

New South Wales Dairy Industry Conference

ABN: 16 995 168 559

Submission to the Economics References Committee

Inquiry into the impacts of Supermarkets price decisions on the Dairy Industry

4th March 2011

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1. Introduction

We welcome the opportunity to make a submission to the Senate Economics References Committee Inquiry into the impact of supermarket price decisions on the dairy industry. In this submission we will address the following terms of reference:-

- Whether such a price reduction is anti-competitive
- The recommendations of the 2010 Economics References Committee report, *"Milking it for all it's worth – competition and pricing in the Australian dairy industry"* and how these have progressed
- Any other related matters – some specific recommendations.

2. Executive Summary

Competition and competitive pricing in any industry and category is very important for consumers, and this is very relevant to Milk which is a basic staple. However, pricing is one component of a range of broader things that needs to be taken into consideration. These include but not limited to:- the long term viability of dairy farmers, the viability of stakeholders through the entire Milk value chain, choice to consumers, quality of the products on offer, the diversity of the retailers and availability throughout a range of outlets.

The milk processing industry and retail grocery sector in Australia has become more concentrated and, partly as a consequence, so has the wholesale market. This means that farmers, small businesses in the Route/Convenience Channel and small Milk Vendors/Distributors lack counter-balancing market power and are at a competitive disadvantage.

The aggressive private Milk price reduction by Coles and followed by other Retailers are providing benefits to the consumer – however at what cost to other stakeholders in the Milk value chain? What are the longer term implications to dairy farmers, small business owners in the Route/Convenience Channel and Milk Vendors/Distributors? The supermarket channel share of the Australian drinking milk sales was around 51% in 2009/10 (Source: Dairy Australia). The aggressive pricing will likely see this market share increase significantly at the expense of the Route/Convenience channel. This will severely impact many stakeholders in the Milk value chain and result in the major supermarket chains having further market power, stemming from a higher market share in Milk.

The following recommendations are submitted to the Senate Inquiry for consideration:-

- Establish a Retail Grocery Ombudsman (scope covering all Retail ie Supermarket & Route/Convenience Channels)
- A National Food Value Chain policy be developed and implemented (scope from Farm to Consumer; major commodities; all key stakeholders in the value chain)
- Complete all the recommendations from the Senate Economics References Committee Report *"Milking it for all it's worth — competition and pricing in the Australian dairy industry"* May 2010. Input the outcomes of these recommendations into a single National Foods Value Chain Policy.
- Rigorously investigate the impact of the aggressive price reduction in private label milk by the major retailers on the key stakeholders in the Milk value chain. This includes farmers, small businesses in the Route/Convenience channel and Milk Vendors/Distributors.

3. Is the recent price reduction in Milk anti-competitive?

3.1 The Australian Grocery Market

Australia has one of the most concentrated grocery markets in the world with the two major grocery retailers, Woolworths and Coles, having around 72% share in 2010 (Source: IBISWorld February 2011).

The Supermarket industry in Australia has been subject to increasing levels of concentration since the mid-1970s. In 1975, the major chains had a market share of about 40%; however, by 1985 this had increased to 60%. The steady rise in concentration levels for this industry stemmed from the acquisition activity undertaken by Woolworths and Coles (Source IBISWorld February 2011).

Due to the concentrated nature of the supermarket grocery retailing sector in Australia, the major retailers have the financial power and growing market power, stemming from their high market share. The major retailers utilise their economies of scale and associated lower unit costs to offer very competitive prices for high volume or headline products (Source PriceWaterhouseCoopers Report June 2007).

