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Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

27th March 2011

Dear Committee Secretary,

Re: Inquiry into the impacts of supermarket price decisions on the dairy industry Questions on Notice

The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to provide further information to the Senate Standing Committee on Economics to assist with its inquiry into the impacts of supermarket price decisions on the dairy industry in response to questions asked on notice by the Senator Nick Xenophon.

As previously advised the QDO is currently seeking further advice and working on a set of recommendations we wish to make to this Inquiry and as such the QDO will be seeking to provide a supplementary submission to present these recommendations.

The QDO would welcome the opportunity to discuss any of these issues or information, presented in the following, with the members of the Senate Inquiry.

Yours Sincerely,

Brian Tessmann
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QON 1: The Australian Dairy Farmers have stated that the market share of the supermarkets' private label milk has doubled since the 1999–00 financial year. What direct impact on the dairy industry in Queensland has this had?

QDO Response:

Over the last decade the impact of the doubling of the market of supermarkets' private label milk at the expense of processor proprietary brands has:

- Seen the loss of value to the supply chain grow to from some $444 million in 1999/2000 to more than $414 million over the last decade Australia wide.
- For Queensland the share of this loss is estimated at more then $90 million per annum. Per litre of milk produced currently this would equate to some 18 cents per litre.
- This loss has increased even more now that Coles has discounted the milk price to $1 per litre which was last the price of milk in 1992.
- Resulted in greater downward pressure on farm gate prices following deregulation. The regulated price of milk used for drinking milk in 1999/2000 was 54.9 cents per litre and now more then a decade later it is as low as 47 cents per litre. And had been reduced to lower levels in the years in between.
- Seen direct impacts on farms milk cheques where the farm gate price for Queensland farmers is directly linked to processor proprietary branded milk sales in the market.
- Seen the shrinkage of farm numbers, rationalisation of processing, vendoring and overall investment in the Queensland industry.
- Contributed to the decline in dairy farm numbers In Queensland from 1545 in 1999/2000 to some 582 currently and a decline in Queensland milk production from 848 million litres in 1999/2000 to currently around 500 million litres.
- Contributed to the Queensland dairy industry transforming from a net exporter of dairy products to where now more then 95 percent of the milk produced in Queensland is consumed as drinking milk in the domestic market, effectively making the Queensland industry more vulnerable to impacts from unsustainable supermarket lose leader discounting.

Processors and dairy farmers who supply the drinking milk market rely on the margin from processor proprietary branded milk sales for their profitability as industry returns and margins on supermarket store brand sales are negligible or non existent than those achieved on processor branded product sales.

Competition from unsustainably lose leader priced supermarket store brand milk is taking market share away from proprietary branded products and has caused a net reduction in per unit industry returns and margins on domestic sales of drinking milk. This reduction in revenue has placed downward pressure on both company and farm gate returns from drinking sales.

This scenario continues to place downward pressure on farm gate prices as the return to the supply chain declines as the major supermarkets grow their store brand market share using discount and or lose leader pricing whoch provide little or no margin and less of the more sustainably priced branded milk is being sold.

As is expected if discounting battles continue between major supermarkets the reduction in supermarket ‘store brand’ will have flow on impacts including;

- further devaluing of all supermarket ‘store brand’ milk sales as major supermarket compete with other to protect market share and continue to use ‘store brand’ milk as a lose leader marketing agent,
- devalue processor proprietary brands of milk as processors either resort to discounting and or increase advertising to try and mitigate market share losses across both supermarket and route trade market channels,
- reductions in the retail price of processor proprietary branded product and supermarket ‘store brand’ products will necessarily flow through to wholesale prices and processor profitability, as will any shift to lower margin resulting from these price discounts.
- Increasing pressure on the viability of smaller retailers and the route trade.
- Increasing downward pressure on farm gate prices.

As major supermarket store brand sales increase, they obtain more market power to be able to dictate the price and supply conditions at which suppliers sell to them. The supermarkets also then get to dominate shelf space and as a result the choice to customers declines. This vicious cycle til in the long-term will result in supermarket store brand domination of the market, no customer choice, little product innovation and worst of all for the customer – a likely increase in the price.

