AUSTRALIAN FOOD & GROCERY COUNCIL

AFGC SUBMISSION

Senate Select Committee on Supermarket Prices

February 2024

PREFACE

The Australian Food and Grocery Council (AFGC) is the leading national organisation representing Australia's food, beverage and grocery manufacturing sector.

With an annual turnover in the 2021-22 financial year of $144 billion, Australia's food and grocery manufacturing sector makes a substantial contribution to the Australian economy and is vital to the nation's future prosperity.

The diverse and sustainable industry is made up of over 17,000 businesses ranging from some of the largest globally significant multinational companies to small and medium enterprises. Each of these businesses contributed to an industry-wide $3.2 billion capital investment in 2021-22.

Food, beverage and grocery manufacturing together forms Australia's largest manufacturing sector, representing over 32 per cent of total manufacturing turnover in Australia. The industry makes a large contribution to rural and regional Australia economies, with almost 40 per cent of its 271,000 employees being in rural and regional Australia.

It is essential to the economic and social development of Australia, and particularly rural and regional Australia, that the magnitude, significance and contribution of this industry is recognised and factored into the Government's economic, industrial and trade policies.

Throughout the COVID19 pandemic, the food and grocery manufacturing sector proved its essential contribution to Australian life. Over this time, while our supply chains were tested, they remain resilient but fragile.

The industry has a clear view, outlined in *Sustaining Australia: Food and Grocery Manufacturing 2030,* of its role in the post-COVID19 recovery through an expansion of domestic manufacturing, jobs growth, higher exports and enhancing the sovereign capability of the entire sector.

This submission has been prepared by the AFGC and reflects the collective views of the membership.

OVERVIEW

The AFGC welcomes the opportunity to provide a submission to the Select Committee's inquiry on price setting practices and the market power of major supermarkets. As the national association representing Australia's food and grocery suppliers, the AFGC has unique visibility over supplier-retailer relationships, including the supermarket retailers' price setting practices, and the sector's dynamics. This submission addresses the following terms of reference, which reflect areas on which we can provide unique insights:

- the effect of market concentration and the exercise of corporate power on the price of food and groceries
- the pattern of price setting between the two major supermarket chains
- rising supermarket profits and the large increase in the price of essential items
- frameworks to protect suppliers when interacting with the major supermarkets, and
- the role of multinational food companies in price inflation.

With consideration to the key areas of concern identified below, the AFGC's principal recommendations are:

- investigate the barriers faced by new supermarket retailers aspiring to enter the Australian market, with the aim of developing policies to encourage new entrants
- develop investment incentives that deliver on driving manufacturing capability and job creation through boosting the sector's competitiveness, resilience and agility
- retain the Food and Grocery Code of Conduct as a voluntary prescribed code while strengthening its dispute resolution provisions, though increasing the Independent Reviewer's powers, including binding arbitration, and resourcing.

MARKET CONCENTRATION

The concentration of market share between Coles and Woolworths is the principal factor that drives commercial dynamics within the sector. Australia has one of the most concentrated retail markets in the developed world. Despite the emergence of competitors such as Aldi and Costco, Coles and Woolworths continue to hold a disproportionately high share of the food and grocery market, with 65 per cent of Australian turnover between them, compared to 42 per cent for the UK's top two retailers and 33 per cent in the US.[1] The entry of Aldi and Costco into the Australian market has not significantly reduced the market share of the major supermarkets, with Aldi's and Costco's combined market share only reaching 11 per cent since Aldi's entry in 2001. As the AFGC's report *Sustaining Australia: Food and Grocery Manufacturing 2030* shows, the entry of discount retailers Aldi and Costco led to a significant competitive response from Coles and Woolworths. While this benefitted consumers, it led to a decade of significant challenges for suppliers as Coles and Woolworths delivered competitive prices to consumers through more stringently managing their purchasing costs from suppliers. As a result, supplier profitability fell from $8bn

[1] A comparison of Australia with other developed world markets is presented in Appendix A.

to $5bn between 2010 and 2019, manufacturing capital investment stagnated and there was increased offshoring of manufacturing jobs.

The consequences of Coles' and Woolworths' combined market share are numerous, but all centre on a significant imbalance in negotiating power between the major supermarkets and their suppliers. Whereas a supplier may derive half of its revenue from one of the major supermarkets, its business will likely represent a tiny fraction of the supermarket's total revenue. The stakes are therefore much higher for a supplier when dealing with retailers because their viability as a business depends on continuing to sell to the retailer. This gives the retailer significantly greater leverage in the relationship, which it can use to extract highly-favourable terms.

Additional supermarket competition is needed in the Australian market to not only create consumer benefits of choice, innovation and competitive prices, but to also reduce risks for suppliers and keep manufacturing jobs in Australia. Apart from Costco and Aldi, there have been no new entrants into the Australian supermarket sector given the high barriers to entry. In January 2020 Kaufland, another major German retailer, abandoned its plans to enter the Australian market despite having invested several years and more than $500m,[2] thus depriving Australian consumers and suppliers of the benefits that would flow from increased competition. Kaufland's decision to not enter the Australian market warrants investigation to understand the barriers they faced and what policy levers could encourage additional competition.

> **Recommendation:** AFGC recommends the Australian Government investigate the barriers faced by new supermarket retailers aspiring to enter the Australian market, with the aim of developing policies to encourage new entrants.

In addition to their concentration in supermarket retailing, Coles and Woolworths are expanding their operations into new areas, including wholesale distribution,[3] grocery delivery services,[4] insurance, pet products and services,[5] rural supplies, dairy processing,[6] and retail media.[7] This expansion means that Coles and Woolworths not only control a disproportionate share of the retail market, but will increasingly be a significant participant in numerous related channels and industries. Suppliers are sometimes encouraged to use services (e.g. logistical services to deliver goods from the supplier's factory to the retailer's warehouse, or advertising through retail media) controlled by the retailer at above-market rates, thus further boosting retailer profits, increasing the costs faced by suppliers and their reliance on Coles and Woolworths.

---

[2] See Matthew Elmas, 'Kaufland abandons Australia', SmartCompany, 23 January 2020.

