

**Inquiry into the Provisions of the Trade  
Practices Legislation Amendment Bill (No.1)  
2007 & Trade Practices Amendment  
(Predatory Pricing) Bill 2007**

Submission (Part 2A)

Southern Sydney Retailers Association

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## **INTRODUCTION – Part 2A**

Part 2A of our submissions looks at other possible reasons as to why Australian consumers are being penalized, having to live with the developed world's highest rate of Food Inflation since 1990 – and what are the possible reasons as to why Australia has been the only developed country anywhere in the world since 1990 to experience food prices increase that outstrip inflation.

The drought seems the obvious answer – but there is simply no evidence of farm gate prices rising above the CPI, and a recent study by the Queensland Farmers Federation<sup>1</sup> has shown that over the last 4 years, Farmgate prices have risen just **2.3%**, Inflation is up **12.1%**, but food prices at the supermarkets are up **17.8%**

Clearly something is wrong.

Therefore, there must be other reasons for these prices increases, including the possibility of the empty shell of the Trade Practices Act.

- 1. Increased Buyer (Bullying) Power ?**
- 2. Price Discrimination – An Umbrella of Protection ?**
- 3. Are the Big Supermarkets charging prices too high ?**
- 4. Geographic Price Discrimination ?**
- 5. A Rampant Duopoly extracting Monopoly Profits ?**
- 6. The Alternate Arguments**

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<sup>1</sup> <http://www.qff.org.au/weekly.asp?dbid=131>

## 1. INCREASED BUYING (BULLYING) POWER ?

As our two supermarkets chains have increased their market share from **35%** in 1975 to **80%** in 2006<sup>2</sup> - they have also increased their 'buying power'. The increase in buying power comes not only from increasing economies of scale, but also from increasing bullying power – enabling them to threaten suppliers, that unless a supplier gives them special rebates and often secret rebates – they will no longer stock the suppliers products, unless the supplier bows down to these demands.<sup>3</sup>

At first this may seem in the interests of consumers – as the argument goes, the major supermarket passes on the savings of these rebates to consumers – and 'presto', consumers prices are lower !! . Thus increase buying power is good for consumers !!

But this simplistic argument overlooks the commercial realities of the real world. Take for example information recently posted on the Dick Smith Foods<sup>4</sup> website,<sup>5</sup> which gives a rare insight into the bully boy tactics used by the major supermarkets to obtain rebates and special privileges – that if a labour union engaged in the same tactics - the government would call in the dogs.

*"In recent weeks the problem has been compounded by [redacted] [a major supermarkets] suggesting to many of our manufacturers **that unless they receive large sums of money by way of an up-front payment, which in some cases is up to \$100,000, then they will no longer be prepared to carry our products.** Interestingly, none of the requests for money are being sought in writing.*

*As our own company and most of our manufacturers are small businesses, there is simply no way we can afford to pay these amounts and remain financially viable. If this policy continues, **it will force the remaining small Australian manufacturers out of business and open the door to even more products from overseas.**"<sup>1</sup>*

Such coercion is only possible due to the increased market concentration that has occurred in Australia over the last 30 years, whereby now just 2 corporations act as the gatekeepers for 80% of the supermarket shelves of the nation - a level of

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<sup>2</sup> <http://www.narga.com.au/>

<sup>3</sup> The economic powerhouse of the state of California, outlaws such practices, section 17045 of the California Business and Professional Code states; *"The secret payment or allowance of rebates, refunds, commissions, or unearned discounts, whether in the form of money or otherwise, or secretly extending to certain purchasers special services or privileges not extended to all purchasers purchasing upon like terms and conditions, to the injury of a competitor and where such payment or allowance tends to destroy competition, is unlawful."* No similar provisions exist under the Australian Trade Practices Act

<sup>4</sup> Dick Smith Foods Mission statement reads, [We] are made in Australia by Australian owned companies. We believe this is important because it provides employment for Australians and all the profits remain here, helping the future of our country. Dick Smith Foods supports products which are produced by Australian owned businesses, which are Australian grown and made, and those Australian owned companies which operate in a highly ethical manner. Since the beginning of Dick Smith Foods we have donated over \$3.50 million to a large number of charitable organisations.

