect competition and not competitors, but they do not ever explain how reducing the number of competitors enhances competition. So it is a fundamental rethink that needs to be done.

Senator MILNE—Thank you, Chair.

CHAIR—Would you say that this threatens our food security?

Mr Henrick—Yes, it does.

Mr Cummings—Without a doubt. It is not beyond question that we will not see the dairy industry in a few years time. I think that, in a lot of instances with food production, we have gone too far. I do not think you will be able to buy a can of Australian canned tomatoes in five years if we do not do something soon. I am still disappointed every day when I look out and I see that we live in a country with the cleanest paddocks in the world and we are sourcing more and more of our product from China and overseas. I do not see the sense of it. I do not see where we are going. We are fundamentally going down the wrong road.

Mr van Rijswijk—The farmers in Shepparton and the fruit growing areas of Victoria are struggling, yet you have packaged fruit coming from South Africa, Swaziland and other places. Why? Those prices are being used to put the squeeze on the local producer and, if the local producer cannot handle it, they are out of business.

Mr Henrick—There was some publicity in the industry press early last year that a senior executive from Coles was about to leave for Vietnam to interview 23 different companies to source Coles private label products. That displaces Australian primary product and processed and manufactured product. So it is a threat to food security, certainly.

Senator BACK—Can I just ask a question as one who does not trouble the retailers all too often myself.

Mr Cummings—Is that because you do not pay your bills?

Senator BACK—No, it is because my wife does not let me loose with the shopping trolley. Why is it that I can purchase Ferguson Valley milk at Spud Shed down at Yunderup for \$1.99 for two litres when the figures you have been telling me have been \$3.42 for Brownes at Coles and \$3.47 and \$3.41 for Pura and Harvey? How is it that Spud Shed can source Ferguson Valley milk and retail it for less than \$2.00 for two litres?

Mr Cummings—He would be sourcing milk close to or at the contract price of the house brand milk. That is what he would be doing, and that would be what Ferguson Valley is. The prices I quoted you were for the major chains. We do not sell branded milk at that price because we honestly could not sell it. I believe that is there as a further incentive for you to go to the house brand. If it were me, that is what I would do. If I want to sell house brand baked beans and my house brand baked beans are \$1.25, I am not going to sell too many if I sell Heinz at \$1.29. If I sell Heinz at \$1.99, I will sell far more generic baked beans.

Senator O'BRIEN—So they have got a loss leader but it is a cheaper leader.

Mr Cummings—Without a doubt. House brands work if they are positioned below the branded product, so that is what you have got to do. You are forcing people into it, basically.

Mr van Rijswijk—The other thing certain stores do is to look at a product like milk as a way of building traffic, so once you are in the store you buy other things which are at a higher margin.

Mr Cummings—And the Spud Shed do that with their Ferguson Valley milk, which is produced by Harvey Fresh as you know.

Senator BACK—Yes, it is. It just intrigued me. I found the discussion very interesting. I am just sad to watch the demise of the Western Australian dairy industry and I suspect the same with others in other states.

Mr Cummings—It is not what consumers want. I can assure you—and I do not know if you people know this—that every time the price of milk goes up, the most common thing customers say to me is, ‘I hope to God the bloody farmer’s getting the increase.’

Senator MILNE—Exactly.

Mr Cummings—We all understand that—everybody in Australia. Who has ever rung up anybody and said, ‘Oh, jeez, there’s a drought. Don’t give those farmers any money’? They expect us to give them money when there is a drought. That is what we do. We are here because, as I said, we live in a country with the cleanest paddocks in the world. We want to keep on eating fruit from here. We have got in Western Australia, in Donnybrook, farmers pulling up pink lady apple trees, for God’s sake.

Senator BACK—Yes, we have.

Mr Cummings—Pink lady apples are the pick of an apple in the world. You go to London and people line up to buy them and we have got blokes in Donnybrook—

Senator BACK—Yes, but there is no demand for them because there is not enough redness in them.

Mr Cummings—Absolutely, and we—

Senator BACK—They cannot even be used for juicing because Chinese concentrate is cheaper than the seconds apples, so-called. So they are going to waste.

Mr Cummings—Are we going down the right track here?

Senator BACK—No, we are not. Thank you, Chair. I did not intend to get on to apples.

Senator O’Brien—Mr Cummings, you said you have come here from Western Australia.

Mr Cummings—Yes.

Senator O’Brien—Everyone else the same?

Mr van Rijswijk—We are based in Sydney.

Mr Cummings—No, we are from Sydney.

Mr Henrick—Based in Sydney.

Mr Cummings—Our office is in Sydney.

Senator O'BRIEN—Yes, okay. Do you consider this inquiry important in terms of the impact on your business or your organisation's members' businesses?

Mr Cummings—Yes, without a doubt. Looking at the long-term future of this, what is my vested interest? You know, in the race of life always back vested interests because at least you know they are trying. Long term, it would not be hard for a company turning over \$36 billion a year to transport milk from South Australia or Victoria over to Perth to sell it. It would be pretty hard for John Cummings to do that. I am always going to be more competitive—and we are in niche markets. We are better off selling Margaret River cheese from the Margaret River cheese company. If you are in Tasmania, why would you have anything but King Island dairy in your cheese case? If you are in Victoria, why would you have anything but Yarra Valley? If you are in South Australia, why would you have anything but Maggie Beer's products et cetera? That is the way it works. So that is what we want.

Another interesting thing for the long term is to think about this: there is not a major food manufacturer in Australia who is developing new products anymore. It is all niche manufacturers and we are turning our back on niche manufacturers on a daily basis. A major manufacturer told me that it has cost them about two million bucks to develop a new product, it cost them about two million bucks to get it on the shelf of the major supermarkets, and in six months they go, 'Oh, that's not working,' and they throw it out, and he has just burnt four million bucks. What is the incentive to develop new products?

Senator O'BRIEN—But the point that I was leading to was: given you have been prepared to come here and present your evidence and present yourselves, were you surprised that Coles was not prepared to be here in person and only give us about half an hour, and are you surprised that Woolworths is not prepared to be here in person and is only prepared to give us about 45 minutes?

CHAIR—They attended with great reluctance.

Mr Cummings—I find it strange. If you looked at those figures and five per cent of their turnover is in whole milk—so if I go back to those figures—that means collectively they are turning over \$2.6 billion in fresh milk. If they are making their 40 per cent GP, or even if it is 30 per cent GP, they are pulling \$690 million worth of bottom-line profit a year out of the product category, I would have thought it would be in their interest to look for it. And public statements that have been made by both of those companies: I go back as far as Woolworths and Roger Corbett saying, 'We are all about farming sustainability.' If you have got a chance to prove it, prove it.

Senator O'BRIEN—In terms of driving sustainability through prices, short of regulating prices is there any other solution other than the solution you talked about, which is the price which effectively the processor would offer?

Mr Cummings—Again, price discrimination legislation effectively worded and effectively governed would actually have that same effect, because it becomes a self-regulating thing; whereas, as I said, if we find out—

Senator O'BRIEN—But doesn't that just mean that if they drive down the price you get the benefit?

Mr Cummings—But at the end of the day they cannot do that because they will go out of business. So you do not have this waterbedding effect. It gets back to the waterbedding effect.

Senator O'BRIEN—So the presumption you ask us to make is that, without the price being driven down for these large swathes of the market, the processors would be charging a lesser price for their branded product and the consumer—

Mr Cummings—Therefore the contract price.

Senator O'BRIEN—You are asking us to come to the view that the consumer would not be worse off because of what you say is the way you apply prices to a higher wholesale price.

Mr Henrick—The benefit to consumers is an illusion because, while the price for private label milk is down, all of the other non-milk dairy products are up.

Senator MILNE—Up.

Mr Henrick—So there is no real benefit to a consumer in that case.

Mr van Rijswijk—And the price of branded milk.

Mr Cummings—Yes.

Senator O'BRIEN—It would be interesting to see the price effects that you are talking about. Are you able to supply us—either in public, which we would prefer, or in camera—with details of wholesale prices offered to you for the range of products that you say are effectively featherbedding the milk price?

Mr Cummings—I could do it in private, but I would imagine that you could find that out just by asking the ACCC to go and find it out for you.

Mr Henrick—They have the powers to surveil prices.

Senator O'BRIEN—I am talking about historically, because you are talking about a historic effect.

Mr Cummings—They could find out the same information. But, yes, I would be happy to give as much information as I can. But I need to be price sensitive to what might happen. Some of these companies have gone back to suppliers and said, 'Excuse me. We've found out that you are selling this to that. Here is our bill for 35 million bucks.'

Senator O'BRIEN—As I said, I would be prepared, if you were only prepared to supply it in camera, to accept it in camera.

Mr Cummings—Yes.

Senator O'BRIEN—Obviously, from the point of view of any Senate committee report, whatever we can take publicly we can report on and therefore present a more substantial report. So we are in your hands in a sense, but it is one thing to suggest that there is this featherbedding; it is another thing to produce—

Mr Cummings—Evidence of it.

Senator O'BRIEN—the factual information which shows us that, whilst the dairy price has stayed down, other prices have risen.

Mr Henrick—The information is there in the retail price information that Dairy Australia has. It shows quite clearly that, as the private label price has come down in relative terms, the fresh branded milk price has gone up. The track record of private label milk is that its price growth has been less than inflation. The track record of branded milk price is that it is higher than inflation. So that differential is quite clear. I think we put a graph into our submission which shows that. The waterbed effect is demonstrated by that graph. But, as Mr Cummings said, it is also demonstrated by the fact that the price of other dairy products—the yoghurts and cheese and so on—have also gone up.

Senator O'BRIEN—That is what I am asking you to give us the detail of.

Mr Cummings—Yes. I can do that.

