Inquiry into the impact of supermarket price decisions on the dairy industry.

This submission is made by Richard Bovill who has been a supermarket buyer and has assisted sections of the Tasmanian Dairy Industry in contract negotiations. I Chaired the Australian Vegetable Industry Development Group, created the Fair Dinkum Food Campaign and currently farm. Thank you for the opportunity to make this submission.

I will endeavour to set out in this submission how this decision started by Coles will impact on farmers, is an abuse of market power and will have a negative impact on the cost of milk distribution and will see many consumers disadvantaged.

When a supermarket runs a special price on an item it normally runs for a specific and limited period, when it finishes sales in that category return to equilibrium with minor changes if customers have established value in the new offer. When a price change is promoted as permanent, as is the case with house brand milk, its intent and affect completely change. Standard supermarket policy is that they will not be under sold on major lines, so it was clear to Coles that their competitors would match their price. In permanently reducing the price on their house brand milk, Coles claim they are doing this by reducing only their margin, they also claim this price cut will not impact on farmers or milk manufacturers.

The milk manufacturers have their own range of branded milk on supermarket shelves, if Coles have reduced the margin on house brand milk and not branded milk, this puts branded milk in a totally non competitive position. Even if the branded milk was to be put in to the retailers at a much lower price, it would still have the disadvantage of a 20+% mark up from the retailer. In turn if they drop the price on their branded milk into the retailer, the retailer would then expect a price reduction in the house brand milk. **There is a reasonable case to suggest on a daily basis that the retailers should have a higher margin on their house brand milk than they do on branded milk, as branded milk has paid for its own marketing and promotion already,** whereas the retailer must recoup the cost of marketing for its house brand milk from its own margin. Such a situation would not occur if the two major retailers didn't totally dominate food retailing. This is clearly an example of abuse of market power.

The major milk processors are multinational companies whose shareholders expect a fair rate of return on their investment. If they cannot get a fair return in the price they sell their products for they will seek to get a lower price from their suppliers. Some will say they have contract prices or they have to match global prices. Such comments totally miss the detail of the contracts. Supplier contracts cover what are described as contract and noncontract litres. Companies may claim they no longer have a market for the contract litres and may cut the contract volume back. Non contract litres are paid at well below the current world price for milk. Such action would seriously damage farmers businesses. Milk supply contracts are rigid arrangements. Dairy farmers must deliver set quantities of milk through a contract period. It is not possible for a dairy farmer to change customers through a season, their contract doesn't allow it and there appears to be an unwritten agreement between the processors that they don't touch each other's suppliers during a season. Dairy farm viability is about achieving maximum output at a given price, any tampering with a producer's capacity to maximise yield has an extremely detrimental effect on their viability. **As milk manufacturers are losing sales on their higher profit, branded milk range they will look for savings in milk supply and this must have an impact on farm profitability.**

Prior to dairy deregulation all milk was delivered through a vendor network. While this was deemed to be non-competitive it had the effect of evening the cost of distribution across large and small outlets and between larger and smaller population areas. Because the vendor in an area carried all the milk he was able to defray overheads across all customers. The majority of milk was sold outside the major supermarkets and they were unable to use their market power to force a differential in the price, so milk generally sold at about the same price through most outlets.

After deregulation the major supermarkets tendered for their house brand milk in such a way that forced a concentration of power in milk processing. They also sort to take distribution from the vendors and put it through their own distribution channels. This has the effect that vendors now have to charge more for distribution to small stores and regional areas as they cannot share the cost across larger volume deliveries. This is being now accelerated by the milk price war. So when major retailers talk about driving efficiency they are only talking about themselves and for those who are able to conveniently reach one of their stores. So we effectively have two retail chains that are making everything more expensive for people in the regional areas where they don't operate, or for people who lack the mobility to get to one of their stores. These people are generally the most disadvantaged in our community on the lowest incomes.

There should be no illusions about the position the milk industry is in, they cannot complain about their major customers because they represent too large a share of their business. They have to silently watch the value of their brands eaten away by their major customers. This can only happen when businesses have reached such market dominance that they can abuse their market power.

It is not reasonable to suggest that the power of these stores will change. They will continue to grow at the expense of smaller retailers. They will continue to plagiarise the innovation of great branded products. This will limit investment in new ideas and products because you feel the value of your investment will ultimately be seeded to the retailer.

There is a clear need for a better understanding and description of abuse of market power as it pertains to Australia's two major retailers. This is not to suggest Coles and Woolworths represent some form of evil empire. In many dealings they are very responsible corporate players. They represent major drivers in our economy and anything which damages their business and capacity to compete will hurt the economy. In turn because of their size, if they misuse their power the consequences are felt right through the community. There is no alternative market place for their suppliers.

There is a clear need and special role for the ACCC to better understand and monitor how these two companies exercise their market power and importantly how it affects the whole supply chain. Then the powers to immediately stop practices which could not be sustained by smaller retailers.

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