Market Participants	% Market Share
Woolworths	40.0%
Coles	32.0%
Other (IGA 7.0%; ALDI 4.0%; Australian United Retailers 2.3%; Franklins < 1.0%; SPAR <1.0%; Other 12.7%)	28.0%
Total	100%

Source: IBISWorld February 2011

Market Participants	Number of Stores	% Total
Woolworths & Coles	1493	24.1
ALDI & Pick 'n Pay (Franklins)	190	3.1
Independent grocery banner groups – IGA, Foodworks, Ritchies	2140	34.6
Other independent grocery retailers	2360	38.2
Total	6183	100%

Source: PriceWaterhouseCoopers report "The economic contribution of small to medium-sized grocery retailers to the Australian economy, with a particular focus on Western Australia" June 2007 page iv

IBISWorld forecasts that concentration levels for the grocery supermarket sector in Australia will increase over the five years to 2015-16, as players such as Coles and Woolworths continue to implement new strategies for increasing their share of the market. While consolidation activity via the acquisition of smaller players will be the key strategy, this industry may also experience a merger of independent operators.

Despite this, the industry needs new entrants in order to expand (Source: IBISWorld Industry Report "Supermarkets and Other Grocery Stores in Australia" February 2011 page 11).

3.12 Retail Grocery Chain Share of Drinking Milk Sales

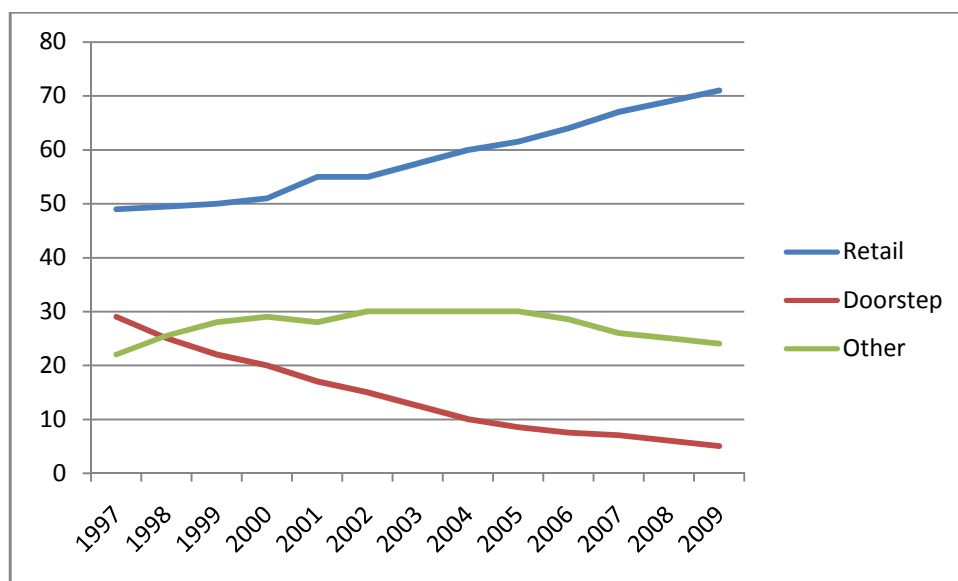
Channel (Drinking Milk Sales)	% Share 2005/06	% Share 2006/07	% Share 2007/08	% Share 2008/09	% Share 2009/10
Retail	46.6%	48.0%	49.1%	50.2%	50.8%
Other Sources	53.4%	52.0%	50.9%	49.8%	49.2%
Total	100%	100%	100%	100%	100%

Source: Aztec SynovateandDairy Australia - accessed 4th March 2011

The supermarket channel share of Australian drinking milk sales has continued to trend steadily up over recent years from 46.6% in 2005/06 to 50.8% in 2009/10 at the expense of small businesses and home delivery. Private label Milk now accounts for 50% of total supermarket milk volumes, up from around 25% in 1999/00 (Source: Dairy Australia). If the aggressive pricing by the major grocery retailers continues the share in the retail grocery channel will accelerate. This will have a huge impact on the small businesses in the Route/Convenience channel.

Observing Milk sales in the UK shows the steady increase in the retail share of milk sales since 1997.

UK Milk Sales by Outlet (% share)



Source: Dairy UK "The White Paper – a Report on the UK Dairy Industry" June 2010 page 32.