Senator O'BRIEN—So that the committee is able to say, 'We have seen evidence in camera which we cannot reveal, but it substantiates the claim that there is waterbedding.'

Mr Cummings—Sorry, I misunderstood you. Those retail prices I can give you and they are fine.

Senator O'BRIEN—I am asking for wholesale price.

Mr Cummings—The wholesale price.

Senator O'BRIEN—And I am happy to accept it in camera.

Mr Cummings—Okay. The wholesale price I will have to do in camera.

Senator O'BRIEN—Thank you.

Senator COLBECK—Can I follow on from Senator O'Brien. The prices where the elasticity has blown out or where the waterbedding pushed the price up would have to be fresh or limited-life products—

Mr Cummings—Yes.

Senator COLBECK—that could not be subject to competition from product that might be imported. I understand exactly what you are saying when you go back to your initial comment about the manufacturers not being able to supply across the board into either of the two majors. But the price pressure for the discounting has to appear somewhere else in some other product. So it is appearing in short-life or limited-life products where there is no capacity for competition from imports so the manufacturers can maintain some margin. So hard cheeses and things like that that could come in from—

Mr Cummings—Would tend not to be, but yoghurt is a prime example.

Senator COLBECK—Those sorts of things would maintain a relatively level price because there is capacity for competition into that market.

Mr Cummings—Yes—plus, some things are very price conscious in the market as well. So a one-kilo block of cheese is very price conscious. Once you get above—

Senator COLBECK—So you have got price points above which something will just stop selling.

Mr Cummings—It just slows. But yoghurt is a prime example, where the deals that we were presented with in yoghurt years ago we do not see any more.

Senator COLBECK—So you have got a number of elements that are feeding into that. You have got the growth in the home branded product, which is placing price pressures through the system to provide the waterbedding effect. You have also got consolidation of manufacturers that removes competition within those various markets. So where there might have been, say, two manufacturers that were providing a yoghurt product, one could have been providing a supermarket branded milk and another one not, but there was limited capacity to increase the price on, say, a yoghurt because the other bloke is over the fence and maintains a price.

Mr Cummings—Yes.

Senator COLBECK—So there are a combination of factors that are feeding into that effect.

Mr Cummings—I believe.

Senator MILNE—I wanted to return to the issue of slotting. You heard me ask Coles about that and they emphatically denied it. That is obviously not the evidence we have had. This is why I am asking about whether they should be allowed to sell generic brands, because it is very clear to me that, if you have a situation like in Tasmania where you have only two processors capable of selling into the supermarkets, they have to sell at a very low price to get the contract, so they have to get a reasonable price for their branded milk to make anything happen and then the supermarket slugs them for placement. Would you describe that as an anticompetitive practice?

Mr Cummings—If you are on the end of it.

Senator MILNE—How do we prove that it is occurring?

Mr Cummings—If you are on the end of it, I call it extortion, because that is how you feel.

Senator MILNE—Tell me how you can prove it is happening. They just denied it. You heard them say it does not happen.

Mr Cummings—I think any manufacturer in Australia would have a budget for it. It would be a budgeted expense—a ranging allowance, I would imagine.

Senator MILNE—That is something we can probably follow up with them. We had reports that the processors were exercising bullying, if you like, particularly of the independent grocery outlets, franchises and so on, in terms of, ‘You only sell our branded product, not other people’s branded product,’ and that sort of thing. We had evidence about that before. Is that common?

Mr Cummings—We honestly do not get that in Western Australia. I have never had it. The reality is, again, that now we are being feted by those companies because they need somebody to sell some volume of branded milk. If I wanted to make the most amount of money and do the wrong thing by the dairy industry, I would just do what my major competitors do. Why wouldn’t I just have 85 per cent of a house brand milk sitting there? The reality is that the sales rep from National Foods has been calling on us for 20 years now—he is the same bloke. The girl from Harvey Fresh has been calling on us for three years now—she is the same girl; a great girl. The bloke who comes to us from Fonterra is new, but we have been dealing with Fonterra for years. So we, rightly or wrongly, kid ourselves that consumers want to buy branded product in Western Australia, and that is where we go to.

Senator MILNE—You do not have any experience of bullying from one processor, with a small or independent franchisee and so on?

Mr Cummings—No.

Senator MILNE—What about your colleagues? Do you have any experience of that?

Mr Henrick—There was a reference in the ACCC’s grocery inquiry report where they said that they had been given no evidence of anticompetitive or unconscionable conduct. However, many suppliers seemed genuinely reluctant to give evidence about these matters out of fear of retribution. Then later on in the same report in a different chapter, they said that over time there had been an erosion of terms of trade in favour of the major supermarket chains, even to the point of unilateral variation of price after delivery of the product. That seems to me to be evidence of bullying and unconscionable conduct and yet the ACCC did not deal with it any further.

Senator MILNE—Okay. One of the recommendations that farmers have been asking for is that the ACCC’s powers be split so that the power to assess and approve a merger be separated from the adjudication function, if you like, or the policing function as to the impact of the merger on the market and on competition. The ACCC itself said that is not a problem; they are one organisation but they have two entirely independent groups in the ACCC and they maintain their independence in that way. Do you have a view about that?

Mr Henrick—The ACCC basically acts only on complaint. They are not very active regulators and they are not very active in surveillance of problems within industry sectors. The other observation I would make is that they tend not to be very expert about different industries; it is a fairly superficial level of knowledge.

Senator MILNE—You would like to see a much more vigorous price surveillance and proactive assessment of marketplace practices?

Mr Henrick—Yes, and I think that they should bring in some more expertise.

Senator MILNE—Quite apart from approving mergers et cetera?

Mr Henrick—Yes, quite so.

Senator COLBECK—I would like to come back to the relationship with the processors and the procurement processes. You said that the larger processors are desperate to get people to sell their generic product.

Mr Cummings—Their branded product.

Senator COLBECK—Their branded product, sorry. Are they to the stage where they are offering you incentives to put their product into the store?

Mr Cummings—Yes. They perfectly understand—take Harvey Fresh. Harvey Fresh set a price to us so that we can sell two litres of milk at \$2.49, and that is both hi-lo and full cream. There is not much point in me having Harvey Fresh milk, trying to sell it at \$3.51. It will not work, and if I have got to try and sell Harvey Fresh at \$3.51, that will force me to go and find a generic milk. We actually have access to generic milk; we just do not sell it.

Senator COLBECK—So National Foods would be prepared to—

Mr Cummings—They would do exactly the same. If you go back to that pricing that I gave you, in my particular instance, we sell two litres of Peters and Brownes milk for \$2.35, both hi-lo and full cream; we sell two litres of Harvey Fresh for \$2.49, both hi-lo and full cream; and we sell two litres of Pura for \$2.69, both hi-lo—

Senator COLBECK—What is the delivery process?

Mr Cummings—We receive daily deliveries.

Senator COLBECK—Via a local vendor or via—

Mr Cummings—Via a vendor, yes.

Senator COLBECK—What is your pricing relationship with the vendor?

Mr Cummings—He is ‘on behalf of’. He is doing it on behalf.

Senator COLBECK—So he might have a round where he does your supermarket, half a dozen local stores, another supermarket around the corner.

Mr Cummings—Yes.

Senator COLBECK—He would have different relationships with the corner store, for example, but he would get paid a price per unit to drop into your store.

Mr Cummings—Absolutely, and in some instances—like the coffee shop that wanted to buy milk for cappuccinos—he would bill them direct and they would pay him. In our case, Pura, Harvey Fresh and Fonterra charge us, so our business relationship is with the company.

Senator COLBECK—So he just delivers it.

Mr Cummings—He is delivering on a ‘for and on behalf’ basis, which would no doubt be a price per crate or whatever.

Senator COLBECK—So, as effectively a vendor, he would have a number of different types of contractual relationships, depending on the scale of the businesses that he was operating into. So your price setting and your account terms—all that sort of stuff—are done directly with the manufacturers. He would get paid a rate. He would have a different set of arrangements with the coffee shop next door.

Mr Cummings—Yes.

Senator COLBECK—That will do me, thanks.

CHAIR—We thank you very much for appearing. It has been very useful evidence. You have given us some ideas for recommendations and solutions—and questions. I hope you have a good flight back to Perth.

Proceedings suspended from 7.27 pm to 7.43 pm

DUNN, Mr Ian, Senior Business Manager, Trade Relations, Woolworths

SAMIA, Ms Nathalie, Group Manager, Government Relations, Woolworths

Evidence was taken via teleconference—

CHAIR—I hereby resume this committee hearing and welcome Woolworths by teleconference in the persons of Ms Nathalie Samia and Ian Dunn. Would you like to make an opening statement? Do you have any comments to make on the capacity in which you appear?

Mr Dunn—I am senior business manager for trade relations, but in more than 30 years of buying I have had experience in a private label business and a perishables business and a milk business some time ago, so I should be able to assist the Senate, hopefully, with the questions that they have. We are very happy to appear and very much appreciate the opportunity to do so by phone link this evening. We also understand that we have been allotted 45 minutes but, if I can continue to assist the senators for longer than that, I am happy to do so. I will be doing the talking. Nathalie will not be contributing, so I will not introduce myself each time, but I will do the speaking on behalf of the company.

CHAIR—Thank you very much indeed. It is true we have 45 minutes, but we can cover a lot of ground in 45 minutes in a Senate hearing.

Senator COLBECK—Could you explain to us the differential in the process of procuring your generic branded milk—your Woolworths brand milk—and the process by which proprietary branded milk appears on your shelves. Then could you give us some explanation of your national procurement process for your generic milk.

