29 April 2024

Select Committee on Supermarket Prices

PO Box 6100

Parliament House

Canberra ACT 2600

Submissions

To inquire into and report on the price-setting practices and market power of major supermarkets.

The effect of market concentration and the exercise of corporate power on the price of food and groceries

The Australian grocery retail industry is characterised by a high level of concentration and a lack of effective regulation, resulting in significant concerns about anti-competitive behaviour and its detrimental impact on local producers and ultimately consumers.

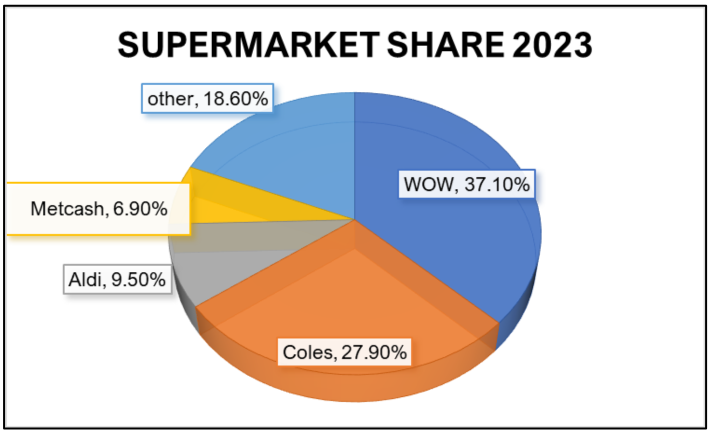
Market Concentration

Australia's supermarket industry ranks among the most highly concentrated globally. According to a 2023 report by IBISWorld on the Australian Supermarkets and Grocery Stores industry, it is described as "*highly concentrated*". This high level of concentration carries significant consequences for both suppliers and consumers.

The Australian grocery retail sector is dominated by two major supermarket chains: Coles and Woolworths Group.

In 2023, Woolworths Group commanded 37.1% of the Australian grocery market in FY2022, with Coles grabbing a 27.9% share. The German-owned arch-rival, Aldi, had a 9.5% stake, while the Metcash Ltd (ASX: MTS) supplied IGA chain held a 6.9% market share. The remaining 18.6% came from other, smaller grocery retailers.

Woolworths Group and Coles, collectively hold a substantial market share, estimated to be over 82%, making them a duopoly that significantly influences the industry[1].



Corporate power is particularly strong within the Woolworths Group, as evidenced by their recent acquisition of a 65% equity interest in PFD Food Services, alongside their ownership of BIG W and their dedicated logistics network.

This means that suppliers are likely to direct additional financial and human resources

[1] Statista https://www.statista.com/statistics/994601/grocery-retailer-market-share-australia/

toward the Woolworths Group's Profit and Loss (P&L) statements. It is widely recognized that PFD will further collaborate with the Woolworths Food Co private label team, seeking to leverage substantial buying power across both the corporate grocery sector and now the food service industry.

This development will exert immense pressure on suppliers, as consumers and end-user customers will gain increased access to lower-cost, own-brand product alternatives in key categories, many of which will be imported. Consequently, this explicitly weakens the position of Australian-based suppliers, particularly those heavily reliant on the grocery channel.

Effects of Market Concentration on Suppliers

The high level of dominant market concentration exerts immense power and control over the supply chain, including farmers, local producers, and suppliers. Further, the dominant position of Coles and Woolworths in the Australian market allows them to exert substantial bargaining power over local food manufacturers, particularly small to medium-sized enterprises (SMEs). According to Richard Forbes, CEO of Independent Food Distributors Australia, the sheer size of Coles and Woolworths enables them to push rising costs back down the supply chain to other industry players, which often include local manufacturers.

SMEs often lack the negotiating leverage to resist demands for price reductions, promotional contributions, and other concessions made by major supermarket chains. Consequently, they are compelled to accept lower prices and reduced margins, solely to inflate retailer margins, which are among the highest in the food retail world when benchmarked.

Effect of Market Concentration on price of food and groceries

As an SME, we have encountered specific instances where retailers have requested additional promotional funding for an 'Every Day Value' (EDV) campaign. This was to enable the running of promotional price points that are either equal to or lower than the same promoted price points from the previous 12 months in the market.