Background: As presented in the QDO’s Senate Inquiry submission, in particular referencing pages 8 and Table 1 on page 10, the data provided from Dairy Australia presents that:

- From 1999/2000 to 2009/2010 through using a range of discount and marketing tactics major supermarket chains have doubled their market share of ‘supermarket brand’ sales from some 25% to over 51% of total supermarket sales. Over the same time processor owned proprietary brand sales through supermarket as a percentage of total supermarket sales has fallen from 75% to 50%.
- In relation to regular white whole milk, in 1999/2000 supermarket brand label price for regular whole milk was $1.26 per litre, and supermarket market share of whole milk sales through supermarkets was 31 percent and processor brands 69 percent. Whereas in 2009/2010 ‘supermarket brand’ label price for regular whole milk had dropped to $1.12 per litre or 11% and supermarket market share of whole milk sales through supermarkets increased to 71 percent and processor brands declined to 29 percent.
- The current discounting has seen prices drop to between $0.96 and $1.00 per litre.
- As a comparison with the drop in supermarket brand milk prices, over the last decade the average price for processor owned proprietary brand has basically followed inflation, rising from $1.33 to $1.83 per litre or 38% (inflation increasing by 36%).
- Due to the unique nature of fresh drinking milk as a perishable, every day dietary staple of our society, the major supermarket have over the last decade continued to use it is a marketing agent to attract customers to their stores, to entice customers to purchase other products while at the store.
- Over the last decade the difference in price between proprietary ‘branded’ milk products and major supermarket chain ‘supermarket brand’ label products has increased significantly. In 1999/2000 the difference per litre on average was 18 cents per litre and just 7 cents per litre for whole white milk. However by 2009/2010 the difference had increase to on average 71 cents per litre.

If the major supermarkets continue to discount milk to $1 per litre then the price difference will increase to over 87 cents per litre, assuming no other price changes occur in milk processor proprietary 'branded' products.

- When this value difference of milk sales is equated across the market share of major supermarket chain 'supermarket brand' sales for 2009/10 compared to the value of proprietary brand sales through supermarkets the difference is $414 million and some $90 million per year in the Queensland market. In 1999/2000 the value difference amounted to some $44.5 million.
- As a result processor brands have lost market share and the margin to the industry has been reduced to a point where the loss in value to the dairy industry is over $414 million per annum, compared to $44 million ten years ago.
- If this amount of money, $414 million, was retained at the farm gate it would translate to an increase in farm gate price for dairy farmers of 18 cents per litre for milk supplied for the domestic fresh drinking milk market.
- This is the amount the large retailers have taken out of the value chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry value chain.
- Major supermarket discounting of milk from the 26th January 2011, as initiated by Coles, has already seen sales growth of 'supermarket brand' milk of between 15 and 20 percent, as recently publically reported by the head of Wesfarmers.
- At the same time major supermarkets have increased their market share of the 'route' trade through sales of milk through their fuel station network etc. Whilst we do not have data on the loss of market share within 'route' trade operators, such as independent fuel stations, corner stores, other small retailers, and distributors and vendors, to major supermarket brands but we note that some vendors have recently reported losses of sales of up to 20% following the Coles discounting to $1 per litre.
- If the current $1 per litre discount continues it will further devalue milk nationally in the fresh milk market. For example if it was assumed that the discount remained in place for a year and even with no movement in market share between processor proprietary brands and supermarket store brands the discount would erode a further $96 million dollars off the value of fresh milk, so that the annual loss to the value chain would increase from $414 million to $510 million.
- If the inclusion of the change of market share, of say 15% of whole and reduced fat milk from processor proprietary brands to supermarket store brands, then the additional devaluation of milk would increase to $158 million, so that the annual loss to the value chain would increase from $414 million to $572 million.
- If the impact on the whole national fresh milk market is considered covering both supermarkets and 'route' trade sales of milk and you applied the discount of $1 per litre for supermarket store brand milk and a change of market share, of say 15% of whole and reduced fat milk from processor proprietary brands to supermarket store brands the annual devaluation of the whole national fresh milk market would equate to over $840 million. If the impact was shared equally across the three main sectors of the supply chain it would amount to approximately a loss of value of $281 million per sector.