Mr Dunn—That is fine. I will cover the branded products first. It is a fairly simple process and exactly the same as we do for other branded products throughout our business, and that is purely on the basis of brand producers offering us supply. We typically look at ranges of product on a twice-yearly basis, for efficient operation more than anything else, and we publish those dates. Suppliers come to us with products that they suggest that we might care to range. We will evaluate those on behalf of the customer and range those that we think will do the best job for the business. Obviously we stand or fall on that every six months and review the range again. We do that for all our branded products.

We tender supply on our private label products. We tender for those periodically. We do fresh milk typically over a three-year period. We seek submissions from any party with the capability to supply milk. The current contract was mostly awarded to National Foods, but it was not exclusively National Foods. It has resulted that way towards the end of the contract life because of takeovers and changes in market ownership, but there is no prerequisite for National's supply. In fact, there is no tender advantage in that regard either, because we have a business that is spread over more than 800 supermarkets around Australia, some in very remote locations, and there are some economic benefits for local producers in certain areas.

We do not have a state based allocation of tendered supply, so we are probably slightly more flexible than, perhaps some other retailers in the marketplace. If milk is warehoused in a particular region, we typically will want them to supply all of the stores associated with a particular distribution centre, but that milk will be distributed by us. So it is quite possible for a small supplier to supply us. Then there are some specific geographic areas where it is actually better to have direct store supply. North Queensland is one of those. Again, a regional producer may be in a position to supply a limited number of stores on a direct-to-store basis.

Senator COLBECK—So, when you say ‘not state based’, it can be dealt with and managed regionally within states, but with also a capacity for one company if they wanted to make an offer across the broad—

Mr Dunn—They would make an offer across a number of regions that might, if accepted in every region, add up to a national supply.

Senator COLBECK—You mentioned the contract, which is effectively a national supply contract, that you have got at the moment, and it was not initially that way but it has become that way because of takeovers and mergers. That is one of the elements that we were looking to investigate. It is part of our terms of reference—what the effects and what the impacts of that are. Would you, for example, see any risk in having your entire supply contract for a commodity like that with one particular provider?

Mr Dunn—I might take the liberty of saying that I listened to some of the earlier presentations, so I may from time to time refer to some of the information provided by previous retailers just to save time, if you like. Our position is very much similar to Coles: that, if you take the proportion of our fresh milk sales that are in private label and you take that either as a proportion of total milk production, as they did, or look at it as a proportion of the white milk market, we represent a very small piece of overall milk production, and our numbers are not that dissimilar to theirs.

We see about 24 per cent of the milk production being in retail milk, and our market share and our private labels—we have about 13 or 14 different varieties—runs at about 46 per cent of our sales. So when you work that back to a share of the market it does come back to the five or six per cent that Coles was stating. So, from that point of view, we do not particularly see ourselves at any risk.

Senator O’BRIEN—Do you mean drinking milk? You are saying that as a proportion of all milk produced in Australia, aren’t you, not just drinking milk?

Mr Dunn—Twenty-four per cent of all milk produced in Australia is used for drinking—

Senator O’BRIEN—The stuff that goes into powder and cheese and butter and all sorts of things—that is how you are defining your market share?

Mr Dunn—I am defining the drinking milk portion of that total production as being 24 per cent. I am then saying, as Coles did, in very rough numbers, that we are something like half of that in the two or three major retailers in the marketplace and, if private label is half of my total fresh milk sales, it comes down to around six per cent.

Senator O'BRIEN—But it is to a different market. The people who are processing drinking milk comprise quite a different market to the processing, say, of powder.

Mr Dunn—In some states, in some places, yes. But usually those producers are producing branded milk as well as private label milk.

Senator O'BRIEN—With different equipment.

Mr Dunn—I do not know. I would not necessarily think so. I would have thought it would be on the same equipment from an effective production point of view. You would have to ask the producers whether they do it on a separate basis.

Senator O'BRIEN—You do not know?

Mr Dunn—No.

Senator O'BRIEN—You have been around a long time not to know that.

Mr Dunn—Yes, but there is a limit to how much knowledge or information you get from producers on some of their commercially-sensitive practices. They compete in the marketplace also.

Senator O'BRIEN—By 'producers' you're referring to processors?

Mr Dunn—Processors, yes.

Senator O'BRIEN—Sorry, Senator Colbeck.

Senator COLBECK—So you do not see any risk in having one national supply contract, effectively? I again recognise some of the history with one supplier.

Mr Dunn—I understand. No, we feel that there are quite a broad range of branded producers in the marketplace who are producing and selling in our stores a wide range of branded products and selling them very effectively. We do not see the market as being a private label market; we see it as being a drinking milk market, of which a very large proportion—more than half—is in the proliferation of brands that are out there from various processors.

Senator COLBECK—Yes, but in the proportion of what you are selling, about 40 per cent of what you sell goes through your own branded product.

Mr Dunn—Yes, a little bit more than that, but that is spread over a very wide range of products and not products that are directly competing with each other. So that is whole milk, that is low-fat milk—all the various modifications that there are on milks.

Senator COLBECK—It is still a fairly high proportion of a product line to be at 40 per cent. Having spoken to your MD, I know that the target is to have about 30 per cent of your product going through as a home brand, but you have well and truly exceeded that in respect of milk products.

Mr Dunn—You are quite right. It is higher than that in some other commodity markets around the supermarket and much less than that in some other markets that are dominated by strongly marketed brands. It varies across the board and, despite the best efforts of the milk producers to establish brand loyalty and brand strength, there is obviously some perception out there from customers that milk is a commodity and milk is milk and therefore they buy more of the private label than they might in another category where brands are perceived to have greater value.

Senator COLBECK—Given that you were listening in to our conversations earlier, and the conversation that I had with Coles in particular about how they came to their particular price points with their supply, would you be prepared to put some figures on the table for us, and particularly I am still interested in why this differential seems to exist in milk prices across cities, particularly from somewhere like Hobart where it is \$1.85 and \$1.59 in, say, Brisbane, and yet those two locations are at opposite ends of the raw milk supply cost scale. Hobart is in an area where it is much cheaper to produce the product and in Brisbane it is much more expensive. It has been recognised through this inquiry that dairy farmers are getting paid something like 50c a litre up in those regions, because it reflects cost of supply, and that is information that has come to us from farmers and also from companies like National Foods. Yet in Tasmania they will probably average mid-30c.

Mr Dunn—Can I ask which product you are referring to when you talk about—

Senator COLBECK—I am talking about a whole milk product. As I understand it, composition-wise, the evidence that we got in Melbourne from National Foods was that, for a full-cream branded product versus a generic one, there is effectively no difference in the composition, so we are talking like for like. I am trying to reconcile, I suppose, where the money goes from what the farmer at the gate receives in a market to what the price is on the supermarket shelf in a particular market, if in Hobart the figure is about \$1.85 and in Brisbane it is \$1.59 but they are at the opposite ends of the price scale as far as raw supply.

Mr Dunn—I understand. I looked earlier today at the price of Woolworths two-litre milk and it is exactly the same cost and exactly the same retail price in Sydney as it is in Hobart currently. I did not look at Brisbane, unfortunately, so I am not sure what the prices are there. The retail price—

Senator COLBECK—Can I just butt in there and ask perhaps another question, particularly with the change in pricing that is coming through, I think perhaps with some pressure from the competition with ALDI. Does milk fall within your national supply policy from Woolworths' perspective?

Mr Dunn—National supply or national price?

Senator COLBECK—National pricing.

Mr Dunn—We treat fresh milk very much as a fresh product and, as with our other fresh products, there is much more fluctuation around the nation in terms of retail price. The point I was going to get to in terms of retail pricing is that there is a basic correlation with the cost of the product, obviously. At the end of the day, we look to make a margin from a given category.

Senator COLBECK—Yes.

Mr Dunn—But the retail price is much more likely to change than the cost price. It is relatively fixed over a period of two or three years when you talk private label. But the retail price will move more often in those three years than the cost price will and it will move between stores and between regions and between areas, even though the cost may not change. That is just an effect of competition. You might then say we will make a greater or lesser margin on a given product in a particular store at a particular time, and that is true, and part of the skill of buying is to manage the mix of those sales and those margins over time to get an acceptable return, but doing so selling competitively in the marketplace. So there is not always a direct correlation between the price we are paying the producer and the retail price that we are offering the consumer.

Senator COLBECK—One of the things that we have been trying to establish as part of this process is to get a good sense of where the costs are as part of the production chain. It has been, I suppose understandably, relatively difficult to get that through the processors. Coles has given us a rough break-up, which you would have heard before.

Mr Dunn—I am unable to assist to quite the same degree because I have not got visibility of the farm gate price and we do not expect to have from our suppliers. But in terms of the actual cost to us from the processor and the retail price and, therefore, the margin that we have at the end of the day, it is very much, as you might expect, similar to the figures they were quoting. Our gross profit margin across the category runs at about 24, 24½ per cent, so it seems to be pretty much in line with what they were saying, other than the fact that I do not know what the split is between what the processor gets and what the farm gate is.

Senator COLBECK—Yes. I have to say I thought that was a pretty interesting piece of information, because I did not expect to get that information either, to be honest.

Mr Dunn—I did not expect to hear it given either, but I am happy, to the extent that I can, to give the information that I have.

Senator BACK—Of concern to me and, I am sure, others on this committee over a period of time has been the declining size of the dairying industry in the various states. I am from Western Australia, but I was in Tasmania. As a person who has been associated with the retailing side of the industry for many years, does this interest or concern Woolworths on a state-by-state basis? Would it be of any major concern to you where you sourced your product from?

Mr Dunn—To the extent that we can, we absolutely look to support the health of the industry and the marketplace in many towns. In country towns and in other places we are often one of the largest employers. A lot of the people involved in the rural industry, whether it is farming or anything else, are also our customers, so it is certainly in our interests to support them to the greatest degree that we can, and we absolutely do so. We publicly have stated, and do in our contract negotiations, that we expect our contracted suppliers of private label milk to deal fairly with their providers and we expect those providers to get an economic return, and that is part of the conditions of the contract that we put out there. We varied twice in 2007 and 2008 the contracted price that we had for the supply of private label, without being required under

contract to do so, but to reflect conditions in the marketplace we added a variation to the contract to offset some of the additional payments being made at the farm gate.