<sup>5</sup> <http://www.dicksmithfoods.com.au/index.php?d=media&p=noproducts> (note the original posting on the Dick Smith Foods website has since been modified to delete the identity of the supermarket chain that engaged in the attempted coercion.) The identity of the supermarket chain involved has been blacked out from this submission to spare Dick Smith Foods any possible reprisals.

market concentration unprecedented in world history (excluding failed former Eastern Bloc economies of the Cold War era).

When faced with such demands from a buyer with such a huge market share, a supplier such as Dick Smith Foods<sup>6</sup> simply has no option than to bow down.

### 1.1 Undermining the Operation of our Free Enterprise System ?

One of the basic premises that underwrites the operation of our free enterprise system is that all firms have freedom of choice – the right to buy or not to buy from - or the right to sell or not to sell to, a variety of other firms.

Although Dick Smith Foods may be technically free not to sell to the large supermarket chain that made these coercive demands – the reality is, that when just two buyers are the gatekeepers of 80% of the supermarket shelves of the nation (up from 35% in 1975) – just how conceivable is it for Dick Smith Foods or any other Australian food producer to walk away and say no ?

These food producers have long term leases on plant & equipment, they have investments in machinery, bank loans that require servicing, on-going commitments to their skilled employees - to say no to any demand from one of the major supermarket chains and to walk away, would simply be suicidal.

The producer simply has no way to replace the lost sales, or any practical alternate mechanisms to get his products to the consumer, in such a highly concentrated market as has evolved in Australia, under the Trade Practices Act.

Therefore, the increasing market concentration that has occurred in the Australian retail sector - even if there has been some short term “benefits for consumers” (to which there is not a shred of evidence of) - has in fact perverted the functioning of our free enterprise system.

The possibility that the increasing market (bullying) power of Australia’s major supermarkets, and their growing ability to dictate terms to suppliers, may have actually subverted the functioning of the free enterprise system, and has **pushed up** prices for consumers – may come as a rude awakening to reality for some<sup>7</sup> - but it is highly possible that this is exactly what has occurred in the Australian market, and is the reason why Australia has experienced the developed world’s highest food inflation over the last 17 years.

### 1.2 It Pushes Up Prices ?

Take the example of the situation faced by Dick Smiths Foods – what is the effect of a supplier being faced with a \$100K bill from the major supermarkets just to keep their products on the shelves enabling their business to survive ??

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<sup>6</sup> The Southern Sydney Retailers association has no affiliation with Dick Smith Foods in anyway.

<sup>7</sup> Especially supporters of the speculations of the “Chicago School” economists

The \$100K extra a supplier is forced to pay out to the major supermarkets, has exactly the same effect as an inflationary wages outbreak, being bullied by a big union, a government tax increase, increasing raw material costs, or even being forced to pay protection money to a gangster.<sup>8</sup>

The supplier is already operating in a highly competitive environment, fighting against hundreds of competitors both in Australia and overseas to produce the highest quality product, at the lowest possible cost.

Therefore faced with this additional cost burden place upon the business by the major supermarkets with their demands for special rebates & privelegded terms - to recoup these additional costs forced upon the supplier, he does either one or a combination of the following to recoup the costs;

- a) Increases his wholesale price
- b) Reduces the quality of existing items, such as reducing their size or volume.
- c) New products introduced to the market, are done so at a higher price.

The \$100K rebate given to the major supermarket is not passed on to consumers in full (or even part) in a corresponding lower prices - therefore the buyer (bullying) power exercised by the major supermarkets, rather than lowering prices – has the exact opposite effect – it results in increased prices to the consumer.

With Australia having the developed world's most concentrated supermarket sector – giving Australia's 2 major supermarket chains more market (bullying) power than anywhere else in the world - perhaps this is directly related to Australia having the developed world's highest food inflation, and being the only developed country in the world since 1990 where price increases at the supermarket have outstripped inflation.

### 1.3 Inducing Price Discrimination ?

Another possibility is that the major supermarket chain may not accept any cost increases from the supplier – but the supplier still needs to recoup the additional costs of the special rebates handed over to the major supermarket.

This leaves the supplier with no other alternative than to engage in a policy of Price Discrimination<sup>9</sup>, where he pushes up prices to his smaller customers to pay for the rebate he has given to the major supermarkets.

When this happens the major supermarket chains are not only forcing up costs to their smaller competitors, but they are effectively getting their smaller competitors to subsidize them.

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<sup>8</sup> But at least with a gangster he can call the police.