- If this loss was translated to the milk production sector it would amount to a loss of value of 12.4 cents per litre or for a average farm with a production of 1 million litres a loss of $124,000, which for the majority of dairy farmers at this size would render them unviable. For the Queensland dairy industry this would equate to a lose of approximately $62 million. (please refer to page 11 of the QDO submission for assumptions).
- This data clearly presents that the large discounting of milk by Coles is devaluing the value of milk sold through supermarkets nationally and is causing a significant loss in returns to the dairy industry value chain which is not sustainable.
- Further to the above, this impact is also increasing across the whole Australian milk market as the major supermarkets are now actively pursuing market share from the 'route' trade including from independent fuel stations, corner stores, other small retailers, and distributors and vendors.
- While the price cuts to supermarket 'store brands' announced by Coles and Woolworths are currently being absorbed by the retailers, if they are maintained they can be expected to flow on to other branded products and market channels.
- This is an extreme concern to the dairy industry as the margin from processor proprietary brands sustain the dairy industry value chain at this time compared to the extremely slim or non existent margins available from supermarket 'store brand' milk sales.
- The current aggressive move by the major supermarket Coles is aimed at changing consumer behaviour and increasing market share and other retailers are seeking to protect their market share.

QON 2:

a. Are you aware of informal agreements between processors that they will not poach each other's suppliers?

b. How complicated are the contracts between processors and producers? Could they be simplified?

QDO Response:

a. The QDO is not aware of any informal agreements between processors not to approach each other suppliers to change processors. During the last decade a significant number of dairy farmers have changed processors. However as in any business relationship the QDO believes that loyalty of dairy farmers to processors is taken in consideration by processors in their current and future dealings with dairy farmers.

b. The QDO supports recommendation number 2 from the last Senate Inquiry where "The Committee recommends that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions", as the QDO believes there is a need for greater simplicity, transparency and comparability for dairy farmers with regard to contracts offered by processors.

It needs to be noted however that while greater simplicity, transparency and comparability of contracts between processors and farmers would be of assistance, the current major difficultly for the industry lies with major supermarkets using and devaluing fresh milk as a marketing agent and undermining the sustainability of the fresh milk supply chain.

QON 3: Coles have said that they are 'fully absorbing the price cut' and that there is 'no justification for a reduction in farmgate prices from processors now or in the medium term'. On the other hand, a number of submissions have claimed that eventually Coles will decide not to absorb the price cut and will pressure processors to accept a lower price. If Coles are able to influence prices in this way and pay less to processors, why have they not always done so?

QDO Response:

The QDO recognises the statement by Coles that they are fully absorbing the discount on their Coles branded milk to $1 per litre.

However this statement by Coles does not present the full picture of the current and real and present danger of impact to the Australian fresh milk production and supply chain.

Firstly, whilst Coles are presenting that they are absorbing the discount, the question that needs to be answered is for how long is Coles going to absorb the discount, as it will be affecting the profitability of Coles unless Coles is offsetting the discount somehow for example by charging more for other grocery products or fuel, or changing the cost structure of the delivery of milk from the processor to the Coles store.

As Coles increases its market share for Coles branded milk, through its cutthroat ‘Down Down’ discounting campaign, it will gain even more market power thereby enabling more pressure to be placed on processors when they put their Coles brand milk supply out for tender.

Processors are in a difficult position in that the major supermarkets now control well over 50% of all milk sales nationally through supermarkets and the route trade and of all milk sales through supermarkets more then half of that is made up of supermarket store brand sales.
As such the major super markets now control the main avenue for the sale of the processors proprietary brands to consumers as well as controlling a larger and larger volume of milk sales under there own supermarket brands which processors also need to bid for to sell milk.

Coles does have a material influence on milk prices, as other retailers dropped their prices to $1 per litre and further for their store brands after Coles dropped its price of Coles branded milk to $1. This devaluation or downward pressure triggered by Coles across the nation will see all retailing margins on milk placed under pressure if other retailers do not wish to lose market share and with this there is little other option to restore margins on discounted sales in the future other than seeking to reduce the price paid to the supplier. As such the processor will seek to reduce the cost of the raw resource thus placing subsequent follow on downward pressure on farm gate prices.

While the question of Coles influencing prices and paying less to processors, is really a question for the processors and Coles, the price and sales data evidence provided by Dairy Australia as presented on page 10 of the QDO’s submission and in response to the Question On Notice 1 clearly presents that:

- Since the deregulation of the domestic fresh milk price in 1999/2000 the retail price of supermarket store brand milk has on average declined while the retail price of processor proprietary brands has tracked closely with inflation.
- Over the last decade the major supermarkets have more then doubled their market share of milk sales under their own supermarket store brands.

- Since the 1999/2000 the average price difference per litre, between supermarket store brands and processor proprietary brands have increased from 18 cents to over 87 cents now, as a result of growing supermarket market power and the use of supermarket store brand milk as a discount marketing agent.
- The last time fresh milk was priced at $1 per litre was in 1992.
- Major processors have publically stated that the margins in supermarket store brand milk contracts are negligible at best.