Senator COLBECK—That was at the time when farm gate prices were very high?

Mr Dunn—Yes.

Senator BACK—You would have heard the discussion with the previous party appearing before us, and I just want to take you to some observations on the ACCC, if I recorded them correctly. I will repeat it and ask you if you have any comment. They were making the observation—or one of them did—that, in his view, the ACCC protects competition but not competitors, but in so doing is not protecting consumers in retail. Would you care to make an observation on that from your experience as a retailer over a long period of time?

Mr Dunn—My observation would be that I'm a simple buyer and Mr Henrick's economics defeat me every time that I hear them. I had some difficulty with some of the matters being raised. The suggestion, for instance, that there are slotting fees in the marketplace: as far as Woolworths is concerned, that was specifically stated not to be the case to the ACCC in the inquiry and yet tonight it was stated or inferred that we do have them. So I have some difficulty with some of the things that were stated but, as I say, I also have difficulty with the economics behind some of the statements that were made.

I have a very clear belief that the market is highly competitive and that there is, particularly in fresh milk, a very large number of retail outlets. Almost every store, from a video hire store down to a corner store down to a supermarket, is out there selling fresh milk, so I think that there is a very strong and healthy market out there for retail milk and I am not sure that there is an issue with competition in that regard. I might say that that is my view, not necessarily the company's view, if you would not mind.

Senator BACK—Sure, yes; I understand that. But you are reaffirming that slotting fees are not a feature of the supply chain in the Woolworths retail market?

Mr Dunn—Absolutely. As far as Woolworths is concerned, that is correct.

Senator BACK—Thank you. Continuing on with the ACCC, the argument was made that the ACCC has two, possibly conflicting, roles. I wonder whether or not you have ever addressed your mind to that particular question and whether you believe that there is any sensitivity or conflict between the approval role and the ongoing policing role of price surveillance by the ACCC.

Mr Dunn—No. We look to assist the ACCC with any matters that they raise in regard to monitoring the market and we are happy to do so. For instance, they monitored the removal of the milk levy and ensured that it was passed on and we were happy to report on that. They come to the market and seek information in regard to mergers and acquisitions and we happily give whatever assistance we can there. For instance, in Western Australia when groups of farmers want to get together in terms of collective bargaining with processors, we are happy to assist and give a view, and our view is, of course, that we have no issue whatsoever with farmers being able to negotiate the best price they can get.

CHAIR—When you talk about Western Australia and collective bargaining, are you talking about the Margaret River cooperative?

Mr Dunn—I cannot recall, to be honest. It was a couple of years ago when the ACCC sent around an inquiry asking if we had any objections to a group of farmers getting together to negotiate with the processors as a collective group.

CHAIR—That was presumably to get higher prices for their product. Did they achieve their objectives in that endeavour?

Mr Dunn—I would not know. I am not privy to farm gate prices. I do not know.

CHAIR—Some concern was expressed by the last witnesses about the long-term future of food security in Australia and, in particular, milk production. It was suggested that milk powder from Brazil could be sent to China, rehydrated and then sent down to Australia to be marketed in stores like yours. Do you see that as a potential future for the sale of milk in Australia—that we will lose our domestic producers and simply have imported milk?

Mr Dunn—I think that, if 76 per cent of current production is devoted to manufacturing, to food service, to the production of product for further manufacturing and for export, there is a long way to go before there is a specific problem in milk, if there is going to be a problem in milk. But as far as local production in food generally in Australia goes, we operate on the basis that if we can buy Australian we will. One of the difficulties, we find, is being able to find producers who can produce enough volume to meet all of our needs, but our first question is always: what Australian producer can produce a private label product for us? Seventy per cent of all of our private labels are manufactured in Australia. I think about 96 per cent of our fresh foods are sourced in Australia and the other four per cent are basically counterseasonal—California oranges at the opposite end of the year and that sort of thing.

We work hard to, wherever we can, replace imports with local production if we can possibly encourage it, and have done so in things like garlic production and so on. We would like to buy more Australian product if we can and what we do is put an artificial limit on our buyers, a hurdle that they have to get over if they want to buy the product somewhere else. We will put a significant premium on the cost of buying a product somewhere else, to make sure it is worthwhile, as opposed to buying locally if a local product is available.

CHAIR—Another point that was made by the last witnesses related to the Trade Practices Act, section 49 on price discrimination. They said that, while that was repealed in Australia, there still exist legal provisions in Canada and the UK and US to protect producers in that way. Do you have any comment about that?

Mr Dunn—I think some of these matters were canvassed quite extensively in the grocery inquiry and there is probably quite a lot of material in the minutes and the report that came from that that would go to some of the discussions on that particular topic. I would probably leave it at that.

CHAIR—You do not want to comment on the reintroduction of section 49?

Mr Dunn—I am not necessarily qualified to comment. Our business would operate on the basis of whatever legislation is out there that we are required to operate under, and we would go out and do so in a proper manner if we had to.

CHAIR—Another comment that was made was that the ACCC does not protect competition. While they regulate, they do not protect competition. Do you have any views on that?

Mr Dunn—No. We certainly find that it is a competitive market out there, and we are not necessarily of the view that there is a lack of competition in the retail market.

CHAIR—I see. Thank you.

Senator O'BRIEN—Mr Dunn, I understand that there were officers of your company in Parliament House, Canberra during the week speaking to certain senators. Why is it that we are hearing you on the telephone tonight?

Mr Dunn—I was not a party to making the arrangements. I was asked to speak and appear before the committee, and I am very happy to do so.

Senator O'BRIEN—You mean by the committee secretariat or by someone at Woolworths?

Mr Dunn—By someone at Woolworths.

Senator O'BRIEN—So you do not know why, although someone was able to be here in person during the week to have a private meeting with a senator, no-one from Woolworths was able to be here in person to appear at a public hearing?

Mr Dunn—I know that it is a time of year where a large number of our people are in transit in various places and they may well have been in the ACT for another reason yesterday.

Senator O'BRIEN—So we would be better having this hearing in public some other time. Is that what you are telling us?

Mr Dunn—It would have been, perhaps, easier for people to make the arrangements to attend at another time.

Senator O'BRIEN—But I do not think Woolworths were keen to attend. The chairman has advised us that Woolworths were not keen to attend and were appearing reluctantly. Is that true?

Mr Dunn—Not reluctantly. My understanding is that—

Senator O'BRIEN—Not reluctantly?

Mr Dunn—Not reluctantly in the sense of being willing to assist to the degree that we can assist. The reluctance, if it can be called that, relates in my view—and it was certainly my opinion when I read the terms of reference—to the matters that were canvassed in the terms of reference appearing to be very much related to producers and to their source of milk, and those are matters that we have no knowledge of.

Senator O'BRIEN—So you have not read term of reference (d), which specifically relates to concentration of supermarket supply contracts.

Mr Dunn—Yes, but that is in terms of—

Senator O'BRIEN—So how is that not relevant to Woolworths?

Mr Dunn—That is for producers to answer rather than retailers. I may say that, having heard the—

Senator O'BRIEN—So you are content for Woolworths to submit itself to the finding of this inquiry, with whatever we find, and Woolworths is content for those findings to be made without it putting a fulsome submission on its role in the marketplace?

Mr Dunn—No. What I was about to say was that, having heard the earlier presentations and the questions that went with them this evening, and with the time we spent in the last 15 or 20 minutes or so, I very much appreciate that the inquiry relates as much to retail as it does to the manufacturing and sourcing side of the products, and therefore I am very happy to answer the questions now and any further questions there are. If there is a requirement for us to appear or to do something else, I am happy to receive that invitation for another occasion.

Senator O'BRIEN—Receiving an invitation is one thing but accepting it is another. Are you able to assure this committee on behalf of Woolworths that Woolworths will attend a hearing and assist this or another committee in relation to this matter in the future?

Mr Dunn—I can take that on notice and get an answer back to you from the people who need to make—

Senator O'BRIEN—You do not know whether Woolworths has that view? I am interested to know. You are obviously giving us the assistance you can, but I am a bit concerned that Woolworths is giving us a bit of a token presence at this inquiry—with due respect to yourself and, apparently, Ms Samia—and is otherwise not keen about presenting information to this inquiry.

Ms Samia—We are always happy to provide information to the inquiry. When the request came through—I think it was last week or the week before—I think it was more a timing issue. We said we were more than happy to provide in writing the answers to any questions and we were, in fact, working on that this week. When we were told that there was an opportunity as well to do it by phone, Ian was available when others were not, so we took that opportunity. We can answer as many questions as you like here or at a future date. We are more than happy to do that.

Senator O'BRIEN—Thank you for that information, Ms Samia. So Woolworths will be prepared to attend a future hearing and to answer questions, or are you saying you want them on notice so that you can apply in writing?

Ms Samia—No, I think we said that previously we were provided with questions to reply to, so we were doing that in writing, but we are happy to answer any questions you have now. But, if you wish to have further questions put to us, we are happy to do that as well.

Senator O'BRIEN—So, if this committee were to hold a future hearing where we wanted to see you in person—not you personally but Woolworths—appropriate officers would attend?

Ms Samia—Yes. Presuming we could organise their diaries, we would make every effort to do that.

Senator O'BRIEN—How much notice would Woolworths need?

Ms Samia—I do not know. An appropriate amount of notice.

Senator O'BRIEN—That is not very helpful, with respect. Perhaps you could take it on notice and come back to us with how much notice Woolworths needs.

Ms Samia—I think a couple of weeks notice is more than appropriate.

