Submission to the
Senate Inquiry into the Impacts of Supermarket Price Decisions on the Dairy Industry

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This submission provides updated information with relevance to the Association's previous submission to the inquiry. The Association predicted two possible scenarios resulting from the devaluation of milk caused by the retail price war. The prediction in italics and updated information relevant to these predictions (''outcome'') are below.

1. ***If, as Coles claims, there is no impact on the contract price between the processor and the retailer, the Association expects the processor will bear the direct burdens of reduced margins. This will also mean; further loss of sales in the supermarket by the processing companies, degradation in value of well recognized brands, reduction in competitiveness of smaller retail outlets, possible increases in other product lines, increased market share of the respective home brand milk products, and possible reductions in the farmgate price.***

Outcome:

During the period February to June period of 2011, NSW supermarket home brand fresh milk sales increased by 10% compared against the 2010 milk sales, largely at the expense of processor branded milk.

Milk sales have only increased in line with population growth.

According to Ian McLeod of Coles on 25 July "Increased milk consumption over the last 6 months, well above long term trends, shows that both customers and the dairy industry are winning as a result of our Down Down milk pricing initiative.'' As always, data can be interpreted in many ways. Figure 1, which has been derived from data available from Dairy Australia, shows percentage change in month on month milk sales (red) and milk production (blue) for the past 2 years in NSW. For instance, May 2011 sales of fresh milk were around 4% higher than May 2010 and June 2011 sales increased by about 2% from June 2010 figures. In contrast to the analysis reported by Coles, the graph also shows that there has been quite a degree of fluctuation in sales. For example, March 2011 sales actually dropped from those recorded in March 2010 and June 2010 milk sales increased about 3% on the June 2009 figures. So whilst it is correct to note that milk consumption is up for the past 6 months since the Coles initiative was implemented on January 26, this of itself cannot be attributed to the marketing strategies undertaken by major retailers. The inability to causally link the two events can be understood when noting that sales were also up to a similar degree many other times in the past 2 years, obviously without any supermarket initiative at play.

Taking the February to June 2011 period as a whole, supermarket milk sales according to Dairy Australia have increased by 5% in 2011 compared to the same period last year. However, total milk sales have increased by 1.5% broadly in line with population growth. One can only assume that the other 3.5% of sales have been derived directly by taking market share from independent retailers, highlighting the reduction in competitiveness of smaller retail outlets.