During discussions with a senior commercial team member at the retailer, it was explicitly stated that their CEO has mandated an emphasis on all promotional price points, in response to media pressure.

Since Q2 F24, retailers have actively sought to address the cost-of-living crisis by seeking additional promotional investment support from suppliers. There has been pressure to provide additional spend to generate goodwill for activations such as out-of-aisle locations during promotional periods. In these conversations, retailers will reference their gross margin percentage at the promoted price point as a critical KPI to be supported. At no point have retailers displayed behavior that suggests they are investing in addressing the cost-of-living crisis from their own P&L. The lack of competition allows them to consistently display such behaviour and continue to extract margins significantly higher than international best practice benchmarks.

The pattern of price setting between the two major supermarket chains

A simple supermarket visit, or online search will confirm that all Private Label prices on comparable goods are set at exactly the same price across both major retailers (see examples below). In the instance of one retailer changing price, the other retailer will follow. In the ‘Orange Juice’ examples, Woolworths is disguising their 2L offer as a promotional ‘Low Price’ when it is line priced to the Coles offer. This is a deceptive behaviour aimed at driving market share and sales.

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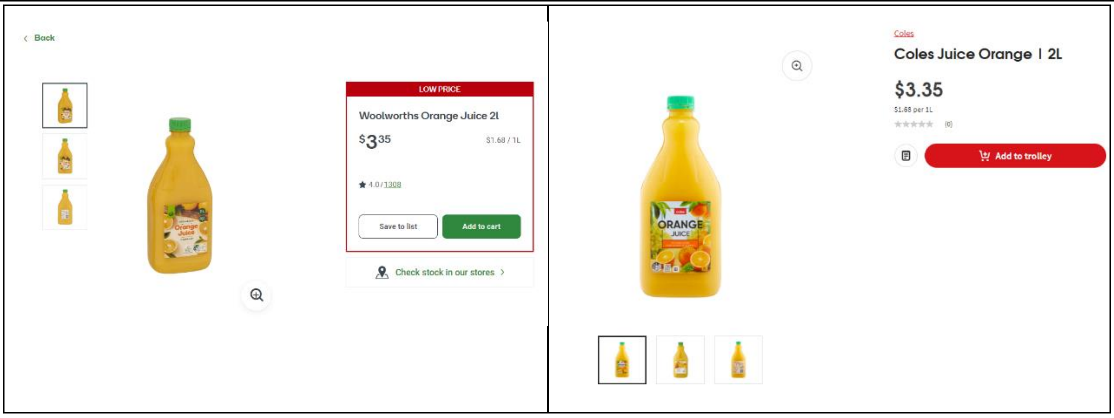
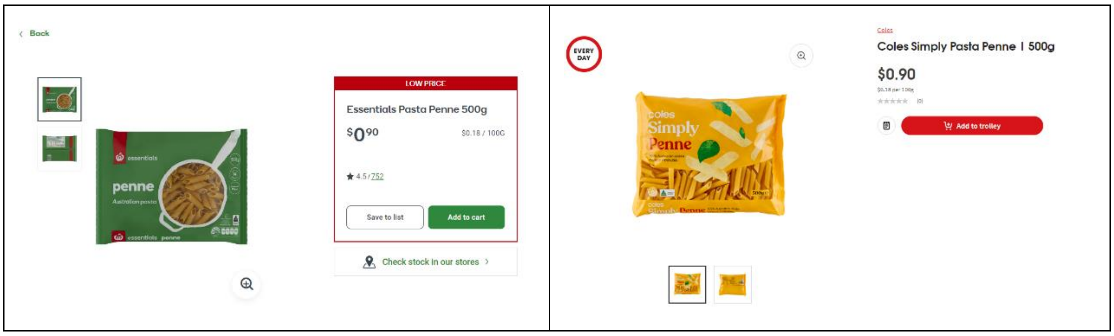




It is common practice for a major retailer to contact a supplier on a Wednesday, which marks day 1 of any promoted week, pressuring them into 'price match' activities if competing retailers are offering lower price points on the same product or product family. This extends to state-based independent retailers such as Drakes and Ritchies IGA. For example, if a supplier runs a short-term discount with a state-based independent banner and this conflicts with a major retailer's promoted price point, which is higher, the retailer will drop their price and demand increased trade investment support from the supplier. If a supplier declines, the retail commercial team will continue to apply pressure, which can lead to doubts about the future viability of the trading relationship. The onus is on the supplier to document such behavior with reference to the Food & Grocery Code of Conduct.