Doorstep is Home Delivery and *other* includes small shops, restaurants, hospitals, schools etc.

There are around 50,000 business outlets in NSW (Source: NSW Food Authority website 3rd Mar 2011). These business use and/or sell Milk and include milk bars, bakeries, small corner shops, butchers, canteens, delicatessens, health food shops, hotel/motel operations, kiosks, licensed clubs, pubs, restaurants, service stations, street vendors, takeaways, businesses and wineries.

Extrapolating the number of outlets in NSW on a population basis equates to approximately 150,000 small business outlets using or selling milk throughout Australia.

It is estimated that there are around 745 Milk Vendors/Distributors across Australia (Source: AMVA submission to the Senate Inquiry 4th March 2011). These Milk Vendors/Distributors deliver fresh milk to the small business outlets across Australia up to seven days a week. If the share continues to move towards the retail channel, many of these small businesses will likely to cease. This has the potential to significantly impact regional Australia in particular with the loss of milk distribution capability and other chilled products that are carried with fresh milk.

Dairy Australia states that owner-operated dairy farms dominate the Australian dairy industry. Share farming was employed on 15% of farms in 2009/10 as it operates successfully within the family ownership. Corporate farms make up just 2% of the total. The number of farms has fallen by two-thirds from 22,000 in 1979/80 to 7,511 in mid-2010 (Source: Dairy Australia "Australian Dairy Industry In Focus 2010").

With an even greater share of the Australian Milk drinking market by the major grocery retailers, there will be greater pressure on farmers to reduce their prices. The increased share by the retail grocery retailers will give them further power in their negotiation of milk pricing and this may accelerate the reduction in dairy farms which may decimate the industry and impact regional Australia.

3.13 The Increased Concentration of Milk Processor's in Australia

In the Senate Economics References Committee Report "Milking it for all it's worth — competition and pricing in the Australian dairy industry" May 2010 is observed that the manufacturing sector of the Australian dairy industry has become more concentrated since deregulation in the 1980's. The outcome of this being increased foreign ownership and a reduction in the market share of farmer-owned cooperatives. The five major companies have increased their milk processing capacity from 50 per cent to 75 per cent of the market (Source: "Milking it for all its worth").

Milk sold into the drinking milk market is dominated by two major processors - National Foods and Parmalat. Share of the milk drinking market in 2010 is as follows-

Processors in Australia producing Drinking Milk	% Share 2010
National Foods	81%
Parmalat	12%
Fonterra	5%
Other	2%
Total	100%

Source: In the Senate Economics References Committee Report "Milking it for all it's worth — competition and pricing in the Australian dairy industry" May 2010 page 16

Milk is a key category for supermarkets and it is highly likely that the major supermarket players will continue to use Milk as part of their strategies to increase consumer traffic to their stores/banner as demonstrated by Coles in January 2011 with its price reduction of Private Label Milk to \$1.00/litre. The result will be an even greater concentration of this share resting with the major supermarket players and a reduction in the availability of Milk at a reasonable price in the non-supermarket channel. The short term price reduction benefits to consumers needs to be off-set against the

damage that could be done to the Milk/Dairy value chain and those stakeholders who have lost the counter-balancing power with the concentration of the retailers and processors. It is recommended that this be rigorously investigated.

It is reported that Coles is absorbing reduced earnings of between \$300,000 - \$400,000 a week (Source: Phillip Coorey Sydney Morning Herald February 28, 2011 "Milk war heats up as Woolies sides with farmers"). If this is correct and the low pricing is not sustainable over the long term in the Milk Value Chain, irreversible damage will be done to dairy farmers throughout Australia, small businesses in the Route/Convenience Channel and small Milk Vendors/Distributors operating chiefly in the Route/Convenience channel.