<sup>9</sup> Such Price Discrimination was previously prohibited by section 49 of the Trade Practices, although rarely enforced, it was repealed in 1995 at the recommendations of Westfield Director Fred Hilmer. The repeal was based on the speculation that such laws “discouraged price flexibility” – but since its repeal we have certainly seen greater “price flexibility” – but upwards. The repeal was also based on the absurd speculation that s46 would capture anti-competitive Price Discrimination – which history has shown his assumption to be erroneous.

The buyer (bullying) power of the supermarket chain – then becomes a double edged anti-competitive sword against consumers,<sup>10</sup> as it not only does it raise prices in the market, but the major supermarkets small competitors, whom are now discriminated against – placing them at a competitive disadvantage, which reduces the competitive pressures that used to bring to the market place.

The fact that the Trade Practices Act is impotent against such anti-competitive practices, may be an explanation as to why Australia has had the developed world highest food inflation since 1990.

#### 1.4 Deterring Investment ?

Another detrimental effect to consumers and the nation from the major supermarkets exercising such bullying power - is that suppliers are squeezed to such a degree, that they are unable to make an adequate return investment.

Therefore, suppliers reduce expenditure on research and development, they become less innovative, they don't make the necessary investments to upgrade their production facilities – which all result in consumer detriment and eventual higher prices.

This possible effect has been commented on by Professor of Competition Economics, Paul Dobson of the Loughborough University, in the United Kingdom. Professor Dobson has warned of this possibility in the UK<sup>11</sup> which has much lower levels of market concentration that in Australia.

*“The longer-term effect of such strong buyer power could be to threaten the viability of even the most efficient suppliers over the long term if suppliers are forced to price at marginal cost and are unable to cover their fixed costs.*

*Accordingly, even large suppliers may be deterred from making product and process investments if buyer power prevents them making an adequate return to cover costs.*

*As a consequence, product quality, variety, and innovation may suffer—**all to the detriment of the consumer.***

Perhaps what Professor Dobson warns of is already happening in Australia, and this is yet another reason why Australian consumers have suffered with the developed world's highest food inflation since 1990.

Further, this may have also be related to Australia's appalling productivity growth which remains near of the bottom of international rankings.

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<sup>11</sup> Exploiting Buyer Power : Lessons from the British Grocery Trade  
<http://www.antitrustinstitute.org/archives/files/384.pdf>

## 1.5 Increasing Australia Trade Deficits and adding to our Foreign Debt Mountain. ?

Dick Smith Foods warns;

*As our own company and most of our manufacturers are small businesses, there is simply no way we can afford to pay these amounts and remain financially viable. If this policy continues, it will force the remaining small Australian manufacturers out of business and open the door to even more products from overseas.”<sup>1</sup>*

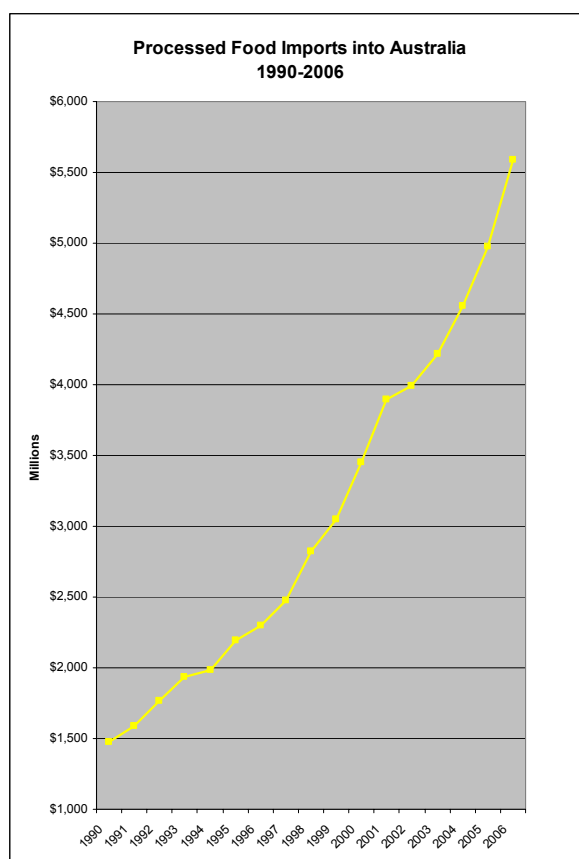
Perhaps this is already a major problem in Australia – with the unprecedented market (bullying) power of two supermarkets, they have the ability to bleed small Australian food producers dry – and the distorted nature of the overly concentrated retail market in Australia, may in fact be slowly be killing off the very productive facilities that as a nation we rely upon to create wealth and prosperity.