Throughout the CPI negotiations dating back to 2020, Coles has stated that they will only follow the market with cost price and subsequent RRP increases, rather than setting the new benchmark price. This approach appears to contradict free market forces. Woolworths, on the other hand, has been more inclined to lead under the premise that a commercial benefit was delivered to their P&L in the negotiations.

Rising supermarket profits and the large increase in price of essential items

The profits of major supermarket chains like Coles and Woolworths have been rising, while farm profits have been declining. With a combined market share of over 80% in the Australian grocery market, Coles and Woolworths wield significant power over their suppliers, including farmers.

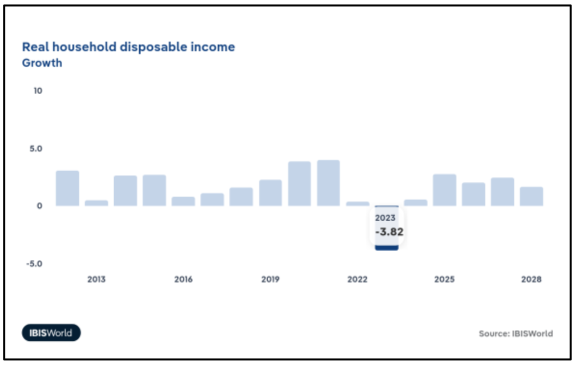
At the start of the pandemic, when suppliers began facing cost pressures, it was widely understood among suppliers that Woolworths tasked its commercial buying teams with recovering an additional 200 basis points of 5th margin from any CPI negotiations. Many suppliers were struggling under COVID-related cost pressures but needed to maintain trading relationships, ultimately accepting new margin levels for which the consumer ultimately must foot the bill. This new norm has fundamentally shifted the power balance more in favor of the retailers and reset all future negotiations to a new base.

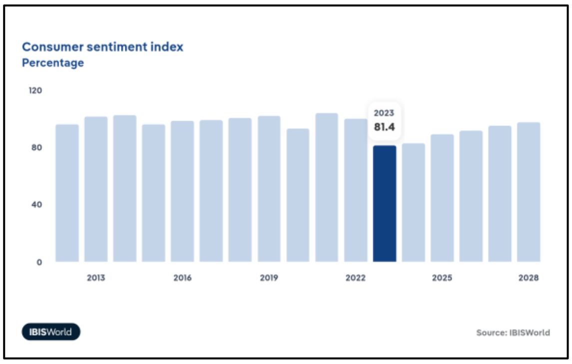
There is evidence, through CPI negotiations, of retailers engaging in 'margin grabbing' by raising recommended retail prices (RRP) beyond the CPI requirements from suppliers.

Excessive percentage margins are being extracted by Australian retailers : Between 2018 and 2021, the profits of major supermarket chains in Australia increased by an average of 9%, while farm profits saw a decline of 6% during the same period.[2]

The Australian grocery industry witnessed consistent profits and a high level of concentration among major players throughout the period from 2019 to 2023. However, consumer buying power faced challenges due to inflation and rising prices, impacting the affordability of groceries. These economic pressures contributed to an increase in bankruptcies within the food and Agri industry, especially among smaller businesses.

The relationship between grocery industry profits, real household disposable income and inflation, underscores the complex dynamics of the Australian food sector during this period.