Senator O'BRIEN—A couple of weeks? If we were to convene a hearing in two weeks, Woolworths would have appropriate officers here to answer any questions we had?

Ms Samia—I am sure that we could find an appropriate person to be able to respond to your questions, yes.

Senator O'BRIEN—Within two weeks? All right, we accept that. I find it very difficult dealing with these issues in teleconference circumstances. We often provide this facility to people who do not have easy means to travel or the resources to come to hearings, but we do prefer to see people in person and we do prefer organisations with the resources of Woolworths to come before hearings in person.

Ms Samia—I accept that, but I would also like to point out that we have appeared before a number of committees, including this one, so we do not have any issues with appearing before the committee as such. It was more the fact that this facility was made available due to the timing issues.

Senator O'BRIEN—Thank you very much for that information, and I appreciate what assistance we are getting. As I say, I find it very difficult at the end of a sitting week, in the evening, trying to get across what we have. Although Mr Dunn said he was available for whatever time we have, we have actually only been able to schedule three-quarters of an hour for this witness and we have another witness after Woolworths. So we do have time limitations which are imposed in part because of us but also in part because of the way we are conducting this hearing.

In relation to Woolworths' share of the drinking milk market, can you give us some information as to what proportion of Australia's drinking milk market Woolworths supplies as a retailer?

Mr Dunn—I probably cannot give you any more than Coles gave you. The major retailers would have something less than 50 per cent of the drinking milk market.

Senator O'Brien—Is that the retail drinking milk market, or are you including that part of the market which might be described as ingredients market or business supply market?

Mr Dunn—No, that is retail drinking milk, or retail liquid milk, not the manufacturing product.

Senator O'Brien—Not as ingredients, but you would include in that retail market places like coffee bars and places that use a lot of milk but do not retail milk.

Mr Dunn—I would include packaged flavoured milks but not bulk milks from dispensing machines and so on. I would include any outlet that sells whole bottled milk, and most stores who are not necessarily in the chilled milk business do have a milk fridge out there and sell milk as a convenience—so a fruit and vegetable store, a video store or a fast-food store; lots of them have retail milk for sale.

Senator O'Brien—I am not sure of the breakdown, but I was interested in, for example, all the coffee shops that do not sell milk but sell a lot of milk in coffee. It does not include that part of the market?

Mr Dunn—No, I was not looking to include that. That would not be a fair representation of the market in which we play.

Senator O'Brien—How is Woolworths supplied by its suppliers, both for its home brand product, if I can call it that, and for the product branded by the manufacturer to their own brand? Does Woolworths receive that into its storage areas and then convey it to its stores itself, or does the manufacturer arrange delivery, either directly or via a contractor, to supply the milk to your stores?

Mr Dunn—There are a wide range of arrangements in place. The majority of the arrangements are on the basis that we distribute the milk from our distribution centres on pallets that are picked by store quantity. So the amount of milk that a particular store wants is packaged, delivered to our distribution centre and we then transport that and take it on our own transport to those individual stores. Cross-docking, if you like, is the most frequent way of distributing milk, but there are some other arrangements in various places, including some that go direct to stores.

Senator O'Brien—So, when I look in Tasmania and go to my local Woolworths supermarket and someone is putting milk into the cabinets, that will be a Woolworths employee?

Mr Dunn—Yes, it will.

Senator O'Brien—That is not the case for other products, is it?

Mr Dunn—Yes, it is in the vast majority of cases. Supplier representatives go into stores usually to assist with promotional activity rather than standard shelf filling. The vast majority of standard shelf filling is done by Woolworths employees.

Senator O'BRIEN—Sure. I had the impression—and perhaps I was wrong—that bread was supplied by the bread manufacturer's contractor or employee and the bread displays were stocked by those people.

Mr Dunn—There is a greater degree of merchandising by bread manufacturer representatives than there is merchandising of products in other categories, but even there it is not universal by any means; it is a mix. They will come into the stores once or twice a day and do merchandising, but they will not necessarily do so throughout the day.

Senator O'BRIEN—No. The turnover of their product in part will be dependent on them keeping it stocked.

Mr Dunn—Yes. Milk, on the other hand—

Senator O'BRIEN—But that doesn't apply with milk?

Mr Dunn—Compared to bread, milk is something that requires frequent refilling during the day. It does not necessarily last on the shelf all through the day, so it is very much a staff refill job.

Senator O'BRIEN—You heard some evidence obviously from the National Association of Retail Grocers, if you have been listening in, and some evidence about the discrepancy between the price that you offer branded milk at and the price that they offer it at. What do you say about that?

Mr Dunn—I say we make a very similar gross profit margin—and this is gross margin, so it is not net margin—on both groups of products: on branded products and on private label products. So as far as that is concerned, it is based on a cost that was supplied by the manufacturer.

Senator O'BRIEN—So when the manufacturer supplies a branded product to you, they supply it at a price they nominate or at a price that is negotiated with Woolworths?

Mr Dunn—It is a price they nominate and we have the right to negotiate that and we have the right to compare that to the price that we pay for other brands. We have the right to take that into consideration in the mix of branded product that we ultimately buy, but at the end of the day we have to pay the price that the manufacturer is willing to supply at or he may choose not to supply.

Senator O'BRIEN—So if someone is getting it cheaper than you are, and you are obviously paying a lot more for the branded product than the home brand product, shouldn't that indicate to us that the picture painted for us by the National Association of Retail Grocers in the milk market is correct, given that the evidence they have is that they are being encouraged to be in the branded product market because the processors need them for survival, given the pressures that the main grocery chains place on the processors for the so-called home brand milk product price?

Mr Dunn—I understand. I do not think that is the case. We are under as much pressure as they may be under to range as many branded products and as much branded product as possible. The manufacturers want us to range their brands and to give them as much exposure as they can possibly negotiate with us. So they want to sell as much of their brands as they can through our stores as much as anywhere else. I cannot speculate on transfer pricing or anything else, because I have no knowledge of how the producers come to market.

Senator O'BRIEN—But wouldn't it stand to reason that, if they can afford to easily supply at the price that they have to supply your home brand product at, there wouldn't be such a differential between the home brand and the branded product in your stores?

Mr Dunn—No, I have got no knowledge of whether it is more profitable for them to supply us branded product or for them to supply us the private label, notwithstanding the supply cost difference that is evident in the marketplace. There are many economies of scale and lower costs associated with producing a private label compared to producing a brand that requires marketing that may have more uncertain distribution and so on. That is a question properly put to the producers to understand how their margins—

Senator O'BRIEN—I thought you said that in terms of distribution most of their product would go to your sort of warehouse rather than directly to the stores and therefore why would they have problems with distribution?

Mr Dunn—No, what I am saying is that it may be more efficient for them to bring that product to market in the guaranteed volumes that they have. So, in a volume driven business, to have guaranteed amounts of milk that they are going to ship every day I am sure is of considerable advantage in terms of planning their business. So there are things like that that make the private label perhaps more profitable for them at a given cost than a branded product may be, albeit at a higher cost.

Senator O'BRIEN—Or, alternatively, that they cannot afford not to have the volume that you provide for their operation to be efficient, so they have to take a much lower price to get that volume into their process.

Mr Dunn—I was speculating on how their structure might be and you are absolutely right—you can speculate to the ends of the earth—but at the end of the day it is—

Senator O'BRIEN—Sure. That is why I introduced the evidence you have heard about the National Association of Retail Grocers' witness evidence about getting a better price than you do for that product, because it is essential for them to be promoting their brand rather than perhaps being somewhat captive to major retailers.

Mr Dunn—Unfortunately, I have got no knowledge of what price they pay for the product, unlike—

Senator O'BRIEN—And they are not going to tell you, for obvious reasons, which you heard.

Mr Dunn—I cannot comment on the price that they pay for their product; I do not know what it is.

Senator O'BRIEN—Does Woolworths use milk as a loss leader?

Mr Dunn—No, not at all.

Senator O'BRIEN—No?

Mr Dunn—Absolutely not.

Senator O'BRIEN—So, if they are not using it as a loss leader, there is a differential in the price offered? You heard the evidence that they can get the so-called home brand milk at a similar price. Why would that be? I suppose Woolworths does not know why that would be. Is that what you are saying?

Mr Dunn—No, I have got no idea, to be honest.

Senator O'BRIEN—I invite you to take that on notice if you want to give us a more fulsome answer to that question. But I will leave it in the hands of Woolworths as to whether you do; it is a matter for you.

Mr Dunn—With respect, the question is going to the price which another retailer pays for the supply of his goods. I have no way of answering that. I have got no way of getting that information. I mean, if the assertion is made that they can buy at a better price than I can, that is fine, and if that is taken as evidence, that is fine too. But I have no way of, on the other side of the coin, refuting that because I have got no actual knowledge of pricing that is paid.

Senator O'BRIEN—You may have given this evidence, but what proportion of the milk sold by Woolworths is home brand?

Mr Dunn—The private label suite of various products, about 13 of them altogether, is about 46 per cent of our fresh milk sales.

Senator ADAMS—I would like to know how Woolworths determines the shelf space allocated to its generic brand products in comparison to that given to the branded products for the companies that supply generic milk and those that do not have a supply contract.

Mr Dunn—The answer again is somewhat similar to Coles, but hopefully I can be a little bit more expansive on that. There is a basic need to fulfil the requirements of customers, so we must be able to give enough space to each product to satisfy the minimum requirements of keeping it on shelf, doing so reasonably effectively. If you have to fill it up every five minutes, it becomes not cost effective to do so. If you give it enough space to last all day, then you are perhaps not maximising the use of your scarce refrigeration.