[3] Woolworths' acquisition of a majority stake in PFD

[4] Woolworths' acquisition of Milkrun

[5] Woolworths' acquisition of a majority stake in PETstock

[6] Coles' acquisition of milk processing facilities from Saputo

[7] Woolworths Cartology and Coles360

THE IMPACT OF MARKET CONCENTRATION ON FOOD AND GROCERY MANUFACTURING INVESTMENT AND JOBS

The dominant market position of the major retailers provides enormous influence over pricing dynamics, enabling them to structure commercial agreements in such ways as to prioritise their own profitability. As a result, the profitability of food and grocery manufacturers has differed significantly from all other Australian manufacturing sectors since the turn of the century.[8] Whereas the rest of the manufacturing sector has, in general, been able to respond to increasing input prices by increasing the prices for which their goods are sold, this has not been the experience for food and grocery manufacturers. Instead, the past decade has seen suppliers' input costs rising at a greater rate than the wholesale prices the major retailers have been paying. Between 2011 and 2021, input costs to food manufacturing (such as agricultural commodities, wages, and energy prices) rose at double the rate of output (wholesale) prices. During this period, manufacturers made efficiency gains to offset some of the cost increases, however they also faced pressure to absorb a significant portion of costs leading to declining profitability and investment stagnation. In more recent years, the gap between input and output (wholesale) prices has narrowed slightly, with food manufacturers' input prices 20 per cent above output (wholesale) prices between June 2020 and June 2023.[9]

It could be argued that the major retailers' downward pressure on the price at which they purchase from suppliers helps to maintain downward pressure on retail prices for consumers. However, this ignores the fact that while retailers reap the benefits from lower shelf prices (i.e. remaining competitive against other retailers; selling a greater volume of goods), their ability to do this is effectively subsidised by suppliers. Over the past decade a substantial gap has opened between food manufacturing input prices and the food and non-alcoholic beverage consumer price index (a proxy for shelf prices), with the most recent data showing a 19 per cent differential.[10]

As a consequence of the major retailers' market power and capacity to structure commercial arrangements in ways that prioritise their own returns, it has become increasingly challenging for food and grocery suppliers to operate profitably. Ultimately, the ability of the major retailers to use their market power to extract more from their suppliers has a detrimental impact not only on the suppliers themselves, but also on the size, economic contribution and jobs in food and grocery manufacturing. This is because suppliers rely on profits to fund further investment in their operations. Investment is the key driver of innovation and increased productivity, but investment in the sector has been languishing for the past decade. Whereas the sector's compound annual growth rate for turnover has been 4.8 per cent over the last five years, capital investment has seen a 0.3 per cent decline.[11] Without increased investment in the sector, Australian food and grocery manufacturers will find it increasingly challenging to compete with imported

[8] See the graphs provided in Appendix B

[9] See the second graph provided in Appendix B

[10] See the graph provided in Appendix C

[11] See the graphs provided in Appendix D

products. This portends a greater challenge to maintain the long-term viability of Australia's largest manufacturing sector, with implications for those whose jobs and livelihoods depend on the sector.

> **Recommendation:** The AFGC recommends the Australian Government develop a suite of policies, including investment tax incentives, that deliver on driving manufacturing capability and job creation through boosting the sector's competitiveness, resilience and agility.

PRICE SETTING

The major retailers are effectively the gatekeepers of food and grocery prices. This is not only the case for consumer prices, which are rightfully under their full control, but also to a large extent for wholesale prices. The major retailers effectively exercise a disproportionate influence over the prices charged by suppliers by virtue of being the most significant buyers. Any supplier seeking to increase the wholesale price for their goods must navigate a price increase process that is controlled by the retailer, who can ultimately accept or reject a supplier's proposed price.[12] This is a lengthy process that typically takes three or more months. During price negotiations, the retailer generally continues to order at the 'old' price and suppliers can only start to recover their increased costs from retailers upon conclusion of the negotiation process. In many cases, suppliers also face extensive and intrusive questioning from retailers, who request suppliers to justify why the price increase is necessary, providing potentially sensitive details such as which input costs have gone up and by how much.

The pre-COVID decade during which suppliers struggled to gain retailer approval for price increases provides important context for the rise in consumer inflation in the last few years. Suppliers stripped significant costs from their businesses during 2009-2019 and hence there was limited ability to offset the significant escalation in input costs over the last few years that resulted from COVID supply chain related disruptions, adverse domestic and global weather events and geopolitical tensions as well as more recent wage and energy increases. Suppliers, seeking to maintain viable Australian manufacturing operations and jobs, needed to pass through some, not all, of their input cost increases through increased wholesale prices. In addition to supplier led inflation, supermarket retailers have sought to recover their own cost increases.

The combination of wholesale and retail cost pressures has led to an average annual rate of consumer inflation for food of 4.4 per cent from 2020-2023. This compares to an average annual rate of consumer inflation for food of only 1.6 per cent during the pre-COVID decade 2009–2019. The AFGC argues that the artificial suppression of prices during the pre-COVID decade not only caused pressure for suppliers but was only of benefit for consumers in the short term. One has to wonder whether, had there been less pressure on suppliers in the previous decade, there would have been more ability to absorb costs now.

The AFGC supports the aspiration of keeping consumer prices low for the benefit of Australian consumers. However, it should not be suppliers who disproportionally shoulder risks and costs, but a contribution balanced between retailers and suppliers. Since 2021, Australia's major supermarkets have maintained profit margins of between 5 and 6 per cent, compared to between 3 and 4 per cent for Tesco and Sainsbury's in the more competitive British market. Furthermore, according to JP Morgan estimates, the

---

[12] A flowchart depicting the price increase process is provided in Appendix E

major Australian retailers have also expanded their gross margins by around 200 basis points over the last four years.[13]

THE ROLE OF MULTINATIONAL FOOD COMPANIES

The Inquiry's Terms of Reference seek information regarding the role of multinational food companies in food inflation. Singling out multinational food companies as playing a unique role in price inflation ignores the universal elements of recent experiences with increasing prices. Multinational food companies are no more immune to the inflationary forces that have swept the globe in recent years than any other organisation. Like all companies operating within the sector, multinationals have seen the costs of key inputs increase significantly.[14] Natural gas has increased in cost by more than 50 per cent since 2019. Global fertiliser prices have more than doubled since 2020. In the AFGC's Supply Chain Disruptions Survey, respondents reported a 78 per cent year-on-year increase in the cost of road freight and a 44 per cent increase for rail freight from 2021-22. These and other input cost pressures are faced by all food producers, regardless of the scale of their operations or the location of their headquarters. The size of a company is also not a factor when it comes to navigating retailer price increase processes, which are universal processes without special dispensation for larger suppliers.