[2] ACCC, 2022

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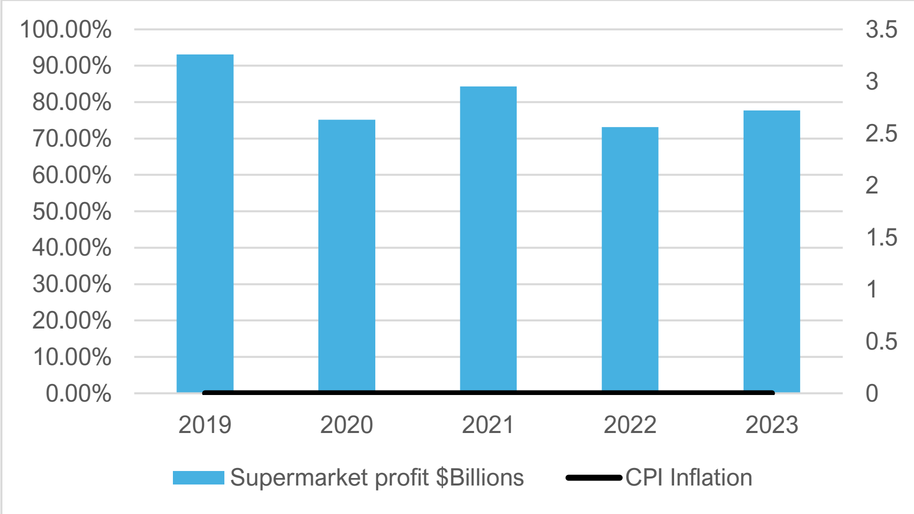

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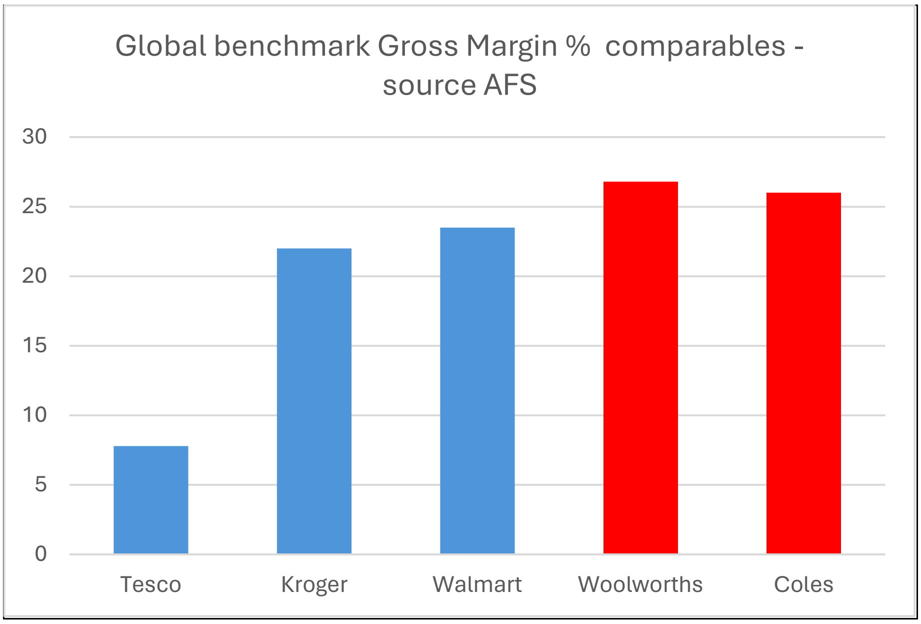


According to CSIMarket data, Gross profit margins in the food processing industry (i.e. manufacturers) in 2019 was 22.05% with an EBITDA margin of 9.56% (a measure of company efficiency)

At a retail gross profit % level, Walmart Globally realises 23.5% (Source: Walmart AFS FY 2023), The Kroger Company GM% is 22.2 % (Source : Kroger AFS 2023), and Tesco Plc a GM% of 6.76% (Source :Tesco AFS 2023). It is worth noting.

that both major Australian retail chains GM% viz Woolworths and Coles are both substantially higher than global best practice benchmarks, and with substantially less scale to enable. To the extent that both WOW and to somewhat of

[3] Source for inflation: https://www.macrotrends.net/countries/AUS/australia/inflation-rate-cpi#:~:text=Australia%20inflation%20rate%20for%202022,a%200.3%25%20decline%20from%202018.