We support genuine competition in Australia's retail and other channel sectors. However pricing is only one element that needs to be assessed. As well as aggressive pricing, other factors such as the long term viability of our farming sector, the viability of stakeholders through the entire Milk value chain, choice to consumers, quality of the products on offer, the diversity of retailers and availability throughout a range of outlets need to be taken into consideration.

4 The recommendations of the 2010 Economics References Committee report, "Milking it for all it's worth – competition and pricing in the Australian dairy industry" and how these have progressed

There are a number of recommendations from the 2010 Economics References Committee that are in progress. For example, Recommendation 8 recommends that the ACCC "conducts further study into the implications of increasing shares of the grocery market being taken by the generic products of the major supermarket chains.

The Committee recommends that the terms of reference of any such inquiry include not just the current and future impact on prices paid by consumers but also the needs of Australia in terms of food security and economic and environmental sustainability, as well as the economic viability of farmers and processors. This is due to be reported by 30 April 2011.

Recommendation 10 recommends "that the topic of competition and pricing in the dairy industry be again referred to the Senate Economics References Committee in May 2012 to assess whether progress has been made or whether tougher and more interventionist measures need to be adopted".

Recommendation 4 "recommends that the Government requests the ACCC to undertake monitoring of the pricing practices within the dairy chain with a view to establishing whether predatory pricing or misuse of market power is occurring".

It is unclear about the status of these recommendations. We propose that all the recommendations from the 2010 Economics References Committee report, "Milking it for all it's worth – competition and pricing in the Australian dairy industry" be treated in an integrated manner and, where appropriate, be incorporated into an integrated single body such as a National Food Value Chain policy.

5 Recommendations

5.1 Establish a Retail Grocery Ombudsman (Scope covering all Retail i.e. Supermarket & Route/Convenience Channels)

We recommend that an Ombudsman position be created to cover all Retail Food Channels – not only the Supermarket channel. The Ombudsman would work closely with the relevant Government bodies, the ACCC and other stakeholders.

It is envisaged that the Ombudsman would have the responsibility and scope to look at issues that may impact all stakeholders across the Food Value Chain including Farmers, Processors, major retailers and small outlets in the Route/Convenience channel as well Milk Vendors/Distributors.

5.2 Develop and implement a National Food Value Chain Policy

We recommend that an integrated and co-ordinated National Food Value Chain Policy be developed and implemented. There is a current need to bring together the numerous regulators, State and Federal bodies into one integrated body with a single approach. The scope would include food security, food safety, food recall and development of contingency plans in the case of national or global pandemics. We recommend that the policy commence with the basic food staples such as Milk, Bread, Eggs and Water etc. It is vital that one body has a full grasp of the full value chain - from Farm to Consumer and to be able to professionally evaluate issues and provide input into such issues as the ones we are looking at with this Inquiry. We envisage that this group would have the capability to conduct independent fact-based analyses across the value chain e.g. cost of milk and margins of farmers; distribution costs and margins; retailers and small businesses costs, pricing and margins.

5.3 Complete the recommendations from the Senate Economics References Committee Report “Milking it for all it’s worth — competition and pricing in the Australian dairy industry” May 2010.

Take a co-ordinated approach and, where relevant, they should be integrated into a single authority e.g. a National Food Policy.

5.4 Investigate the impact of the aggressive price reduction in private label milk by the major retailers on the key stakeholders in the Milk value chain.

Appoint a small independent team to investigate the impact of the aggressive price reduction in private label milk by the major retailers on the key stakeholders in the milk value chain. These stakeholders include but not limited to farmers, small businesses in the Route/Convenience channel and Milk Vendors/Distributors. We recommend the scope of the team include the following:-

- Costs, pricing & margins along the value chain
- Assess whether the current low milk pricing is sustainable over the long term
- Assess the impact on regional Australia
- Assess the impact on stakeholders across the milk value including farmers, small businesses in the Route/Convenience channel, Milk Vendors/Distributor’s and the retailers.
- Assess grocery retailer strategies

These assessments should be fact-based and maintain confidentiality.