FRAMEWORKS TO PROTECT SUPPLIERS

Given the high level of concentration within the Australian retail market, and the barriers for new entrants, it is essential to have frameworks to protect suppliers from the effects of supermarket buyer power. The Food and Grocery Code of Conduct (FGCC) acts as a safeguard to prevent the worst abuses of market power, and has, since its inception in 2015, considerably improved commercial relationships within the sector by prohibiting once-common practices such as retailers unilaterally changing agreements that had been reached with suppliers, or deducting from suppliers' invoices without notice or consent. Although, regrettably, such practices occasionally come to the attention of the AFGC, their prohibition under the FGCC has made them much less common features of the Australian food and grocery landscape than was previously the case.

The FGCC is currently under review and the AFGC will actively participate to ensure that it remains fit for purpose and can achieve its intent of ensuring transparency, certainty, trust and co-operation in the sector. Though it is not a panacea for the issues noted in this submission, which principally stem from a lack of competition in the supermarket retail sector, targeted improvements to the FGCC can help to mitigate the worst effects of the fundamental power imbalance between suppliers and retailers.

One of the major questions within the FGCC Review is whether the FGCC should be remade from a voluntary code to a mandatory one. The AFGC supports retaining the voluntary nature of the FGCC, for both practical and legal reasons. Practically, the major retailers are already signatories, and signatories are legally bound to adhere to the FGCC's provisions once they have signed. The major retailers have shown a strong commitment to the FGCC and the AFGC considers it highly unlikely that they would withdraw in

[13] See the graphs provided in Annex F

[14] See examples in the graphs provided in Appendix G

the face of substantial pressure and reputational damage. Suppliers have continuously stressed the need for a fast, flexible and low-cost mechanism for resolving disputes between suppliers and retailers, which maintains confidentiality and does not jeopardise commercial trading arrangements. The FGCC provides a number of dispute resolution processes that span from compulsory and binding arbitration by retail appointed Code Arbiters through to independent arbitration, ACCC and court enforcement. While the AFGC has maintained concerns at suppliers' fear of retribution in raising a complaint with retail appointed Code Arbiters, the solution does not lie in a mandatory FGCC. In his 2018 review of the FGCC, Graeme Samuel noted that a mandatory code with scope for compulsory arbitration and binding decisions (which are included within the FGCC) may present constitutional issues, given that the compulsion of an entity to be bound by conclusive determinations on the law is reserved exclusively to courts. The likely outcome is that disputes would need to be resolved through an ACCC- or court-based process, which will be expensive, time consuming and will raise fears of retribution.

The AFGC maintains that there is a unique opportunity to introduce a more effective binding mechanism for resolving disputes between suppliers and retailers, establishing a fast and low-cost process to find solutions while providing safeguards to protect suppliers. There is room for further improvement in the FGCC, borrowing from international experience, by augmenting the role, powers and resourcing of an Independent Reviewer (who is appointed by government rather than the retailer) to enable binding arbitration decisions, including compensation orders for suppliers.

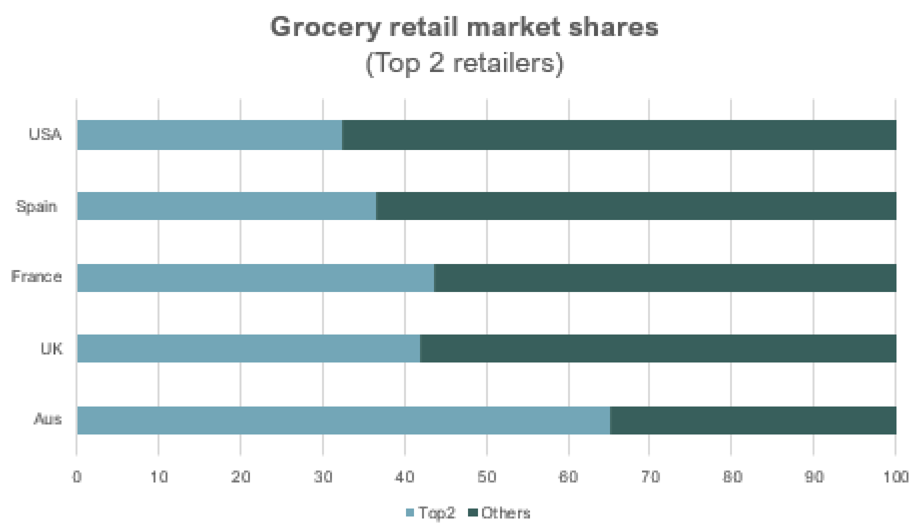
> **Recommendation:** The AFGC recommends retaining the Food and Grocery Code of Conduct as a voluntary prescribed code while strengthening its dispute resolution provisions, through increasing the Independent Reviewer's powers, including binding arbitration, and resourcing.