With this history it presents that Coles and other major retailers, with their substantial market power, have in fact had a major influence over milk prices and lower returns to the fresh milk supply chain since the domestic fresh milk price was deregulated, whilst at the same time by using milk as a marketing agent have grown their own market share of over grocery sales and of their own supermarket store brand milk.

QON 4: Coles' managing director Ian McLeod has said that 'Coles believes there should be greater transparency of farmgate pricing by the multinational milk-processing companies so everyone knows what is really going on'.

a. Do you agree with this view? How transparent are the prices and terms of the contracts for private label milk and branded milk between the major supermarkets and the processors?

b. Do you think there would be noticeable benefits if this information was more widely available?

c. What complications or issues would prevent this?

QDO Response:

a. The QDO supports greater transparency within and across the supply chain of the industry from farm gate through to retail, particularly at the processor and retail levels. The QDO is not privy to any information about prices and terms of the contracts for private label milk and branded milk between the major supermarkets and the processors. Greater transparency on these contracts would be beneficial to the sustainability of the industry. The QDO believes that through a domestic drinking milk code of conduct a Commissioner should be appointed and be given the power to apply a sustainability test to all private label milk contracts.

b. The QDO believes that greater transparency would assist in the provision of better information to guide more informed decision making and interaction within the supply chain and possibly assist in avoiding pricing formats that undermine the sustainability of the supply chain. Greater transparency would also help prevent unconscionable conduct within and across the supply chain, for example price and cost swapping.

c. Retailers and even processors may resist transparency as they fear that it may lead to a loss of commercial advantage or expose practices which could be deemed as undesirable. Additionally smaller retailers trying to compete against the market power of the two major retailers. There is a lot more resistance or sensitivity to transparency at the retail and processing sector levels of the supply chain then at the production sector.

QON 5: In the UK some of their major supermarkets have introduced dedicated supplier arrangements, such as Tesco's Sustainable Dairy Group, and it is claimed that these farmers are paid a higher farmgate price which is reviewed by a consultancy to account for changes to costs of production, rather than relying on market forces.

a. Are you familiar with these types of arrangements?

b. Would they work in Australia?

c. Are they beneficial to dairy farmers overall or do they just crowd out other cooperatives and processors, eventually leading to less competition?

QDO Response:

a. The QDO understands that in the United Kingdom the Tesco Sustainable Dairy Group (TSDG), which has about 800 farmer members, was established four years ago in response to significant uncertainty facing British dairy farmers caused by the continuing volatility in the markets and poor returns undermining the sustainability of milk supply in the United Kingdom and thus to Tesco.

It is understood that this initiative has followed a long and difficult path for dairy farmers in the United Kingdom as large supermarkets have taken the majority of the market share from proprietary milk brands and now with major supermarket chains only stocking their own store brands or a variation there of. It is understood that dairy farmers in the United Kingdom regardless of being subsidised, in the environment controlled by large retailers could not achieve sustainable farm gate returns.

This also follows a recent trend in the United Kingdom where by retailers have contracted milk supply directly with groups of farmers and the processor has become a ‘contract pack and delivery’ operation only, with no ownership of the product.

It is understood that Tesco’s through the TSDG has given the group a pledge to ensure the TSDG dairy farmer members are paid above the cost of production, with provisions for capital investment, depreciation and unpaid family labour, enabling them to invest and plan ahead. To ensure that the farmers are paid above a sustainable farm gate price a regular review of Tesco farmer production costs, or cost tracker review, is carried out by an independent research group. It is understood that Tesco is paying its farmers some 3.04ppl more than the average processor’s price.

b. The QDO believes that such a system could become a resultant need if;

- the major retailers are allowed to continue to use supermarket store brand milk as a discounted loss leader marketing agent to undermine the value market share of processor owned proprietary brands in order to grow their own market share,
- the continuing loss of market share by proprietary brands to supermarket store brand renders proprietary brands unviable, leaving consumers with a limited choice of supermarket store brand milk, and by which processors would be left by default with contract pack operations, with no product ownership.

c. The QDO believes that the TSDG model has some benefits for the dairy farmers involved relative to the environment which has evolved in the United Kingdom due to the domination of the market place by large supermarket chains with supermarket store brand products.