So there is a balance there somewhere that first of all says you allocate the space to try and keep every product on shelf for as long a period as you can. You then vary the amount of space relative to sales. There are considerations then of size and cube of the product. If the product

comes in a carton of six or eight or 10 or 12 then there is a requirement to give it a certain number of facings on the shelf, irrespective of the volume of sales. There needs to be a minimum amount of space to fit the carton on the shelf. Any discretionary space is then used for faster-selling products.

You have considerations of the shape and how it fits. You have considerations of blocking certain types of product together to make it easier for the customer to reach or to recognise or to compare brands. So there are a whole lot of considerations that you would take into account when you try to set the range. Again, you look at that, measure the results, change it every few months to suit the needs of the market.

Senator ADAMS—Just one quick question: on the service station sales, what percentage of milk from Woolworths would go through that outlet?

Mr Dunn—Through our outlets—

Senator ADAMS—Yes, through yours.

Mr Dunn—I would have to take that one on notice, if I may.

Senator ADAMS—Thank you very much.

CHAIR—I think that concludes your evidence. I thank Woolworths for being available for this hearing tonight. Thank you very much.

Mr Dunn—Thank you.

[8.34 pm]

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

TESSMANN, Mr Brian Arnold, President, Queensland Dairyfarmers Organisation

Evidence was taken via teleconference—

CHAIR—We welcome the Queensland Dairyfarmers Organisation. Would you like to make an opening statement?

Mr Peake—Yes. Senators, thank you very much for fitting us into your schedule. We had written to your committee seeking an opportunity to address you, because I understand you could not fit a scheduled meeting in Queensland, so it is greatly appreciated that you could fit us in tonight. We would like to quickly talk on the submission that we put to the inquiry, and we have raised some key issues that we would like to explore a bit more with you and some initiatives that we think the government could support to help the industry deal with some of the issues that we have in the value chain. So I might hand it over to Brian just to quickly go over some of the industry background for the northern dairy industry—which we include as covering northern New South Wales and Queensland—and then I will just talk on some of the issues that we wish to pursue as part of this inquiry.

Mr Tessmann—We have got some concerns, as you would know, and as presented in our submission we are mostly a domestic focused industry in the north. We do have some concerns with things which Adrian will expand on in a minute, particularly around the generic brands and the effect that that has on the market conditions in the north.

We also are particularly concerned about the collective bargaining groups, which we have found to be certainly a very useful thing in the northern region, but we think they could certainly be a lot more useful. They have certainly got restrictions on them that the ACCC has imposed, and I think there are issues around that so that they could actually even up some of those market distortions that I just spoke about, and I think any help, such as in training, would be really good for them. We also are concerned about the other costs that make us uncompetitive, particularly for any part of the industry that relies on export and costs that affect our sustainability in our region.

The industry in the north in Queensland has around 600 farms that produce about 512 million litres. The whole northern industry, covering northern New South Wales and Queensland, is more around 830 million litres, with around 800 farms. But the industry is certainly expanding in the north. There is a huge population that is migrating to the region—there are various figures quoted on how many people come in every week—but our information is that we will probably need about 30 per cent more milk than we have got now in a decade's time. So there is certainly a need for more milk and we think, if market conditions are right, that we can certainly produce that milk in Queensland.

Mr Peake—I want to explain a bit more on those issues that Brian has raised. It is a bit hard on teleconference; it would be easier if I were there with a whiteboard. But, if I were to start from the value chain at the retail level, we have got some very serious concerns about what has been happening in the last decade in terms of the major supermarket strategies on branding. As you see in our submission, we have put some figures in there of what has happened nationally, and the major supermarkets now have increased their market share of their own supermarket brand or their private label and the proprietary brand share is reduced, and also the supermarkets have implemented a significant price differential between their own brand and proprietary brands and they have actually, through that dual strategy, grown their overall milk sales. So their milk sales now account for about 60 per cent of all milk sales in our area and that market share is increasing.

As a recent example of the differential between pricing, I got some prices today from one of the major retail outlets in Brisbane, and one has just announced a price reduction on the weekend for a two-litre bottle of whole milk down to \$2.09 for their private brand and the advertising was structured in a way that you could possibly term it as a loss leader strategy in terms of marketing as a reduction to get people through the front door of the supermarket. But, if you look at the price differential compared to the proprietary brand of one of the processing companies that sits on the same shelf, it is probably \$3.20. So there is quite a significant price differential and that differential now, with this latest marketing strategy by the major retailers, is actually increasing. So that is a real concern for us, because at the end of the day, as that major supermarket chain share increases and more milk goes into the private label volume away from proprietary brands, it means that there is less return back down the value chain to the processor and thus back down the value chain to the farm gate. That situation is an extreme concern for us and we question whether it is sustainable long term.

If you were to ultimately follow that sort of branding strategy through to where potentially proprietary brands were not viable any more, the consumer actually could be faced with the situation of having a reduced choice and one could also ask the question about what would happen to the actual pricing to the consumer if there were not a choice and it was only a choice between a number of supermarket brands on the shelf. We do not know the answer to that, but it is certainly a question we would like to see the ACCC investigate more. We know that this issue has been covered under previous inquiries, such as into the price of groceries, but we think it warrants further investigation. We, as a small organisation, do not have the resources or the power to get that sort of data or information, but we believe, in the interests of our industry, it needs to be looked at further.

Brian raised, and I would like to touch on, the issue of collective bargaining groups. We have some really successful examples of collective bargaining groups in Queensland. In fact, historically we had the first collective bargaining group to be registered in the dairy industry, and that group has been successful not just in terms of working with the processor on the issue of price but on a much broader basis in terms of getting a better understanding between the producer group and the needs of the processor and also what was happening in the marketplace and the issues the processor was facing.

They have managed to negotiate not just on price but also on supply conditions, terms of contract and a range of other issues, including transportation, testing et cetera. That relationship has matured over time, and I would have to say in the northern industry, from where I sit in my

chair in the Queensland Dairyfarmers Organisation, when they managed to negotiate longer term contracts, it did have a positive effect on arrangements with other producers and processors. So they did set some precedents and lead the market in that sense. It is hard to quantify in dollars, of course, but from where we sit we can see the positive effects of that sort of negotiation process on a number of fronts.

The problem since 2000, but more in the last few years, is that there has been ongoing rationalisation of the processing sector. The last major movement, of course, for us was the takeover of Dairy Farmers by National Foods. That has meant that the processing companies have expanded their coverage in terms of not only farmer numbers but also geographic area and milk pool. At the same time, I think the collective bargaining groups that currently exist with authorisations under the ACCC need to be allowed to expand their farmer base representation and geographic areas to enable them to keep up with what is happening at the next level in the value chain. At the moment there is a disparity that has occurred, and there needs to be the opportunity for the collective bargaining groups of farmers to rectify that by being able to expand their representation.

We strongly recommend that as a positive initiative that the committee could consider. Also—and I know this has been raised in other submissions—we would like to see additional resources provided for training and professional advice to these groups. A lot of these groups are made up of people who are professional farmers but they are not professional negotiators and they are in an environment where they are having to negotiate with highly skilled and very experienced people in the processing sector of the food industry. We have seen the positive results that training and support can provide to collective bargaining groups, and so we would strongly recommend and encourage the government to have a look at ways in which additional support can be provided to those groups.

With those three major issues, Brian also highlighted our competitiveness and the impacts on the cost base of our industry. The real issue there is on a number of fronts, but ultimately, even for us in Queensland where we are a domestic focused industry, the international price through the milk pools of Victoria and up the east coast affects what our farmers received at the farm gate as well. It does have lag effects, because of contracts et cetera, but ultimately it does impact on us. So, even though we are a domestic focused industry, we still need to retain our competitiveness, not just in our own market but internationally, and we need to continue to be the first best option of choice of milk supply for the processors in our region.

Anything that impacts on the cost base undermines that and, obviously, puts more pressure on the sustainability of our industry. At the moment, if I was to paint a picture, we are receiving a lot of pressure on the cost base but we are also receiving the pressure of the reduced returns back to the value chain because of what is happening in the retail market. I will leave it at that. I have just thrown a whole lot of words at you, but I would like to open it up if you have questions of us.

CHAIR—Yes, of course.

Senator O'BRIEN—I am very interested in exploring the issue of the way that the collective bargaining provisions work under current legislation. You talk about the authorisations. You

want broader collective bargaining groups authorised by the ACCC. Is there anything in the legislation that prevents that from happening?

Mr Tessmann—One of the successful collective bargaining groups made application to the ACCC not all that long ago to expand its region, to simply take in a number of other suppliers to the processor that they were the collective bargaining group for, and were refused. So, yes, they certainly have been prevented from expanding, even to a small extent, their region that they are allowed to represent suppliers in.

Senator O'BRIEN—Can you supply us with more information, particularly any correspondence, that would assist us to fully understand the way that the ACCC went about making that decision?

Mr Peake—Because we are a farm organisation, what we could do is ask if the collective bargaining group could present some information directly to the committee. Would that be suitable?

Senator O'BRIEN—However we can get it, to understand the nature of the problem—whether it is simply the view of the ACCC or whether legislation might need to be changed to alter the way they look at a matter, for example, if that is why they are limiting themselves, or perhaps something else. I do not know, because until we know the basis for such a refusal, it is hard for us to construct anything that might be useful in responding to it.

In terms of the collective bargaining process, you are probably aware that there has been until recently a longstanding dispute in Tasmania between National Foods and the dairy farmers supplying it, particularly those in that collective bargaining unit. It was ultimately resolved, but I have asked National Foods what view they would have on, for example, provisions in legislation which would introduce someone into the process who would be an honest broker to ensure that there was bargaining on a genuine basis by both sides. How would you see that?

Mr Peake—It is an interesting process. In terms of trying to look for someone who could professionally facilitate the exchange—is that what you are saying? Is that correct?

Senator O'BRIEN—That could be it, yes.