CONCLUSION

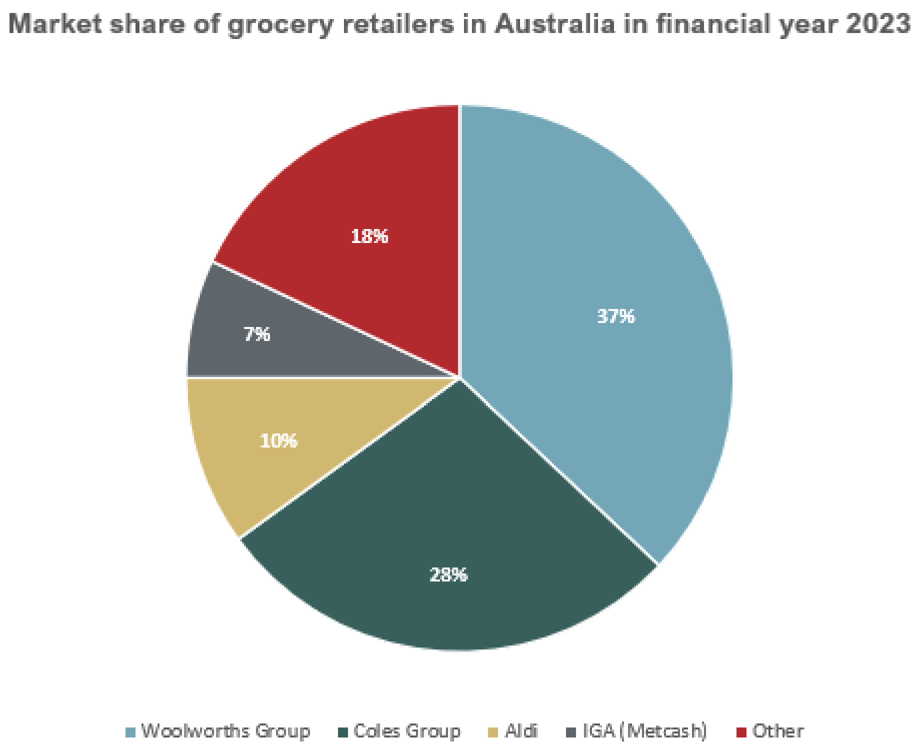
The challenges outlined in this submission largely stem from a lack of competition within the Australian supermarket retailer sector. Despite the gradual increase in competition marked by the entry of operators such as Aldi and Costco, the Australian market has yet to hit the 'tipping point' at which the full benefits of competition can be realised. Consequently, the most effective way of addressing them would be through measures to increase competition. Increasing competition within the supermarket retail sector would remove the foundation upon which the most problematic pricing practices are built, and promote a fair distribution of benefits for consumers, suppliers, and retailers. Competition drives increased investment, encourages research and development, and promotes innovation, leading to fair prices, higher quality, consumer choice, and ultimately provides a catalyst for economic growth.

Measures to increase competition should be complemented by bolstering protections for suppliers through further improvements to the FGCC – retaining its voluntary nature while strengthening its capacity to resolve disputes in a fast, low-cost and binding manner by augmenting the position of the Independent Reviewer.