The initiative has evolved as the major retailer Tesco started to become concerned about the security of supply of milk to their stores, meaning that the dairy industry had to get to the lowest possible point, even with subsidies, before something was initiated to seek to secure a sustainable supply of milk.

One could be excused for taking the view that the major supermarkets in the United Kingdom had realised that finally they had reached the point where they could not possibly 'screw any more out of the dairy farmers' without risking losing supply altogether.

One could also be excused for taking the view that even with systems such as the TSDG the major retailers are able to keep a close watch and a 'supermarket ceiling' on farm returns, thereby controlling the entire vertical supply chain.

The TSDG type model, as previously presented, is a model derived out of the need to rescue the sustainability of the milk production sector to derive some means of supply security. Such a situation would not be likely to crowd out other types structures as in this environment they would have already collapsed as occurred in the United Kingdom.

There is little doubt, as has been the experience in the United Kingdom, that once such an environment is allowed to result, particularly at the retail level where supermarket store brands dominate the market, it will result in;

- Devaluation of fresh milk as supermarkets use it as a loss leader marketing agent,
- Unsustainable returns to the supply chain,
- Less competition, choice and higher prices for consumers,
- Little or no investment in product innovation,
- Divestment from the supply chain, threatening supply security.

The QDO believes that a similar approach to the TSDG sustainable return type model has relevance if attached to a Mandatory Whole of Supply Chain, Code of Conduct under the Competition and Consumer Act, with a Commissioner which has the authority to apply a Sustainability Test and direct mediation and or apply arbitration to proposed contracts at any point in the supply chain, whether it be between Collective Bargaining Groups of dairy farmers and processors, processors and retailers. The QDO will provide more details of this proposal in its supplementary submission with recommendations for the Senate Inquiry.

Background: As presented on page 25 of QDO's submission to the Senate Inquiry the QDO is aware that Wesfarmers has introduced new management for Coles with the engagement of a management and marketing team from the United Kingdom where these types of 'home brand' discount price tactics has been common place to get market share from their competitors and to grow their own store brands. It is understood that the executives engaged from the United Kingdom by Wesfarmers are experts in the area of home brand development and procurement and marketing strategies and tactics to grow home brand market share.

In the United Kingdom independent branded products are now a rarity; they are all supermarket brands now and in some European countries fresh milk is getting harder to find and consumers are left little options but to purchase Ultra High Temperature (UHT) treated milk.

A 2008 study by Oxford University estimated the big four accounted for 70% of the milk market in the UK. In turn supermarket 'store brand' products account for around 70% of total milk sales. UK retailer brands have been highly successful due to the strength of the parent brand. Consumers identify strongly with the brand values of Sainsbury, Tesco et al, believing they confer attributes of quality and supply chain values.

In response, processors have struggled to develop viable differentiated brands in this market. The effect of this supermarket 'store brand' dominance has been to stifle innovation, as evidenced by the lack of product differentiation in the UK milk market. The Oxford Study noted the shift in dominance in the dairy industry supply chain from processors to retailers, with only a small percentage of the supply chain profits attainable for farmers and processors.

A 2010 study by DairyCo on dairy supply chain margins noted the absence of any decline in retail prices for milk at a time of falling commodity and farmgate prices, concluding that processors and farmers absorbed the full impact of the decline in the dairy market.

Comparing 2009/10 with 1999/2000 indicated the retail price of milk increased 60% compared to a general food price increase of 36%. Over the same period the average farmgate price increased 34% and the estimated wholesale price increased 31%.

Before major supermarket chain 'supermarket brand' pricing and marketing strategies, these returns flowed to the processor and then to farmers. The loss of these returns to the industry is not sustainable.

QON 6: The Produce and Grocery Industry Code, which was introduced in September 2000, aims to promote fair and equitable trading practices within the produce and grocery industry supply chain. The code aims to minimise disputes and provides a dispute resolution system which is available to dairy farmers.

a. Are you aware of the Produce and Grocery Industry Code?

b. How relevant is the Code to the dairy industry?

c. How effective do you consider the Code is? How could it be strengthened?

d. Do you consider the effectiveness of the Code and the Produce and Grocery Industry Ombudsman is limited by the fact that the Code is voluntary?