This is like the egg producer whom in a drive to “increase efficiencies” and boost profits, cuts back on the grain he gives to his chickens. Then one night after counting up all the extra profits he has made from reducing his expenditure on grain, wakes up find all his chickens dead.

For our major supermarkets, this is not a problem, as they can simply replace any ‘dead’ Australian producers, with ones from overseas – but in doing so, the major supermarkets will destroy much of the productive capacity of our food manufacturers.

With existing food producers held as captive hostages, and new firms discouraged from setting up new food manufacturing plants in Australia, ABS figures show record quantities of imported food flooding the country.

This may not be a great problem if as a nation we were running a trade surplus – but even despite the current once a century mineral boom, Australia is still running a significant trade deficit month after month, building on our mountain of foreign debt which is now one of the largest in the world, so what is going to happen when the mineral boom finishes and international interest rates start to rise ?



Therefore as a nation we need to think very carefully about an empty shell of a Trade Practices Act that results in ever increasing market concentration in the Australian retailing sector – as this could not only be responsible for Australia suffering from the developed world’s highest food inflation and putting upward pressure on interest rates - but it could also be dampening our productivity growth, blowing out our Trade Deficit and adding to our mountain of foreign debt.

## 2. PRICE DISCRIMINATION - an Umbrella of Protection for the major supermarkets ??

Another possible reason for Australia having the developed world's highest food inflation, is the massive degrees of Price Discrimination rampant throughout the Australian economy<sup>12</sup> that throw up an umbrella of protection for our 2 major supermarkets to hide behind – enabling them to shield themselves from the competitive pressures that independents can no longer bring to the market.

A buyer of a smaller quantity should in most circumstances expect to pay a higher price than a larger buyer – as this difference reflects economies of scale and in most circumstances should be encouraged, as it promotes efficiencies in the economy.

However, there is a point where true economies of scale finish, and price differences paid between competitors result from bullying and special privileged. Such price differences are anti-competitive, they distort the working of the free enterprises system, and result in damage to both competition and consumers – put the current Trade Practices Act in Australia is completely useless to prevent such consumer detriment through anti-competitive price discrimination.

Price Discrimination in retail rents provides an example.

Following are just a few examples of the massive level of Price Discrimination in retail rents paid per m2 in major Shopping Centres<sup>13</sup>

- \* Westfield Liverpool – Coles \$245 v. Bush's Meats \$1,338
- \* Westfield Eastgardens – Coles \$208 v. Beef Bullion Butcher \$1,009
- \* Westfield Warrarong – Woolworths \$211 v. Prime Quality Meats \$1,529
- \* Westfield Hornsby – Coles \$155 v. Joes Meat Market \$1609
- \* Westfield Parramatta – Woolworths \$218 v. Bush's Meat \$1,340
- \* Westfield Miranda – Woolworths \$127 v Caper's Deli \$2,724

There is an argument that the smaller butcher should pay a higher price per m2 for his space than a large supermarket – and we agree with this.

But how much extra ? – 10%, 20% maybe 50% ?

But when the discrepancy is up to 2000% - this is not the workings of the free enterprise system – the whole market becomes a complete distortion and brings back the ghosts of special privilege enjoyed by the British East India Company.

How can Joe's Meat Market at Hornsby apply any competitive pressure to the prices charged by the supermarket chain if he is paying \$1,529 per m2 for his

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<sup>12</sup> Every major developed country in the world has some specific prohibition against Price Discrimination in their competition laws – well every country except one.

<sup>13</sup> Source : Leaseinfo.com.au However the differences above may even be greater as secret rebates to the major supermarkets can be hidden in documents known as "Agreements to Lease"



space to sell meat from and Coles is only paying \$155 per m2 for space to sell meat from ??