APPENDIX A

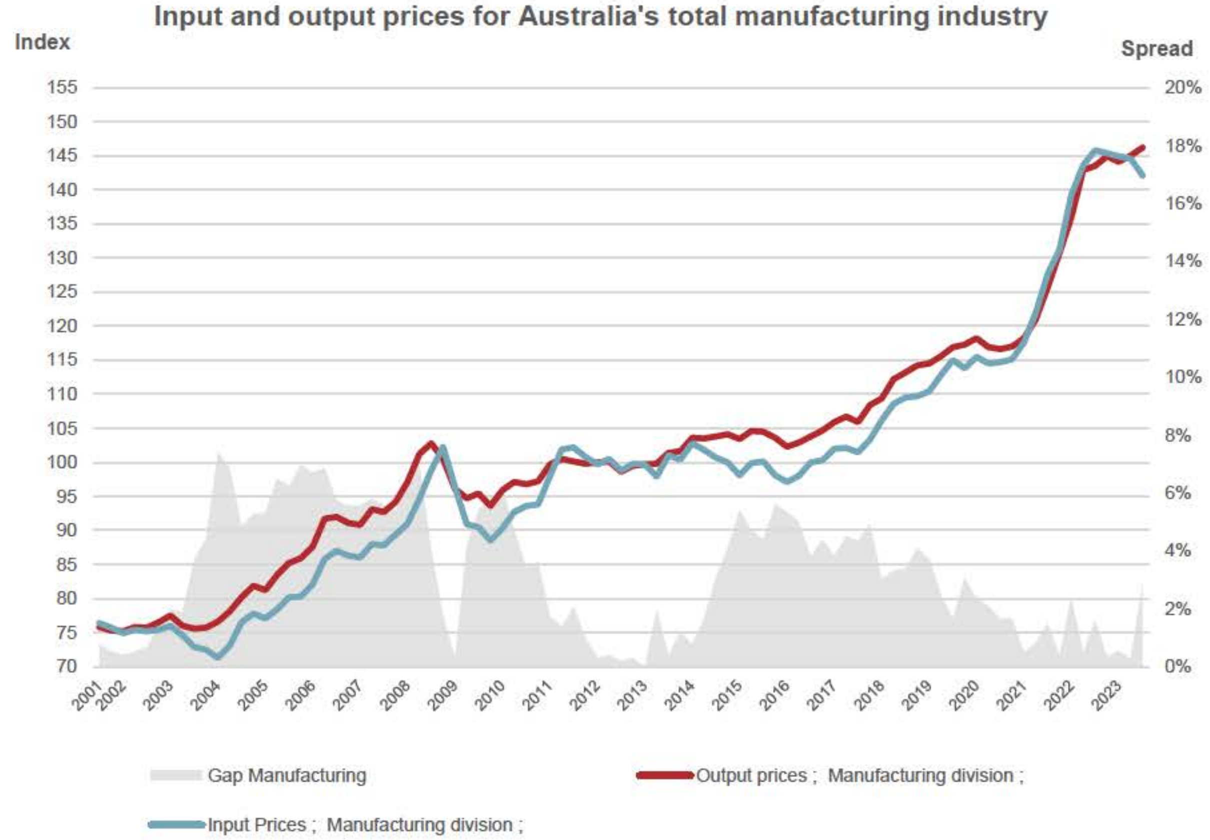


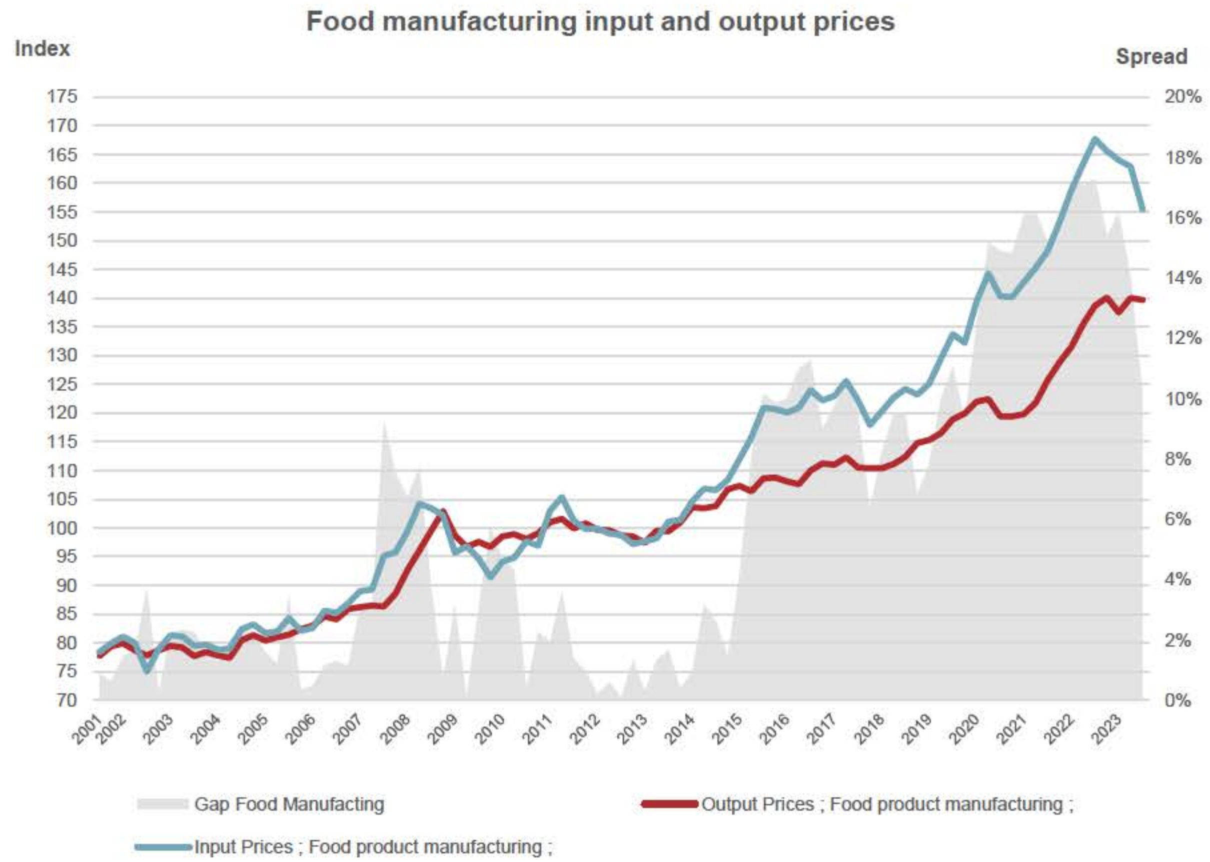
Sources: Statista (Aus), Axios (USA), UK, France, Spain (Kantar)



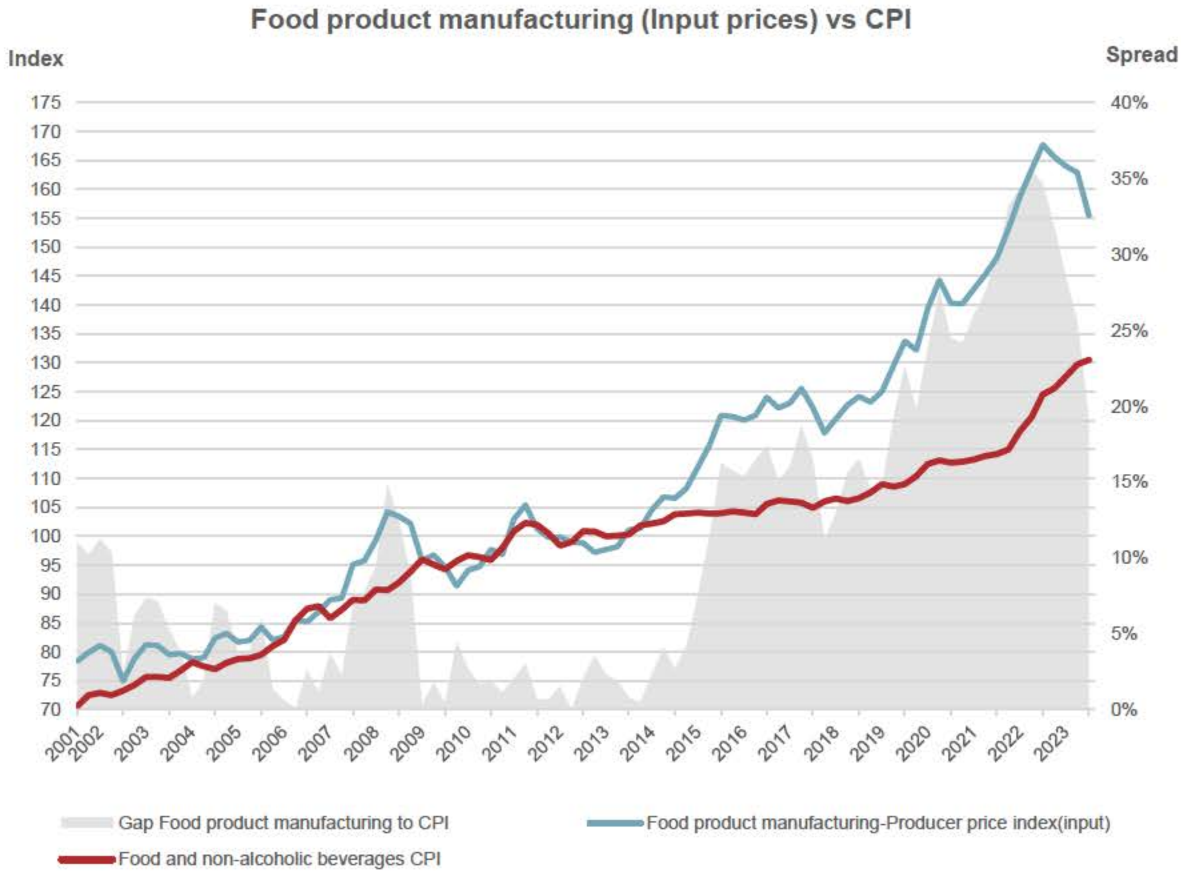
Source: https://www.statista.com/statistics/994601/grocery-retailer-market-share-australia/