QDO Response:

a. The QDO is aware of the Produce and Grocery Industry Code.

b. In relation to the potential relevance of the Produce and Grocery Industry Code (PAGIC) and the Produce and Grocery Ombudsman, we have been advised that dairy farmers cannot take action through the Ombudsman directly with retailers as they do not contract directly with retailers but rather with processors.

c. For the Code to be relevant for the dairy farmers it would need to;

- Cover the whole industry value chain from dairy farmers through to retail,
- Be mandatory under the Act,

- That an Ombudsman or Commissioner would have the power to vet proposed contracts at any point in the supply chain, to apply a sustainability test and to direct mediation and or apply arbitration,
- Have an independent body acceptable to the supply chain stakeholders to maintain a regionally relevant fresh milk supply sustainability index from which the sustainability test would be based.

d. Due to the situation that the Australian fresh milk supply chain now faces the QDO believes that a Code of Conduct to be effective it would need to be mandatory.

The QDO will provide more details of this proposal in its supplementary submission with recommendations for the Senate Inquiry.

QON 7: CHOICE have called for a comprehensive and coordinated National Food Policy to be developed and a supermarket Ombudsman to be established. The Government have also formed a National Food Policy Working Group to develop a National Food Plan.

a. Would you support this proposal?

b. What powers and functions do you consider a supermarket Ombudsman should have?

c. CHOICE have also suggested that the Ombudsman be based within the ACCC—do you have a view on this?

QDO Response:

a. The QDO believes there is a critical need for a national policy framework to promote the sustainability, international competitiveness and growth of our food and fibre production, processing and value adding industries and to protect the natural resources that underpins them.

The National Farmer Federation and the Australian Government has initiated a National Food Policy Working Group which includes a range of stakeholders from the food supply chain and consumers as represented by Choice.
This group has been tasked with the development of a National Food Plan and the QDO sees this as a very important initiative for the future of our and other Australian food industries.

There is a real need for such a policy to set the direction of key Government agencies and to rectify the current policy and practice inconstancies which are actually currently undermining the sustainability, international competitiveness and growth of our food and fibre industries.

The QDO notes that some major players are showing leadership on the issue of the need for sustainable food and fibre supplies. Case in point are the following statements that where made by Michael Luscombe of Woolworths at a recent Sustainability in Agriculture Conference:

"Essentially, a successful supply chain is based on sustainable success for each link. And taking a long term perspective is ultimately better for everyone.

What I say to our team is that as a retailer, our role is to strike a balance between a fair go for customers and a fair go for suppliers – because you can't have one without the other.

I take milk as a case in point. It's one sector where the retailer doesn't have a direct relationship with the farmer, but decisions taken at every level of the supply chain can impact the farmgate price. A competitor's recent decision to dramatically reduce the retail price of fresh drinking milk to $1 a litre is an unsustainable decision. As cost pressures build in the system, this rebasing of the retail price will effect the largest structural shift in the industry since deregulation more than 11 years ago.

The difference this time is that there is no federal government levy to help fund restructure or exit for those farm families in certain parts of Australia unable to make money in this new market paradigm.

And I suspect that as cost pressures build along the supply, through increases in energy costs, carbon pricing and the usual round of labour cost increases, as the export milk market becomes more competitive with a falling dollar, then any snapback rise in domestic customer prices will be large and sudden. That too then shakes consumer confidence in a product and disrupts the market again.

But what we do think is that in the case of milk, margin erosion will jeopardise innovation and investment in new processing facilities, and therefore potentially set back the sustainability of the sector over the longer-term.

We need increasing quantities of available, accessible, affordable and good quality food and we need Australia to be able to produce it.

Just recently we commissioned an independent study to undertake an extensive analysis of the impacts on the sustainability of food supply in Australia under our "Food for Future" program. It's only just commenced but our objective is to enhance our understanding of all the issues that could impact on the affordable supply of food to the Australian consumer. This will enable Woolworths and our suppliers to develop informed strategies that will help ensure the viability of our food retailing supply chain well into the future.

The days of the retailer versus farmer are over for Woolworths. We don't want to work that way – it's not productive, it stifles innovation and it's not sustainable."
The above is in stark contrast to the current representations made by Coles, including in their submission to the Senate Inquiry, which is focused on defending a short term focused drive for market share and bonuses, at the expense of the sustainability of suppliers and other operatives in the supply chain.

b. As presented previously if an Ombudsman or Commissioner was appointed with the charter of improving the functionality and sustainability of the dairy industry supply chain for fresh milk in Australia then;

- The Ombudsman or Commissioner would need to be responsible for a mandatory Code of Conduct under the Act covering the whole industry value chain from dairy farmers through to retail,
- The Ombudsman or Commissioner would have the power to vet proposed contracts at any point in the supply chain, to apply a sustainability test and to direct mediation and or apply arbitration,

- A independent body acceptable to the supply chain stakeholders to maintain a regionally relevant fresh milk supply sustainability index from which the sustainability test would be based.

c. Having the Ombudsman or Commissioner based within the ACCC is logical especially if the Code of Conduct that the Ombudsman or Commissioner is responsible for is mandatory under the Act.