Mr Peake—Yes. I think that is possibly an approach that we could investigate. From our experience, we have seen that where the collective bargaining group of farmers can access professional training and advisory support, that has made a significant difference. It would be an interesting concept to look at a facilitation role. I would not say no to it. I would certainly want to investigate it and get advice on whether it could actually achieve a better outcome. From the experience that I have seen in Tasmania, I think that, maybe with training and support earlier on, that situation could have been avoided. You cannot tell, but from what we have seen of the differences between a number of collective bargaining groups, the ones that have got the professional advice and training have certainly developed a much more professional and effective relationship with their processor than the ones that have not.

Senator O'BRIEN—Is there a reason that collective bargaining groups, in your view, should be regionally based?

Mr Peake—I honestly think that it needs to reflect what is happening at the next layer in the value chain. While we have what you might term regional pools of milk, we now have a situation in the processing sector where processors have increased their milk draw base significantly and now we have a lot of processors that have national draw bases. We need to look at that issue. I think it has gone beyond geographic boundaries in a lot of ways, and so there is a disparity at the moment, and our belief is that we need to look for ways to address that. Because processors have got larger and can draw from a much wider geographic base but also different milk pools, it puts them in a very much stronger position in terms of working out where they pool milk from, which groups they deal with et cetera, and that has created an imbalance which has put the dairy farming community, I would suggest, at a disadvantage. I would like to see some sort of initiative to try and address that imbalance.

Senator O'BRIEN—I think from my perspective, and perhaps looking from afar, the way that the market has changed in Queensland after deregulation and many leaving the market is that processors found that they had to actually push prices up to keep people in dairy farming and to keep their plant supplied.

Mr Peake—Yes.

Senator O'BRIEN—And at the moment dairy farmers are in a stronger bargaining position in Queensland with processors than they might be in states where a lot more manufacturing milk is produced.

Mr Peake—It is an interesting point you make and we have discussed some of it in our submission. You are correct. I will just give you a couple of statistics on it since 2000, since deregulation. Of course, after deregulation we had the worst drought on record, so it is hard to differentiate the impact. There was probably more impact from drought. But we had about 1,450 farmers in Queensland at that time producing about 845 million litres and now we have about 600 farmers producing—probably it will come it at about 540 million litres at the end of this financial year.

We did dip below the regional demand line—that is correct—and that did force the processors to reassess the situation, because they were having to draw milk from further away to fill those gaps in the marketplace. It did give an opportunity for the farmer base to negotiate longer term contracts, and the price went up with it as well, and of course the processing sector in Queensland is now very much focused on just supplying the fresh market requirements for bottled milk.

Nearly the majority of the manufacturing base has moved south, so now it is a case of meeting that fresh market need on a daily basis. We do get paid on average more money than the southern producers, but running a farm in our part of the world is a higher cost system and also the processors are wanting a flat supply line, so they are putting milk in the bottle every day of the year and there is an extra cost with that. We have got some great opportunities in the north because of the growing market, but we have also got a lot of challenges because of our production system.

Senator O'BRIEN—And in a sense prices have returned, not in real terms but in actual terms, to the pre-deregulation price in Queensland, whereas, say, in southern Australia they are not much above pre-deregulation prices and they are well below those prices in real terms.

Mr Peake—Very different systems and markets, yes.

Mr Tessmann—The prices did fall significantly after deregulation in Queensland, as you would be aware, and they returned when the shortage of milk came about, but during the previous period, even though the world price was travelling quite well, the domestic price stayed quite low in Queensland. It was only when milk became short and they were having to draw significant amounts from southern states that then the price went up, but there is certainly pressure on that price and I think it would be true to say that, if those contracts were not in place, the price in Queensland would have dropped already. Some farmers that have come off contract, even though there are a lot of farmers that are still on contract on the higher price. Those farmers have had to take a drop in price, and the potential is there—and I think it is obviously the intent of the processors—to bring that price down again as soon as they are able to with contracts finishing.

Senator O'BRIEN—How easy is it to change from one processor to another? Are processors seeking out suppliers?

Mr Peake—It is a very difficult situation at the moment. The milk supply in Queensland has grown since July and we have actually got a slight surplus of milk at the moment. It is an interesting turnaround for us. That is putting downward pressure on price. In fact, processors at the moment are not looking for new farms and, if a farm sells, some processors are saying they will not allow it to be sold as an ongoing dairy if it is a new person trying to come in to the industry. So there are some restrictions at the moment in our industry in terms of growth. The growth for us is really going to come from the growth in the marketplace from increased demand with population growth and consumption growth and I think, as Brian said, if it were not for longer term contracts that were put in place—for example, if the industry were on annual contracts—the industry would have suffered a significant price reduction last year. In fact, for the group of farmers that are due for contract renegotiation mid this year, we are expecting that they could suffer losses of anywhere between 3c and 5c a litre. In North Queensland it could be even more than that. So we are pretty concerned, and what is happening at the retail level at the moment is only adding to that pressure. We were hoping that the international market would recover before the majority of our contacts became due and would take a bit of pressure off our market situation in the north. However, obviously the high dollar is taking a bit of a shine off that recovery.

Senator O'BRIEN—I will leave you with this, because I have had a fair share of the time. The less you can shop around for a processor, the less bargaining power you will have in the dairy industry in Queensland.

Mr Peake—Yes.

Senator O'BRIEN—Thank you.

Mr Peake—I think it is very much another reason why we would like to see collective bargaining groups being able to expand their member base.

CHAIR—That is a good point.

Senator COLBECK—I might come in on that point. It is probably going over a little bit of Senator O'Brien's ground as well. With respect to how you would like to see the collective bargaining process modified, you would see it being modified more to reflect market based conditions rather than the current geographic system that seems to be imposed on you at the moment.

Mr Peake—I think so. That is a fair comment to make. While we are sitting here as a farm organisation, that question needs to be put to the current collective bargaining group. From where we sit, we can see that that would make a significant difference. From our point of view, we would like to go to those collective bargaining groups, if that was an option that was created, to get their feedback on that.

Senator COLBECK—It was an interesting discussion you were just having with respect to the surplus in supply and the pressure that that is placing on prices, or potentially placing on prices, that you will be offered as part of the current negotiating process, because that certainly was a significant factor in the circumstances that occurred in Tasmania that were resolved just prior to Christmas. The fact that there was a lot of processing milk available and there was a limited capacity of places for it to go was certainly used by the companies, particularly early in the dispute, as a reason or an excuse for the price that they were offering to dairy farmers. What is the situation up there with respect to the number of players in the market? This goes back to our point on consolidation, and obviously you have suffered the Dairy Farmers-National Foods impact, so I would be interested in getting any feedback on what occurred there. But who are the other players up there that maintain that bit of market pressure?

Mr Peake—At the moment in Queensland the two major processors are National Foods and Parmalat and then to a lesser extent Norco, which is based in northern New South Wales. They do have suppliers in southern Queensland as well, but they are a much smaller player. Basically, they are the three players, but National Foods and Parmalat have by far the majority of the farm based supply that they take.

That said, I think it does probably have an impact at the moment in terms of options for producers, because there is a bit of surplus in our region. I suppose from a historical perspective the ability to deal with that surplus has become an issue because all of the manufacturing capacity has been moved out, so it has got to a situation where our processing sector does not have any internal capacity to deal with a surplus when it occurs.

Senator COLBECK—That was going to be my next question: what is the situation with processing capacity? You have not only got some dead ends with respect to surplus and things of that nature, you also have physical processing capacity constraints that have occurred, for a various number of reasons, over the last 10 years.

Mr Peake—That is correct. We are currently reviewing our Northern Dairy Industry Strategic Plan and that is going to be one of our major priorities: talking to the processing sector in our

region about having a more constructive approach to dealing with surpluses when they occur, so that we get a better yield from that surplus when it does occur and it does not end up being a more negative diluter of farm gate returns.

Mr Tessmann—With that situation, the processors are handling that, as these contracts become due again, by various schemes and means of putting a limit on each farm's production. So anything in excess of a given amount that is related to the actual liquid market sales, anything over that, they are only offering them very low prices. That really needs to be factored into the price in Queensland, because a significant amount possibly of that milk could be actually then at an extremely low price for whatever they produce over their contract or their—to use an old term—quota. So that has to be factored into the price as well, and that is in fact the effect of having no ability in this state any more to handle that extra milk.

Senator COLBECK—What are the sorts of prices that they are offering? That was a significant feature of what was occurring in Tassie. It was down as low as 20c, or something like that, that the guys were being offered down there at one stage.

Mr Tessmann—It is my understanding—and I suppose I do not have absolute evidence—that the ones that came up for contract, that extra milk was in that vicinity as well.

Senator COLBECK—What about the parameters, supply limits, around the contracts? Obviously there is a penalty that applies if you get outside your supply volume by a certain percentage. Is that a feature of the supply contracts? One of the things that was being offered by National Foods in Tasmania was what they called their 'model farm', which, thank goodness, has been ditched in that market. It had a whole range of complex and convoluted calculations that the dairy farmers could not understand at all, or few of them anyway. Is that a feature of the supply process up there, or are you on a different form of supply contract?

Mr Tessmann—There is certainly the one supply contract that is for a given number of litres per day, with a variation of either five or 10 per cent built into that. So if you say it was 10 per cent, you must supply at least 90 per cent of that amount of milk or you would suffer penalties. You are allowed to go over by 10 per cent but anything over 10 per cent of that amount of milk would then get that very low price. There has also been—in fact, it is really still in development by the other processor—something more like the old quota system where you will have a certain amount of milk, a bit of a buffer at a lower price, and then the same thing with that very low spot price after that.

Mr Peake—It is an interesting point. In relation to the northern dairy industry region, an analyst told us the other month that internationally we are the only region in the world that is trying to balance fresh market milk supply without regulation.