APPENDIX B

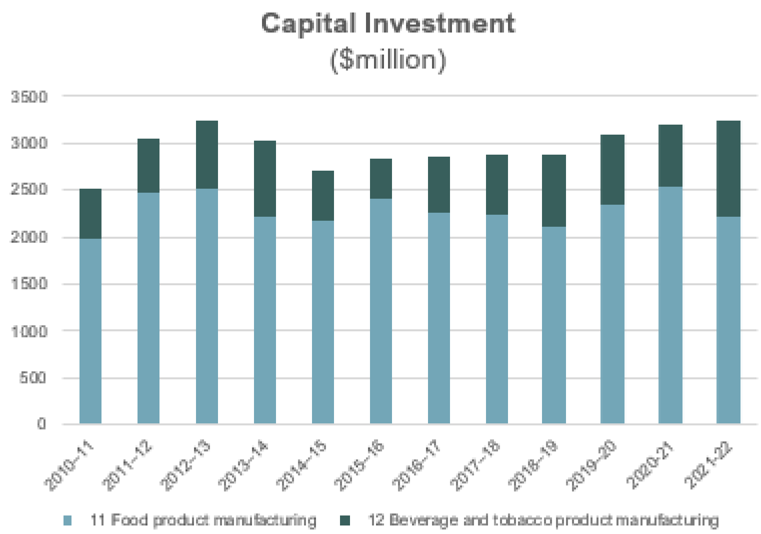

Input and output prices for Australia's total manufacturing industry
Index
Spread
155
150
145
140
135
130
125
120
115
110
105
100
95
90
85
80
75
70
20%
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023
Gap Manufacturing
Output prices ; Manufacturing division ;
Input Prices ; Manufacturing division ;

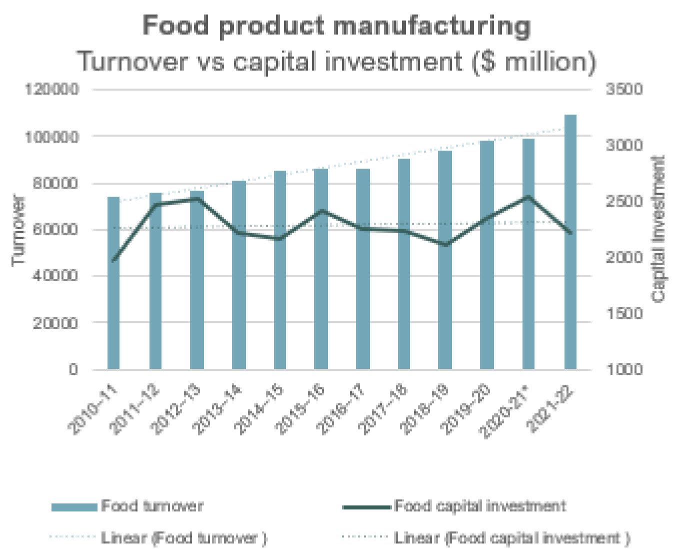

Food manufacturing input and output prices
Index
Spread
175
170
165
160
155
150
145
140
135
130
125
120
115
110
105
100
95
90
85
80
75
70
20%
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023
Gap Food Manufacting
Output Prices ; Food product manufacturing ;
Input Prices ; Food product manufacturing ;

APPENDIX C


Food product manufacturing (Input prices) vs CPI
Index
Spread
175
170
165
160
155
150
145
140
135
130
125
120
115
110
105
100
95
90
85
80
75
70
40%
35%
30%
25%
20%
15%
10%
5%
0%
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
Gap Food product manufacturing to CPI
Food product manufacturing-Producer price index(input)
Food and non-alcoholic beverages CPI

APPENDIX D



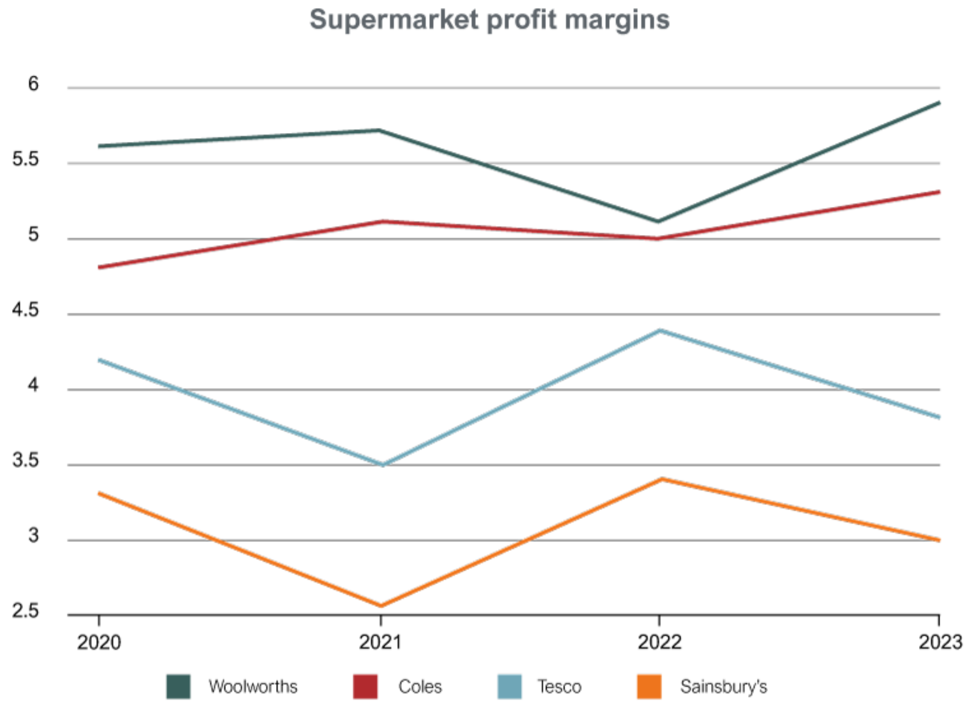


Food product manufacturing	5 yr. CAGR	10 yr. CAGR
Turnover	4.8%	3.7%
Capital investment	-0.3%	-1.0%