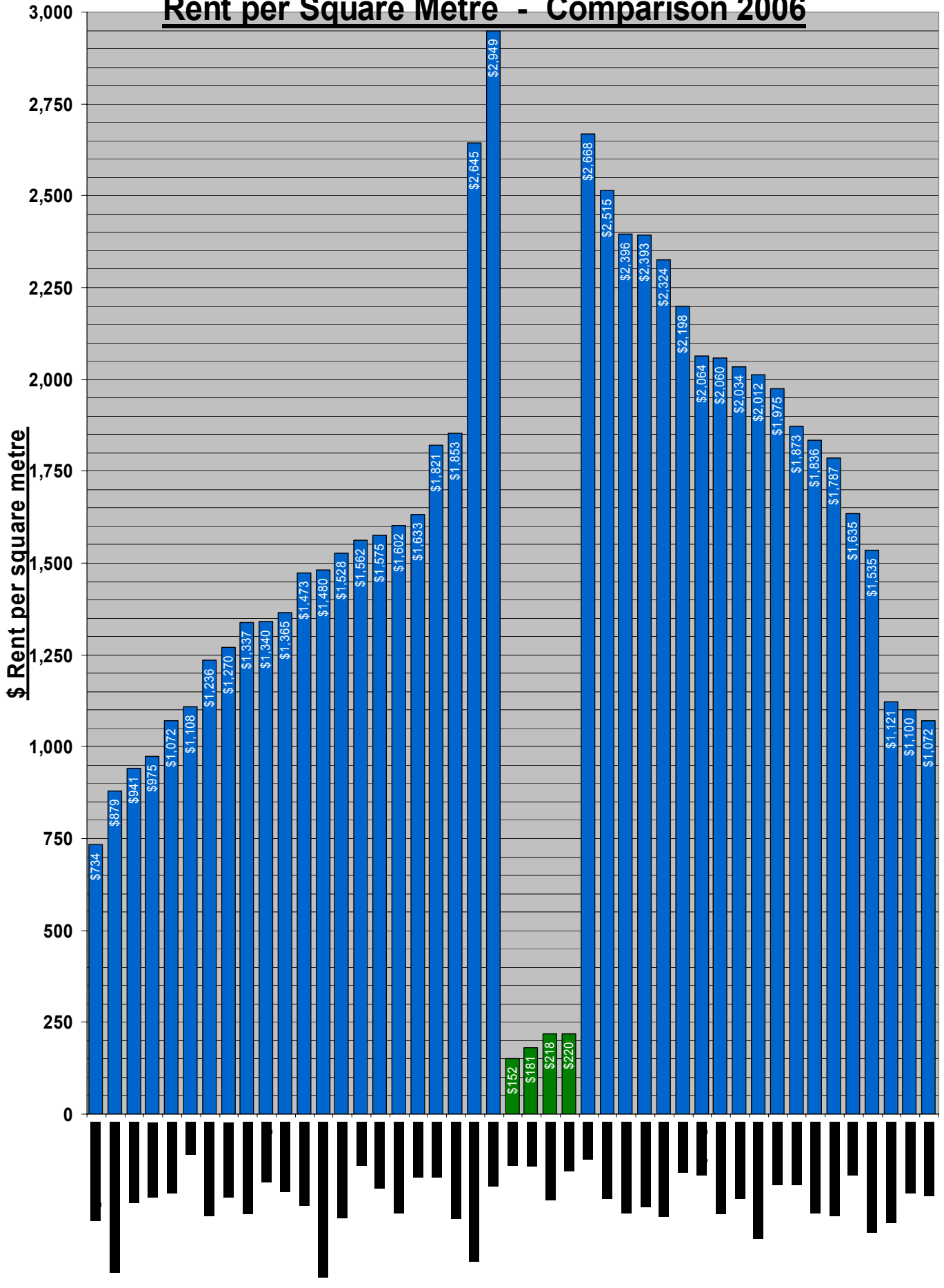
The simple answer is that such discrimination places independent retailers at a hopeless competitive disadvantage and reduces the competitive pressures in the market.

Could this umbrella of protection of Price Discrimination that shields the major supermarkets from competition help explain why Australian consumers live with the developed worlds highest food inflation ??

The following graph shows the estimates of rent paid per m2 at Westfield Parramatta, with data from Leaseinfo.com.au – however the special privileges of the large supermarket chains could in fact be greater as shown, as secret rebates and special terms can be hidden in a document called “the agreement to lease”

# Westfield Parramatta

## Rent per Square Metre - Comparison 2006



### 3 . ARE THE BIG SUPERMARKETS CHARGING PRICES TOO HIGH ??

Another possibility to explain why Australia has the developed world's highest food inflation, may simply be that the big supermarkets are charging prices that are too high.