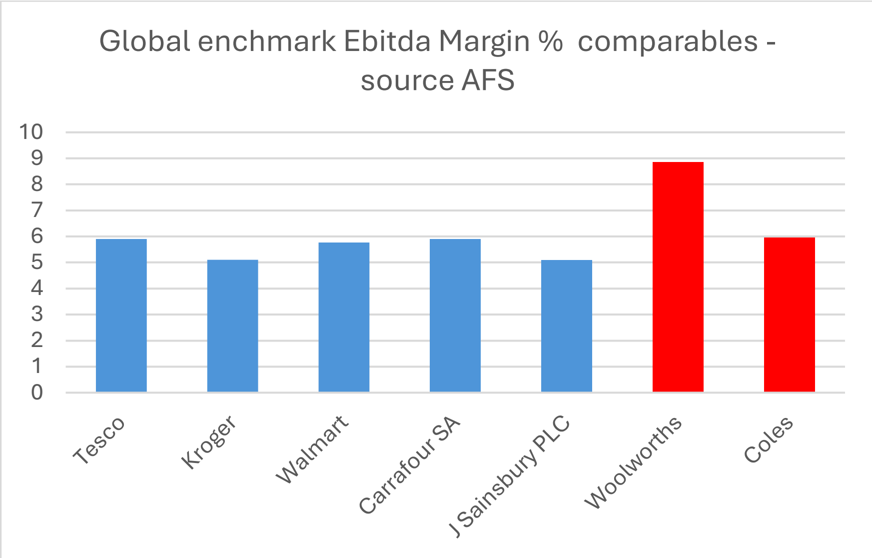
Source for Coles Profits :https://finbox.com/ASX:COL/explorer/ni/

Source for WoW profits: https://www.statista.com/statistics/1116200/australia-net-profit-after-tax-woolworths-group/

a lesser extent Coles, claim that their significantly superior returns are due to efficiencies, the question that is perhaps not being asked is around the possible abuse of dominance in being able to set higher gross margins than comparable

International benchmarks, and comparable to companies that who enjoy scale many multiples higher than WOW and COL combined. E.g. a senior WOW category buyer has gone on record stating that he will not accept a GM% of less than 40% in his core pantry division.

Suppliers are therefore obliged to fund this GM% requirement, and also guarantee WOW GM% margins during price promotions i.e. WOW will not fund any temporary price reduction from their own pocket, must be funded fully by the supplier.



Further to the above comparative global best practice benchmarks, it is easy to conclude that the dominance and bullying behaviour taken against suppliers, enables Woolworths and Coles to realise significantly higher returns than their international peers. In the case of Woolworths and Coles, there is a strong argument to support the contention that indeed their significantly higher than benchmark EBITDA margins are a consequence of their ability to positive influence their own gross margins through supplier funded price, terms and rebates , rather than their own efficiencies as they so claim in the public space.

Year	Inflation CPI	Consumer Buying Power	Australian Grocery Industry
2019	Inflation remained within manageable levels, exerting minimal pressure on grocery prices. Consumers could purchase goods without significant price increases	Consumer buying power was relatively stable in 2019. While there were some fluctuations, overall, it allowed consumers to make their grocery purchases without significant constraints.	The grocery retail sector in Australia witnessed robust profits for major supermarket chains, Coles and Woolworths. These two dominant players saw significant growth in their revenues, driven by higher sales volumes and strong market positions
2020	The pandemic led to some price fluctuations, primarily due to supply chain disruptions. However, overall inflation remained moderate	The COVID-19 pandemic caused fluctuations in consumer buying power. Panic buying led to increased grocery spending, impacting the purchasing power of consumers	Despite the challenges posed by the COVID-19 pandemic, the grocery industry remained resilient. Coles and Woolworths reported increased profits as consumers stockpiled goods and spent more on groceries during lockdowns
2021	Inflation started to rise, impacting grocery prices. Consumers began to feel the pinch as their purchasing power eroded	Consumer buying power fluctuated as the economy recovered from the pandemic. Inflation started to affect prices, influencing the affordability of groceries.	Grocery industry profits continued to rise. Coles and Woolworths leveraged their dominant market share, maintaining their positions as industry leaders. Profits saw a steady upward trajectory
2022	The number of bankruptcies in the food and Agri industry remained elevated, affecting local producers and small businesses	Consumer buying power faced challenges due to rising prices and inflation. The increasing costs of essential goods impacted the affordability of groceries for some segments of the population	Coles and Woolworths' profits increased by 8-10% during this year. Their combined market share exceeded 80%, reflecting their stronghold on the grocery market.
2023	Bankruptcies in the food and Agri industry continued to impact local producers and smaller businesses, reflecting ongoing economic challenges	Consumer buying power continued to face pressures as inflation and rising costs affected household budgets. Some consumers had to make choices about their grocery purchases based on affordability	The dominance of Coles and Woolworths continued. The duopoly's market share remained strong, and their profits sustained growth