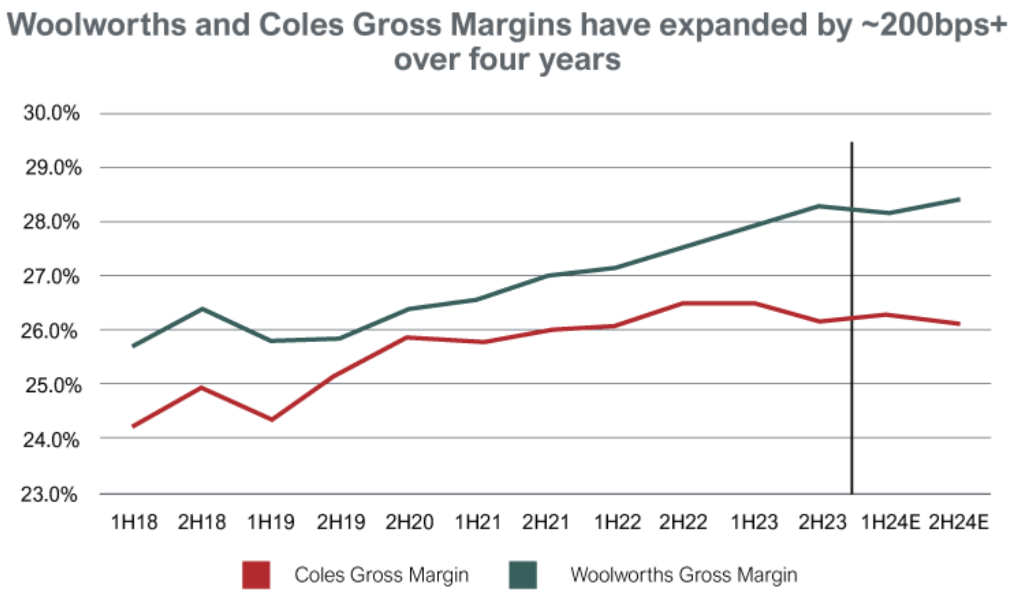
APPENDIX E

Grocery Retailer Cost Price Increase Process

APPENDIX F

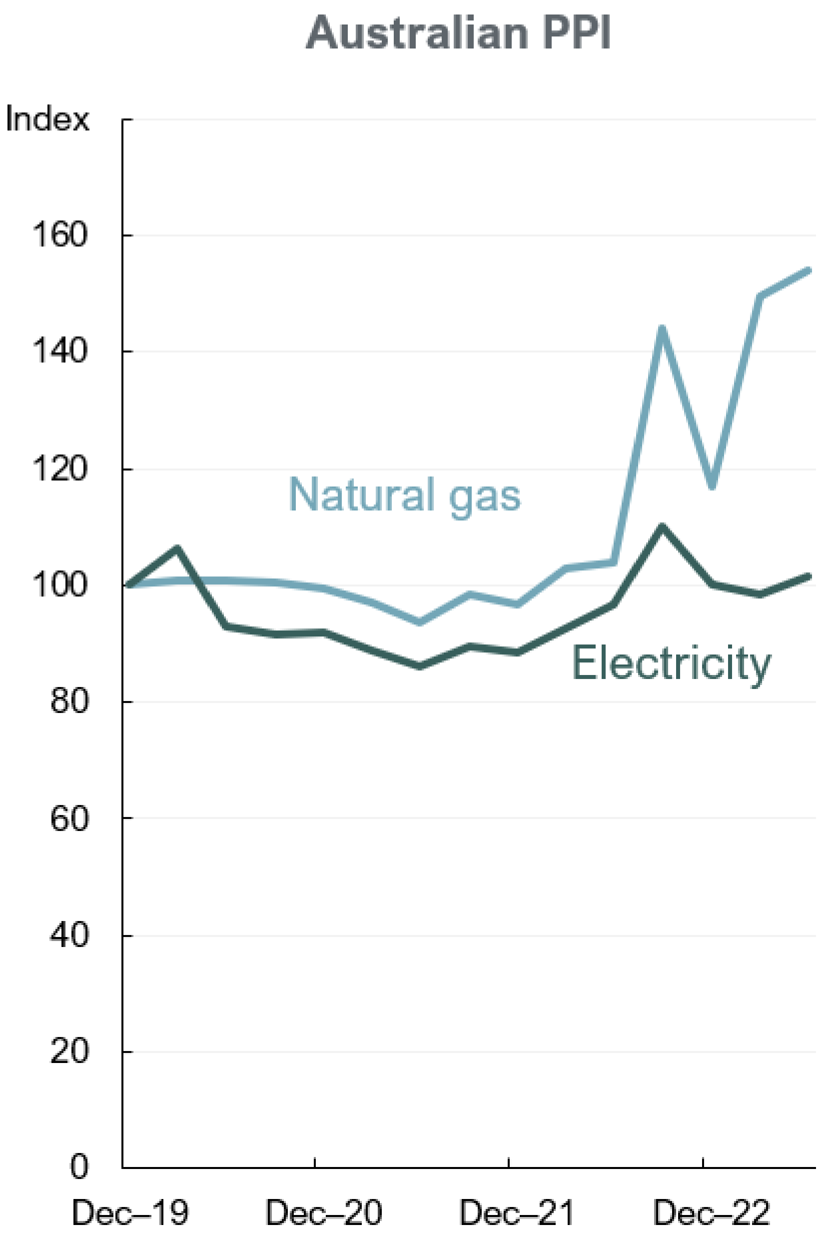


Source: Guardian analysis of financial accounts. The data compares the operating or Ebit margins of the relevant retail and food divisions of the four supermarkets.