However one could be excused for voicing a word of caution in relation to locating the Ombudsman or Commissioner within the ACCC, relative to the apparent inaction of ACCC to date on the issue of growing supermarket duopoly market power and the current potential beaches of the Act by Coles.

QON 8: The committee heard in 2010 that the national health standard for milk meant there were no significant differences between private label full cream milk and branded full cream milk, other than some minor specification differences.

a. Is this correct?

b. Do you think it is inevitable that, regardless of the current price discounts, consumers would realise this and switch to private label milk?

c. Should it be regarded as price discrimination to sell the same product at a different price even if the product is sold in containers with different labels? (i.e. should branded and generic full cream milk be regarded as the same product?)

d. Would you support an explicit anti-price discrimination clause being reintroduced into the Competition and Consumer Act?

QDO Response:

a. In relation to the question that the national health standard for milk meant there were no significant differences between private label full cream milk and branded full cream milk, other than some minor specification differences, to QDO's current knowledge that statement is correct.

There have also been a number of consumer and milk ingredient user tests by different groups which have presented variations in results.

For example Choice performed a comparison of a range of supermarket store and processor proprietary branded whole white milk and presented that there was no significant difference. Choice has also recently preformed a blind taste test between range of supermarket store and processor proprietary branded whole white and reduced fat milk and presented that there was no definable difference in the results.

b. Please refer to the information presented in the response to question one:
As per the information presented in response to Question One, regardless of discounting such as Coles has implemented and as followed by other retailers, there is an existing major price difference between supermarket store and processor proprietary brands and the difference has increased by more then 400 percent since mid 2000 and over 480 percent with the latest discounting. During this same period the major supermarkets have more then doubled their market share of their own supermarket store brand milk at the expense of processor proprietary brands, as well as increasing their share of the route trade.

While this major price differential remains it is forecast that the supermarket store brand milk market share will continue to grow at the expense of processor proprietary brands.

While Coles is saying in their submission that they 'just' reduced the Coles brand milk by 4.3% or 4.5 cents per litre, which is a reference to Coles reducing the price of its Coles supermarket brand from $2.09 to $2.00 for two litres, the full truth is that Coles stopped one line of Coles brand 'Smart Buy' effectively reducing the price of those sales from $2.47 to $2 per two litres or by 19% and reducing Coles litre milk from $2.99 to $2.00 for two litres or by 33%.

Coles promoted in its Press Release dated the 26th January 2011 stating that, "The of Coles Brand fresh milk is being cut by as much as 33% from today……"

"Significantly the price cut also includes Coles Brand reduced fat milk which will be cut to the same low price of $2 for a two litre bottle, bringing it into line with full cream milk so customers will no longer have to pay a price premium for a lower fat milk option.

"By offering the same low price on Coles Brand reduced fat milk we are also enabling more customers to switch to the lower fat option at a price they can afford which is clearly a significant health benefit." (We note that Coles has not made the same health claim with the discounting of alcohol)

From the market share figures presented on page 10 of QDO submission to the Senate Inquiry it is not difficult to conclude that the major objective of the Coles cutthroat discounting, in addition to using milk as a overall marketing agent to lure more costumers, is to target the next major market share growth opportunity being the reduced fat milk category

Coles has discounted the Coles brand reduced fat milk category by up to 33 percent to $1 per litre as that is the next main target for market share from processor proprietary brands.

Over the last decade the major supermarkets have increased their market share of supermarket sales of milk of their own supermarket store brand for whole milk from 31 to 71 percent at the expense of processor proprietary brands, as well as growing their share of the route trade. This is similar to the market share penetration by supermarket store brands in the United Kingdom.

However the supermarkets share of the reduced fate category of milk at the end of 2009/10 was still less then 50 percent of all supermarket sales of reduced fat milk. As such it is not difficult to conclude that Coles sees this as the next best market share growth target yield per promotional dollar spent.

For further information refer to the rest of the information provided in response to question one and or QDO's submission to the Senate Inquiry.

c. the QDO believes there is a prima facie case of price discrimination from supermarket store brands against processor proprietary brands, where the supermarket has sought to match their supermarket store brand against processor proprietary brands.