The prevalence of opportunistic pricing, price mark-ups and discounts that are not discounts;

The practice of running promotional events such as EDV at higher price points than historic RRPs has been publicized in the media. Coles recently admitted pricing errors within its proprietary tomato brand, as evidenced below:

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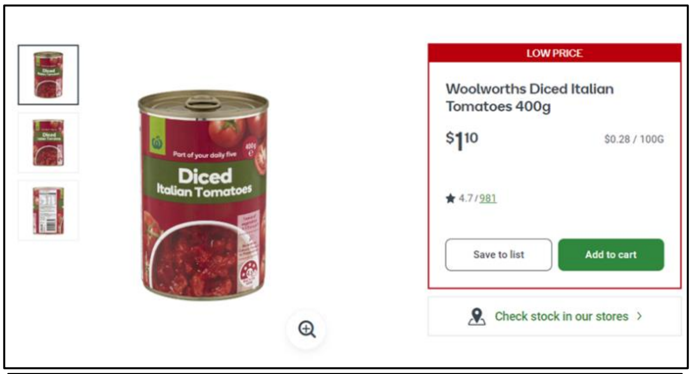
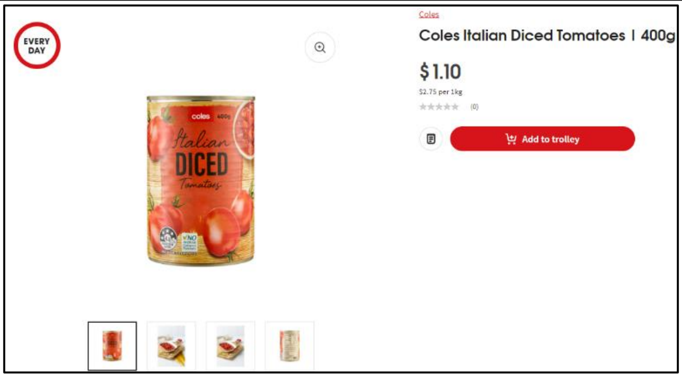
As referenced above in price setting, Woolworths continues to use its Low Price activation lever to present items as value-priced, which are, in fact, line-priced with its competitive set in the market.





The contribution of home brand products to the concentration of corporate power.

Coles and Woolworths hold a significant share in private label brands, which can create conflicts of interest as they compete with their own suppliers by selling their own branded products. Woolworths Food Company (WFC) operates as a separate entity, seemingly initiated so Woolworths could argue that the code of conduct only applies to their commercial buying team and behaviors. To this day, the WFC team and Woolworths' commercial teams remain separate to allow both parties to extract incremental margin and exert separate pressures on suppliers.

In a recent example, our business was placed at the mercy of WFC through the threat of offshoring our existing private label contracts to the Chinese market. The size of our business was substantial, with an estimated sales decline of 20% if the threat were realized. During this process, WFC swiftly transitioned from collaborative discussions to threats of full de-listing, citing accusations of reduced transparency on our part. The discussions escalated to involve senior members of both Woolworths and our business, with the potential for a formal complaint to be lodged against the retailer. After the proposed formal complaint was raised, we observed a shift back to behavior that could be deemed collaborative. However, the impact on sales was still felt, resulting in both lost volume and profit.