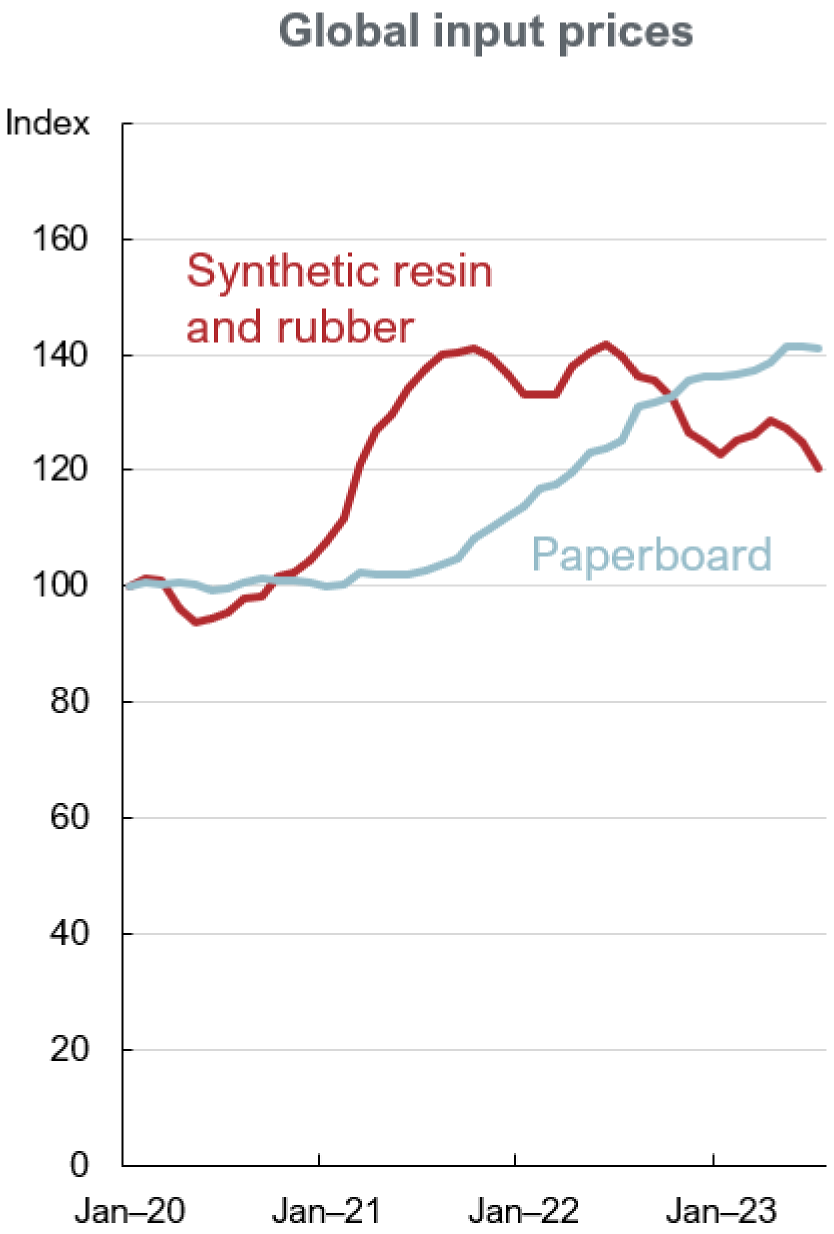


Source: Company reports and J.P Morgan estimates

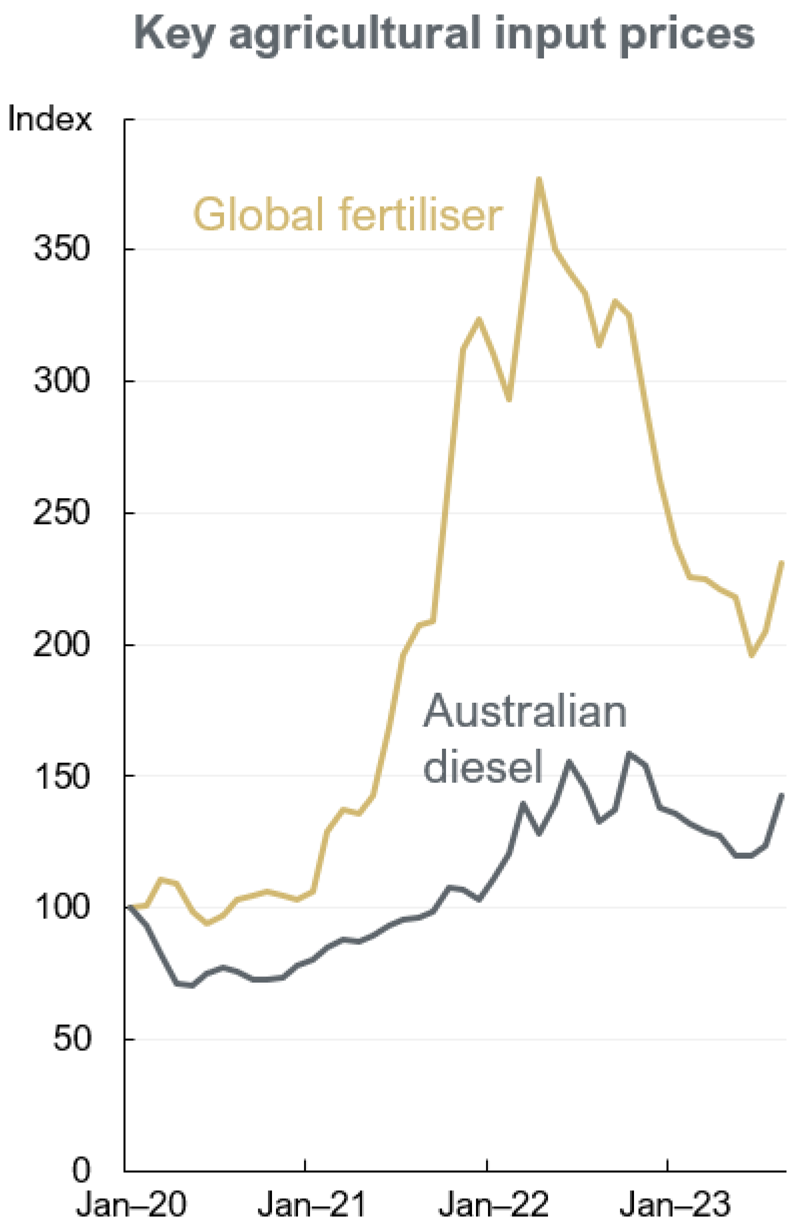
APPENDIX G



Source: ABS (Quarterly)



Source: US FRED



Source: Aust. Institute of Petroleum; World Bank.

State of Industry
2021-22

AUSTRALIAN FOOD & GROCERY COUNCIL

TOTAL TURNOVER
$144.1bn
(+ 7.4%)

AFG TURNOVER
31.3%
(As % of manufacturing)

EMPLOYMENT
270,661
(- 0.9%)

REGIONAL EMPLOYMENT
36.9%
For 2022

CAPITAL INVESTMENT
$3.2bn
(+ 1.6%)

BUSINESS COUNT
17,436
(+ 6.8%)

EXPORTS
$39.4bn
(+ 15.3%)

IMPORTS
$46.4bn
(+ 24.6%)

AUSTRALIAN FOOD & GROCERY COUNCIL

The figures on this page exclude the fresh food sector and are based on 2021-22 ABS data.

1: This is total number of employees, head count basis and does not include seasonal employees.
2: Gross fixed capital formation for food, beverage and tobacco manufacturing subsector is taken as indicator of capital investment.