Senator COLBECK—The only market without regulation?

Mr Peake—The only market region in the world that is trying to balance supply and demand on a daily basis, for fresh milk, without regulation. Basically, what Brian is saying is that the companies now are moving to contracts which have daily targets of its processors, trying to get a flat-line supply regime and, if producers go above that, they will get a lower price. You could nearly say in the old terms that that is like a manufacturing milk price, so they get penalised that

way. But it is about the processors trying to put those signals in the contract because they are wanting to try and get just enough milk to meet that daily demand for fresh needs and not anything above it.

Senator COLBECK—I did write down earlier during your presentation ‘controlling the rate of growth’, and it appears that the processors are effectively trying to do that through that contracted supply process. How closely are they cooperating with you and participating in your forward planning process? We were a bit astounded to hear at one hearing of another committee, but still looking at this issue, that National were not aware of the Dairy 500 future planning process that had been going on in Tasmania and had been under way for about four or five years. How actively and closely are they cooperating and working with the industry up there, given the projections in supply increase that are going to be required just to meet the drinking milk market?

Mr Peake—Over the last, I suppose, five or six years we have tried to, as a farm organisation, actively engage with all sectors of the industry and very much the processing sector. As part of that process we have actually set up a northern industry development group, and the processors sit around that table with the farm organisation, and also government representation from government departments such as primary industries, and they actually oversee our strategic plan. So we do have a constructive relationship with the processing sector. However, we do have boundaries with the role of, say, that group in terms of where we operate from a strategic point of view in cooperation with them versus what the role of collective bargaining groups is in terms of negotiating supply conditions and price et cetera. So there are different groups for different roles, but from a farm organisation point of view we actually do in the northern industry have a very constructive relationship.

Senator COLBECK—Has the process and the discussion that you are having at that organisational level with the processors and the industry given any sense of quantum on the price pressures that the generic branded product is placing on the market? We have heard from a number of people of their perceptions of what the impacts might be in calling what has been described here tonight as a waterbed effect, where the price forced down on the generic product is forcing the manufacturing companies to lift their prices, particularly where there is no competition in other product lines, to try and maintain an overall business return. Could you give us any sense of what feedback you are getting or what effects you are observing as part of that?

Mr Peake—I could comment on observation. In terms of our relationship with the processors as part of the northern industry development group, we do not talk about price, simply because we do not want to get into that territory and breach any laws that may exist around that in terms of trade practices et cetera, or be accused of that. So our relationship certainly has some pretty strict boundaries in that regard. From an observation point of view from our organisation, we see that what is happening at the retail level with the retail marketing strategy by the major supermarkets is having the impact of lowering the overall return back to the value chain. There are a whole range of complications with that, in that the supermarkets have increased their throughput in terms of fresh milk sales overall and they have also significantly increased their market share of their own brand versus the processor proprietary brand.

In addition to that pressure it places on processors, obviously processors are trying to maintain their margins and their market share, but I would suggest that it has put pressure back on other

market channels, including what we would term the route trade, where proprietary brands are sold into smaller store chains et cetera, and that has added to the problem of increasing the price differential between supermarket brands and the proprietary brand. So it actually adds to the problem, and that is why we raised the question tonight and in our submission in that, if you look at the objectives of the Trade Practices Act and the objectives of looking to protect the interests of consumers, we could sit here tonight and say without doubt that over the last decade the consumer has benefited from lower prices. That is evident from the prices I have in front of me tonight.

But in saying that, as I said previously, if you were to take the marketing strategies or branding strategies that the major supermarkets are currently pursuing and follow it through to a potential ultimate situation where proprietary brands are not economic because they do not have enough market share, then potentially you could have a situation with no competition on the shelf and only supermarket brands on the shelf, and in that situation—as I said before, I cannot make the claim, but you would have to ask the question, ‘Will that impact on consumer choice and will it potentially impact on the price to the consumer if there is no competition there?’

Senator COLBECK—I might leave it there and Senator Adams might have some questions. It might be worth your while having some conversations with your counterparts in Tassie over some of the issues that they have been dealing with over the last three or four months.

Mr Peake—It is interesting you say that, actually. We are talking to you tonight from Launceston. We are right in the middle of our national two-day board meeting.

Senator COLBECK—I am sure you are having some very stimulating conversation.

Mr Peake—Yes, we are, and very enjoyable hospitality.

CHAIR—Very good. You should talk to the Western Australians as well.

Senator ADAMS—I am interested in the comment in your submission about the population growth doubling in south-east Queensland.

Mr Peake—Yes.

Senator ADAMS—I would like to know, with your forward planning, how the dairy industry will expand to meet this demand.

Mr Peake—That is the golden question. We have got a number of industry programs. I spoke at the start of the strategic plan. In that strategic plan we identified that there is market potential there and that for us to be the first best option for that market in terms of supplying fresh milk to the processors and the retailers in that region we need to be competitive and producing high-quality product to meet their needs. That raises a whole heap of challenges in terms of growth. Obviously we have got constraints in a range of areas. Our natural resource base is constrained, like many other agricultural zones in Australia. We are facing water issues, we are facing increased risks to the operation from climate variability, we are facing obviously increased concerns about environmental sustainability. We have a number of other issues in terms of impacts on our cost structure, some of those being government related regulation, some of those

being other market issues related to other competition and restrictions in resource supply. We also have number of internal issues that are challenges for the industry.

Ultimately, I think the dairy industry in Australia has a very good R&D structure. Dairy Australia, which is our research and development body, plays a key role for us and obviously receives a matching contribution through the federal government, which we greatly appreciate. As a farm organisation, we work very closely with the R&D body, once we have identified these priorities, to identify initiatives to address those. If I could give you some examples, over the last eight years we have had a Rural Water Use Efficiency program. We receive support from the state government for that program. On average we have helped probably more than half of our industry now to move to modern irrigation systems and a lot of those systems will achieve water use efficiency savings of more than 25 per cent and more than 50 per cent energy savings. That is one example.

If we go to other examples, on the feed conversion efficiency issues, we are looking at feed costs as the major cost base for our industry. We are looking at initiatives and feed conversion efficiency that help the farmer, from a productivity and sustainability point of view, while also at the same time, reducing the greenhouse footprint for the enterprise. So we have got a range of initiatives, but it is extremely challenging. The growing population in south-east Queensland is putting a lot of pressure on resources—in particular water and also good agricultural land—as well as a number of other related issues.

So it is a significant issue for us, and I think in the next few years those issues around water management and water allocation, supply and security will play a fundamental role as to whether we are able to meet those goals or whether we are not. It is a difficult one. We have had some really good initiatives, but in some cases saving 25 per cent water efficiency will not be enough.

Senator ADAMS—The price of land in Western Australia is so good—it is like a carrot dangling there—that a number of dairy farmers are actually giving up their enterprise. So is that the same thing? How are you going to get on with the land as it becomes more expensive?

Mr Peake—The expansion of the population in south-east Queensland has certainly had an impact on the value of land. We are seeing urban pressure in agricultural zones. It is a big issue. We have also got other pressures from mining as well on our natural resource base. Where the urban population pressure is on and land values have increased and there is pressure on water supply et cetera, some farming operations have retired from the industry.

As I said before, from 2000 we had about 1,450 farmers and now we have got about 612. But there have also been a number of operators that have moved their operations, so we are seeing farms that may have been traditional coastal operations in south-east Queensland that have now moved to the grain belt on the Darling Downs. I think we will see more of that and we will also continue to see the trend of less operations but larger operations. So the farmers' enterprises actually have been continually increasing in scale.

Senator ADAMS—What about farm practice? In Western Australia there are a number of farmers now milking three times a day.

Mr Peake—Yes. There are a number of different combinations and permutations of changing farm systems, but definitely, yes, there are some operations doing three times a day milking. It is not a common practice in Queensland. The most common practice is twice a day milking. But there are some changes in farming systems, there is no doubt.

If you look at the longest exceptional circumstances, drought declared region in Australia, being the Darling Downs, and if you look at a Darling Downs farming system from 20 years ago to where it is now, it is much different. It was probably majority pasture based in the past, now farmers have moved to cropping and intensive feed harvesting and energy store systems, which is a response to what has happened with the climate and also other pressures.

So farming systems have changed and I have no doubt in saying that they will continue to change. The trick is for us, as an industry organisation, to help those farmers adapt to these challenges in a productive way and a sustainable way, so that they can maintain and improve the sustainability of their operations while also maintaining or potentially improving their competitiveness.

Senator ADAMS—Just quickly—we are running out of time—what would the average size of a herd be?

Mr Peake—Still in Queensland at the moment we are probably travelling around the 200 milker mark on average. It has increased in recent years. If it were not for the drought conditions we have experienced in the last 10 years, I would suggest that we would probably be a lot closer to the national average. In regions that have had more stable climates, such as North Queensland, the actual average herd size and milk production is greater than the state average, even though they were hit for six with Cyclone Larry. Their production, or their per-farm production, is actually larger than the average. So over time I see that the Queensland production system or farm system will move to the national average and in a lot of areas will probably move beyond it, depending on resource constraints.

Senator ADAMS—Just another question on service stations, with Woolworths and Caltex: what percentage of milk would you think would go through there? It is something that arose in Western Australia and it is becoming a very popular outlet.

Mr Peake—I cannot answer that question tonight. I do not have that data at hand. We do have an industry analyst at the moment working on some data for the northern dairy industry, but I do not expect to have that data in hand for probably another three or four weeks.

Senator ADAMS—If you would take it on notice, we would just be interested in that. It is something that did arise and we thought we would just follow it up through the other states. Thank you very much.

Mr Peake—Thank you.

CHAIR—Thank you very much for staying on a little bit over our time, and I thank you for your appearance tonight and I close this hearing. Thank you.

Committee adjourned at 9.26 pm