Improvements to the regulatory framework to deliver lower prices for food and groceries;

Suppliers should not be compelled to adhere to any retailer-set timeframes to influence the pricing of goods. The arbitrary 13-week period seems to be designed to prolong negotiations and allow the retailer to pressure suppliers, especially in the final few days, to provide more benefits to the retailer. These demands often come in the form of additional trade investment, increased promotional frequency, off-invoice discounts, etc., which pose a risk to the recovery of costs by suppliers.

It is exceedingly challenging for suppliers to independently set prices for their goods that offset cost pressures and deliver sustainable commercial outcomes, crucial for driving ongoing investment in innovation, business growth, and future success.

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Frameworks to protect suppliers when interacting with the major supermarkets;

Suppliers, when documenting all interactions in writing and having a solid understanding of the code of conduct, can utilize the existing code to limit punitive behaviors. However, in extreme cases, the burden is placed on the supplier to file a formal complaint. The fact that not a single supplier has ever lodged a formal complaint in this concentrated market speaks volumes. It is clear that the fear of retribution and reliance on both Woolworths and Coles in Australia is a factor suppliers cannot overlook. Given the ongoing fear of retribution, this hesitance to initiate a formal complaint is unlikely to change even in the event of a voluntary code of conduct being made mandatory by all parties.

The role of multinational food companies in price inflation;

From our experience, multinational corporations tend to use CPI as a margin enhancement tool in Revenue Growth Management (RGM) practices. This approach stems from global markets being more receptive to CPI activity, especially in the absence of a grocery duopoly. In Australia, since the pandemic, retailers have become adept at leveraging these CPI negotiations to drive their own margin improvements. The net result seems to have led to price inflation over the past 3-4 years, impacting the cost of living.

Any other related matters

Exercise of Corporate Power and Market Domination

Dominance in Private Label Brands

Coles and Woolworths have a significant share in private label brands, which can create conflicts of interest as they compete with their own suppliers by selling their own branded products.

Pressure on Margins

Supermarkets have been accused of pressuring suppliers to reduce their margins, leading to questions about the profitability and sustainability of local food manufacturers.

Excessive Demands on Promotions

Major retailers can require suppliers to contribute to promotional costs, and these demands can be seen as excessive.

The two major Australian retailers exercise strong negotiation power in trade investment discussions with a clear willingness to pressure suppliers into incrementally supporting their own priorities and in particular, ensuring that suppliers fully fund price specials or price promotions.

Bullying and Unfair Practices

Reports have emerged of major supermarkets using their market power to engage in bullying tactics. This includes pressuring suppliers to offer additional discounts, reducing payment terms, or threatening to remove products from their shelves if suppliers do not comply.

Major supermarket chains like Coles and Woolworths have also been accused of engaging in price discrimination. This occurs when they negotiate lower prices with larger suppliers but impose higher prices on smaller suppliers. Such practices can place small and medium-sized suppliers at a significant disadvantage.

Supplier Contracts

Major retailers often impose stringent contract terms and conditions on suppliers, which can be onerous and one-sided. Suppliers may have little room to negotiate terms and are often required to accept standardised contracts.

Coles and Woolworths engage in offering only short-term contracts to manufacturers, which hinders the manufacturers' capacity to invest in long-term improvements related to technology, quality, and efficiency. A more favourable approach for supermarkets would be to consider providing stable, long-term contracts, encouraging and sustaining investment in local manufacturing.

De-listing Threats

There have been allegations that major supermarkets threaten to de-list products or delist suppliers if they don't meet certain demands, such as price reductions or promotional contributions.

Unilateral Changes

Supermarkets have been criticized for making unilateral changes to supplier agreements without adequate consultation. These changes can include shifts in payment terms or increases in promotional contributions.

Late Payments

Reports have emerged of major retailers delaying payments to suppliers, placing financial strain on these suppliers, especially smaller ones.

Using suppliers IP for their commercial advantage

Major retailers ask all local manufacturers to present them with new IP in the form initially in the idea stage and then in sample or prototype. Often the retailer will take the idea and procure the development of similar or identical product and/or packing from overseas and launch ahead of or at the same time as the manufacturer practically deeming the new development to failure.

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