With most independent retailers crippled by Price Discrimination, preventing them from bringing any competitive price pressures to the two major supermarkets, it is difficult to make price comparisons to see if Australians are getting a fair price from the major chains.

However, there are still a few independent retailers left that are able to escape the evils of Price Discrimination that are located outside the major shopping centres giving them the ability to compete on a somewhat level playing field.

To test the prices of the major supermarkets, we conducted a survey in South-West Sydney. We purchased 27 standard fruit and vegetable items from Woolworths, and then the following day purchased the identical items at nearby local independent.

The results were astounding. The small business independent simply slaughtered the major supermarket on price - with prices on average at the major supermarket being a truly incredible 44% higher.

Price Comparison Fruit & Veg. South West Sydney 21st - 22nd Oct 2006					
	unit	Woolworths Corporation Revesby	Local Independent Casula	Woolworths Higher Price	
1	Rockmelon Lge	ea. \$5.95	\$3.99	49%	
	Rockmelon Md		\$1.99		
2	Grapefruit	kg \$2.97	\$1.99	49%	
3	Pears (Packman)	kg \$4.48	\$2.99	50%	
4	Capsicum Red	kg \$5.96	\$3.99	49%	
5	Potato Pontiac/Desiree	kg \$3.83	\$2.99	28%	
6	Tomato Roma/Egg	kg \$4.96	\$4.99	-1%	
7	Lettuce ***	ea. \$1.67	\$1.99	-16%	
8	Onion Brown	kg \$3.67	\$2.49	47%	
9	Lemon	kg \$3.47	\$0.99	251%	
10	Onion White	kg \$4.74	\$2.99	59%	
11	Lime	kg \$24.98	\$14.99	67%	
12	Avocado (hass)	ea. \$2.77	\$1.99	39%	
13	Carrot	kg \$2.55	\$1.99	28%	
14	Apple Granny Smith	kg \$5.97	\$3.99	50%	
15	Banana	kg \$11.98	\$9.99	20%	
16	Apple Pink Lady	kg \$5.97	\$3.99	50%	
17	Apple Sundowner	kg \$4.97	\$3.99	25%	
18	Orange Navel	kg \$2.97	\$2.49	19%	
	Orange Navel Bkt		\$0.99		
	Orange Navel Small		\$0.69		
19	Mandarin Murcott	kg \$5.97	\$3.99	50%	
20	Tomato	kg \$1.96	\$3.99	-51%	
	Tomato Bkt		\$1.59		
21	Potato Brushed/G.Delight	kg \$2.24	\$1.99	13%	
22	Potato Washed	kg \$3.83	\$2.99	28%	
23	Cucumber Lebanese	ea. \$3.96	\$1.99	99%	
24	Strawberry 250gram	ea. \$2.50	\$1.90	32%	
25	Onion Red/Spanish	kg \$4.74	\$3.99	19%	
26	Apple Fuji	kg \$5.97	\$4.99	20%	
27	Watermelon s/Less Cut	kg \$3.98	\$2.49	60%	
	Watermelon S/less whole		\$1.69		
				<b>Average Higher Price at W'Worths</b>	<b>44%</b>

\*\*\*\*The lettuces were not an accurate comparison of like for like

The Lettuce from W'Worths was in a plastic bag. Where the stalk was cut it had turned brown an indication that the lettuce was not fresh. "Sad" was the best way to describe the W'Worths product. While the Lettuce from the independent had a clean freshly cut stalk and was twice the size.

All other items were "like for like" or a comparison of "apples for apples"

Although in our opinion the Woolworths items were of a slightly lower quality and not as fresh, however we acknowledge that this is a subjective opinion.

We also conduct a similar survey of meat prices – and the results were the same – where independents operated free from Price Discrimination, they simply slaughter the major supermarkets on price.