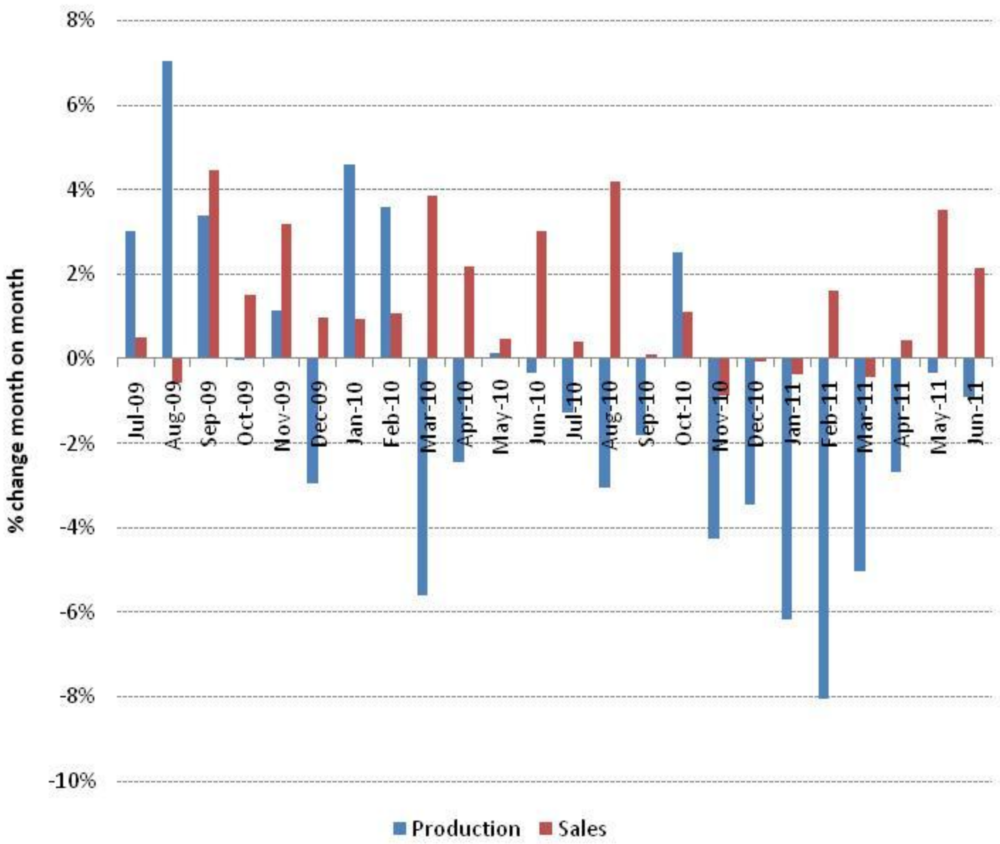

Figure 1. NSW production and drinking milk sales relative to the same month of the previous year (%) (Source: Dairy Australia).

What should be of great concern is the distinct decrease in NSW drinking milk production. There could be many factors at play regarding this shift such as the weather, decreased processor requirements for fresh milk, the processing of milk into alternative products, and/or a system that is failing the dairy farmers of NSW. In this regard, devaluation of a valuable commodity through the sale of discounted home brand may well be a key part of this failure. If this shift in production continues, fresh milk may well become a scarce commodity in NSW, inevitably increasing milk price to the consumer and our very own food security.

2. ***If the level of generic supermarket brand product sold increases this will increase the market power and influence when it comes to contract renegotiations between the supermarket chains and the processors. The Association expects that this will result in lower retail/processor prices and subsequently these will be passed onto the farmers, the altered market distribution will further reduce dairy farmers bargaining power, farmers will be forced to produce under cost price, driving sections of the dairy industry out of the market. In the long term, the reduced supply will either; force the price of milk up, or cause milk and dairy products to be imported from cheaper sources internationally.***

Outcome:

As home brand drinking milk sales have increased at the expense of processor branded milk, supermarkets have increased their market power in the short time since January 2011. Processors are now being placed in a situation whereby their bargaining power with supermarkets is being eroded due to the quantity of milk being negotiated. A continuation of this trend will result in supermarkets dictating price to NSW processors, making the dairy industry more susceptible to price manipulation in the future. Generic milk sales have now exceeded processor branded sales through the supermarket, and therefore there is an increasing need for processors to gain these contracts. This change in market dynamic and contracts shifting between processors has been associated with a reduction in farm gate milk price.

Prices offered by a major processor that have recently gained a supermarket contract have declined relative to last year by 2-3c/L. Putting the fall in price into perspective, for a farm producing 1 million litres per annum, a 2c decrease in milk price is equivalent to a loss of $20,000. The processor that lost the contract in question is now looking to drop the supply from many of NSW farmers or accept milk at a greatly discounted price. The competition between processors negotiating contracts for large volumes of milk to supermarkets for a short term (2 years or less) is exposing the dairy farmers of NSW to increased risk and uncertainty. Short term changes in contractual supply with processors is putting dairy farmers very business at risk as they cannot turn the milk tap on and off at a whim.

The decline in prices paid to farmers equates to a direct loss of $20,000 - $30,000.

What the dairy farmers of NSW require is a milk price that makes farming a worthwhile venture and a market that requires their milk not just now, but well into the future. Farmers can then proactively plan for the future without the fear of having no market for their milk.The Association believes that for a sustainable dairy industry into the future, the market power of the supermarkets needs to be altered.

Recommendation 1: ABARE to investigate the effect of enforcing the reduction in the size of each individual contract offered by supermarkets to processors on competition and efficiency within the market place.

Recommendation 2: ABARE to investigate the effect of enforcing long term (5year or greater) contracts between retailers and processors.

Recommendation 3: Review the 10 recommendations provided by Australian Dairy Farmers (ADF) to the inquiry.