Further to this, as per page 24 of the QDO submission to the Senate inquiry, we believe there is a strong prima facie case under section 46, including 46 (1AA) of the Competition and Consumer Act 2010 that Coles' actions constitute predatory pricing. And additionally in relation to deceptive and misleading statements made by Coles in their discount promotion the QDO believes there is a prima facie case of deceptive, misleading and or false advertising that also should be investigated by the ACCC

d. Subsection 46(1AA) of the Act is designed to prohibit businesses with a substantial market share (having regard to the number and size of its competitors in the market) from selling goods or services for a sustained period at a price below their relevant cost of supply, for an anti-competitive purpose.

Coles' action in using its supermarket store brand milk as an advertising agent and selling it at $1 per litre, a price which was last seen almost 20 years ago in 1992, is designed to achieve a number of goals:

1. Promote a perception of Coles being a cheaper grocery provider than their competitors,
2. Lure more consumers into their stores on a more regular basis;
3. Increase sales and market share of Coles' store brand milk at the expenses of the market share of other brands, particularly in the light milk category;
4. Increase its size and purchasing power of its Coles' store brand milk tenders;
5. To gain greater market share in the 'route trade' by taking business away from its smaller retailers such as corner stores and vendors. These smaller businesses rely heavily on proprietary branded milk sales, particularly small retailers to attract customers and the large discounts by Coles and others major retailers potentially could drive many of them out of business; and
6. Take market share away from its main large retail competitor Woolworths. It should be noted that Woolworths has stated publicly that the milk price cuts are unsustainable.

To put it as simplistically and succinctly as possible, as Coles' sales of its home brand milk causes the following impacts;

- Devaluation of fresh drinking milk across the national as other major retailers have reduced their retail prices as well, which resulting in lower returns to the fresh milk supply chain,
- Processors financial returns are impacted due to the loss of market share of their own proprietary brands, which have better margins then supermarket brand milk contracts,
- Dairy farmers which have farm gate price contracts that link with processor proprietary brand sales have already seen a drop in their milk cheques as processors proprietary branded milk loses market share to supermarket brand milk,
- Smaller retailers are placed at a significant competitive disadvantage because of the higher wholesale prices they pay for branded milk,
- Milk vendors are placed at a significant competitive disadvantage as their regular customers, for example coffee shops, move to purchase milk at a lower price from supermarkets rather then from the vendor,

- The combined impact of lower returns to the fresh milk supply chain will have resulting impacts on investment and employment within the chain.

It is the contention that;

- Coles' is currently selling their home brand milk below their relevant cost of supply and retail.
- The practice is anti-competitive price discrimination through both misuse of market power and predatory pricing.
- The history of the removal of the anti-discrimination clause Section 49 in 1974 from the then Trade Practices Act, should not be forgotten.
- That subsection 46 of the Act was supposedly designed to do the task that section 49 was originally designed for, however in practice this has not been the case and as such anti-competitive behaviour continues to occur.
- That the Act needs to be strengthened to stop the current anti-competitive price discriminatory behaviour.
- Australia has been presented as having the 'weakest competition laws' of any OEDC country.
- That anti-price discrimination is prohibited in every OECD country except New Zealand, where New Zealand has more comprehensive provisions for the prohibition of the misuse market power.
- If the current situation of the growing market power of the supermarket duopoly is not addressed then the current imbalance in market power and function will increase to a point where significant damage to the supply chain will result and inevitably consumers will be left worse off.
- Even though there is prima facie evidence of anti-competitive price discrimination, the ACCC has not yet been seen to take action. As such the inclusion of more effective anti-competitive price discrimination legalisation to provide the necessary means for the ACCC to take action to stop and prevent further cases of anti-competitive price discrimination.
- The reintroduction of an anti-price discrimination clause into the Act is absolutely warranted and should be a foundation recommendation from the current Senate inquiry.

Associate Professor Frank Zumbo of the School of Business Law and Taxation at the University of New South Wales in his submission to the Senate Economics References Committee Inquiry into the impacts of supermarket price decisions on the dairy industry outlined several international precedents that deal with anti-competitive price discrimination. These included the United States *Robinson-Patman Act of 1936* and the *United Kingdom Competition Act 1998 (section 18).* The following recommendation to amend the Act are aimed at more effectively prohibiting predatory pricing, which is something that the current legislation has failed to effectively achieve.