<b>MEAT PRICE COMPARISON SURVEY 16TH Dec 2006</b>					
<b>South - West Sydney</b>					
	<b>Independent Lansvale</b>	<b>W'worths Ingleburn</b>	<b>W'Worths higher price %</b>	<b>Coles Casula</b>	<b>Coles higher price</b>
	\$ per kg	\$ per kg	%	\$ per kg	%
Leg of Lamp	\$7.99	\$10.99	37.5%	\$10.99	37.5%
Scotch Fillet	\$18.99	\$26.99	42.1%	\$26.99	42.1%
T-Bone	\$16.99	\$22.99	35.3%	\$22.99	35.3%
Minute Steak	\$14.99	N/A		\$16.99	13.3%
Blade Steak	\$7.99	\$12.99	62.6%	\$11.99	50.1%
Lamb Leg Chops	\$8.99	\$9.99	11.1%	N/A	
Ham Leg	\$6.99	\$7.49	7.2%	\$7.49	7.2%
Beef Stir Fry	\$12.99	\$18.99	46.2%	\$15.99	23.1%
BBQ Blade Steak	\$4.99	\$4.97	-0.4%	N/A	
Lamb BBQ Chops	\$5.99	\$7.49	25.0%	\$7.49	25.0%
Rump	\$9.99	\$12.99	30.0%	\$12.99	30.0%
<b>Average Higher Price of Woolworths/Coles</b>			<b>29.7%</b>		<b>29.3%</b>

<b>MEAT PRICE COMPARISON SYDNEY 25th March 2007</b>					
	<b>Independent Butcher, George St Sydney</b>	<b>Woolworths George St, Sydney</b>		<b>Coles George St, Sydney</b>	
	Price/kg	Price/kg	W'worths Higher Price	Price/kg	Coles Higher Price
T-Bone	\$10.99	\$22.99	109%	22.99	109%
Leg of Lamb	\$7.99	N/A		\$10.99	38%
Blade Steak	\$7.49	\$8.99	20%	\$12.99	73%
Rump	\$10.99	\$12.87	17%	\$13.99	27%
Sirloin	\$9.99	N/A		\$13.99	40%
Scotch Fillet	\$18.99	\$26.99	42%	\$18.99	0%
Chuck Steak	\$6.99	N/A		N/A	
BBQ Steak	\$6.99	N/A		N/A	
Beef Ossobone	\$5.99	N/A		\$9.99	67%
Diced Beef	\$8.99	\$15.99	78%	\$15.99	78%
New York Cut	\$18.99	N/A		N/A	
Lamb 4 quarter chops	\$6.49	\$9.99	54%	\$7.97	23%
Lamb Lion Fillet	\$10.49	\$12.91	23%	\$12.97	24%
Lamb Lion Chop	\$8.49	\$13.99	65%	N/A	
Lean Lamb	\$13.99	N/A		\$18.99	36%
<b>Average Higher Price than Independent</b>			<b>51%</b>		<b>47%</b>

The results of these surveys indicate exactly what the ABS data and international comparisons from OECD suggest – that Australian supermarkets are simply charging prices too high.

Further it appears that if the Australian Bureau of Statistics were measuring prices from the few independents able to operate free from Price Discrimination - instead of the prices from the major supermarkets - that Food Inflation in Australia would be less than the CPI – and comparable with food inflation in every other developed economy.

But the problem is, that the majority of independent retailers are handicapped by rampant Price Discrimination that distort the operation of the free enterprise system and the independent retailers in the above studies are far and few between. Thus most Australian consumers are paying retail prices for food, that have risen around 30% more than in the rest of the developed world since 1990.

#### 4. GEOGRAPHIC PRICE DISCRIMINATION

Geographic Price Discrimination also known as “Price Flexing”, “Regional Price Predation” or “Locality Discrimination” – occurs when a retail chain charges different prices in different stores subject to local competitive conditions.

Geographic Price Discrimination enables a retail chain to come into a local community and plant a competing enterprise next door to a local merchant, and by leveraging profits from other stores in non competitive territory, the chain is able to subsidize price reductions at the new location which crush the local merchants superior efficiency, and drive him from the market – and once the local merchant has disappeared, the chain pumps up prices and exploits consumers.

Geographic Price Discrimination can also be used by a large supermarket chain to deter small competitors from engaging in competitive activity, and can be used to ward off any new competitors that might enter the market.

Such anti-competitive acts have the effect of destroying competition and exploiting consumers, especially the elderly and those less mobile. The large supermarket chain is able to use no other weapons than those of greater size and the power of outside financial resources to crush the competition has been outlawed in several countries.

