Tuesday 8 March 2011-03-07

The Impacts of Supermarket Price Decisions on the Dairy Industry

Overview

I am the sales manager for Maleny Dairies, which is a family owned dairy processor situated in the Sunshine Coast hinterland. We currently produce fresh dairy products on the farm property, with an emphasis on producing 100% natural milk with nothing added and nothing taken away. All of our plain milks contain 100% locally farmed cow's milk. We currently process milk from four local farms including our own, contributing to the preservation of the post de-regulation local dairy industry.

The dairy currently distributes milk to the Sunshine Coast and to Brisbane with consumption & production showing steady growth over the last few years. Currently the growth has slowed due to a number of factors, but most obviously there was a significant drop in sales after the announcement of the $2.00 a carton milk discounting.

Farm Gate Pricing, Wholesale & Retail Milk Sales.

We operate with our milk suppliers, by fixing an agreed price for their milk. We do have seasonal prices to reflect the real cost of producing milk. The price to farmers is above the $0.50 break-even price for producing milk in Queensland. The wholesale price of our milk reflects the farm price of milk plus the packaging and processing costs, including a moderate profit, with the retail price being set by the stores & consumers based on an acceptable profit margin in order to run their business.

There is a clear link is all sustainable agricultural activity, between the farm prices, processing costs, wholesale & retail price of all goods. In a stable economy, each level derives an income from their activity and the retail price reflects the sum of each level. To date the dairy industry has operated along these lines, but with the introduction of the greatly discounted milk, the market has changed. Discount milks have traditionally been produced using surplus or over quota milk, but significantly increasing the volume of discounted milk over the brand name milks will consume all of the surplus milk and more. Much more milk traditionally purchased at a lower price from the farm, will be required, with the demand for quota priced milk will fall. Subsequently in these circumstances either the net price to the farmer falls or the costs of production will exceed the wholesale price. As the processors are not charitable organisations I believe the pressure on the farm gate price will lead to a reduction in the net price paid. It appears to be unsustainable for the industry to support such a model.

The major supermarkets have stated that the discounting is permanent, and as the milk drinking public convert from branded milk products to the discounted milk products there will be increased pressure for milk processors supplying discounted milk, to deliver increased volumes. We believe that this will put pressure on the dairy farmers to provide increased volumes of milk at the over quota price. This is likely to be achieved by reduction not in the price of milk, but lowering of the contracted quota's, with the net price per litre of milk produced, and paid to the farmer falling. The processing & bottling costs will remain fairly stable, with no change in the real cost of packaging.

This situation cannot be allowed to continue without a significant number of farms receiving a reduction in real income, and continuing the trend for reduction in milk production in the Northern New South Wales and Queensland markets.

Decrease in National Milk Production.

There is clear evidence that national production of milk has decreased over the last decade. Milk consumption for drinking has increased over the same period. Continuing to put pressure on the farming sector will do nothing to maintain a viable dairy industry. What may be good for the supermarkets in the short term, regarding market share will be detrimental to the long term viability of the dairy industry.

Transportation costs associated with milk production and supply.

The reduction of milk processors on a national level, will eventually lead to increased reliance on transportation of milk over longer distances. With fewer processing facilities available, milk is being trucked from further afield. The same milk is then being transported over increased distances to the warehouses and retail stores. There is a significant increase over the last few years of milk being trucked interstate to supply domestic markets. The costs of transport will continue to increase with not only the cost of oil rising, but also with the longer term introduction of carbon trading and carbon taxes, once they are introduced. Overall the centralisation of food production, will contribute to increased demand on fossil fuels.

Effects on the Wholesale and Retail Sectors.

The discounting of milk between the two main supermarkets (Coles and Woolworths) has had an immediate effect on the supermarket industry as well as the hospitality sector. Independent stores have seen a reduction in sales, due to the discounting within the large supermarkets. Smaller retailers are less likely to stock branded milk products at this time as they are experiencing a reduction in sales, not only in milk but across the board in the general grocery lines. The smaller stores do not have the cash reserves of the large supermarket chains, and many traders are now under even more financial strain. The end result is likely to be decreased competition in the marketplace with smaller retailers closing their stores.

The cafe & restaurant business sector is looking to recoup profits wherever it can, hence the number of businesses looking at branded milk products is decreasing, based purely on price. Why would a coffee shop pay over $3.00 for 2 litres of milk, when they can go to a supermarket & purchase $2.00 milk? Currently the wholesale price of milk for many businesses is greater that the retail price of the discounted milk. This cannot be sustainable in the long term.

Anti-Competitive Behaviour of Major Supermarkets

With the two main supermarket chains permanently discounting specific products below their real production cost, there is increased pressure on other supermarkets and retail food outlets. It is one thing to have a short term loss leader to attract customers; it is another to have permanent below cost pricing. It must be against the public interest to have permanent pricing policies which are specifically targeted at reducing retail competition. With the major supermarkets matching each other’s prices they are ultimately targeting all other supermarkets and retail food outlets with anti-competitive practices. If milk was an imported product, these practices would be deemed as contravening the federal government’s anti-dumping legislation.

Conclusion.

I believe that the long term viability of the Australian agricultural sector and in particular the food industry needs to be nurtured and preserved. The supermarket industry is a key player in these industries, but should not be the major influence in policy & pricing within the industry. Un-sustainable business practices should be discouraged and if necessary legislated against. The introduction of below cost retailing of specific products does not benefit the consumer in the long term. It will cost jobs, reduce competition, reduce choice and increase the cost of other food products within the supermarket, with no benefit whatsoever to the farmer, producer or consumer. Only the large supermarkets can gain with such practices. I am very concerned that unless there is government intervention, the supermarket giants will continue to increase their market share, and the dairy industry as well as other domestic food producers will ultimately pay the price. Please send a message to the supermarkets that the government values the farmers of Australia, as well as the other food producers, more than the growth of market share in the growing supermarket duopoly.

David McKinnie
Sales Manager
Maleny Dairies