In Canada, such practice is considered so detrimental to consumers and competition that penalties include a two year jail sentence.

Section 50 (1)(b) of the *Canadian Competition Act*, titled “ Illegal trade practices” states;

*Every one engaged in a business who,*

*engages in a policy of selling products in any area of Canada at prices lower than those exacted by him elsewhere in Canada, having the effect or tendency of substantially lessening competition or eliminating a competitor in that part of Canada, or designed to have that effect.*

*is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.*

The economic powerhouse of California also has a similar provisions, section 17031 of the *California Business and Professional Code* states;

*Locality discrimination means a discrimination between different sections, communities or cities or portions thereof, or between different locations in such sections, communities, cities or portions thereof in this State, by selling or furnishing an article or product, at a lower price in one section,*

*community or city, or any portion thereof, or in one location in such section, community, or city or any portion thereof, than in another.*

And penalties for Locality Discriminations in the state of California include;

*“Imprisonment not exceeding six months or by both such fine and imprisonment, in the discretion of the court.”<sup>14</sup>*

Clearly the Californians like the Canadians understand the harm to consumers of such practices.

However ill-informed commentators in Australia have objected to such laws arguing that price differences may be the result of the ‘different costs’.

But such ill-informed comments simply overlook that these exact circumstances are catered for and allowed - for example Section 17041 of the *California Unfair Competition Act* states;

*“Nothing in this chapter prohibits locality discriminations which make allowances for differences, if any, in the grade, quality or quantity when based and justified in the cost of manufacture, sale or delivery, or the actual cost of transportation from the point of production, if a raw product or commodity, or from the point of manufacture if a manufactured product or commodity, or from the point of shipment to the point of destination.”*

But despite these international precedents, such Geographic Price Discrimination in Australia remains legal under the Trade Practices Act and it appears to be a widely used anti-competitive tool by the major supermarkets to exploit consumers and damage competition.

#### **4.1 The Leichhardt example**

An example of Geographic Price Discrimination was recently exposed by *Choice* magazine.<sup>15</sup>

*Choice* uncovered that the Woolworths store in Leichhardt had increased prices by a massive 23% when the CPI increase for food over the same period was just 13% after a nearby Franklins store disappeared.

*Choice* reported that Woolworths claimed the massive price hike for locals at Leichhardt was;

***“in line with the change in localized competition in the area”,***

Yet only 12 months earlier, this same large supermarket chain was advising the Senate Inquiry into the Trade Practices Act;

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<sup>14</sup> However with over 2 million people now behind bars in the USA and California having run out of room house felons, imprisonment is rarely enforced.

<sup>15</sup> [http://www.choice.com.au/viewArticle.aspx?id=103841&catId=100406&tid=100008&p=2&title=Supermarket+price+survey+2003+\(archived\)](http://www.choice.com.au/viewArticle.aspx?id=103841&catId=100406&tid=100008&p=2&title=Supermarket+price+survey+2003+(archived))

*“All Australian consumers have benefited from the strong competition between food retailers”*

At best, this organisation must have simply forgotten about the citizens of Leichhardt, whom they had slugged with a massive 23% increase in prices – and at worst - they had deliberately misled the Australian Senate.

## 4.2 The Liverpool/Moorebank Example

In June 2007 the TV program *A Current Affair* exposed another example of Geographic Price Discrimination by the major supermarkets.

The residents of Moorebank, whom purchased an everyday basket of fruit and vegetables from Woolworths consisting of; a Capsicum, Tomatoes, Potatoes, Avocado, Bananas, Apples, Grapes, Rockmelon, Pears, Beans, Cucumbers, Broccoli and a Cauliflower – on the understanding that these were “Low Prices you can count on everyday” – were in fact being slugged with prices 81% higher than what they would have paid for exactly the same items less than 5kms from another Woolworths outlet at Liverpool

The possible reason – at Liverpool a new independent competitor had recently entered the market – at Moorebank there was limited competition.

The major supermarkets may attempt to explain the need to engage in this anti-competitive conduct because of an outbreak of a “hot spots of competition” at Liverpool. Clearly this outbreak of competition is unacceptable, and its through the using Geographic Price Discrimination, that retail chains can “stamp out” any unacceptable hot spot of competition.

To keep prices in check, consumers would like to see “hot spots” of competition breaking out across the nation – but with such blatant Geographic Price Discrimination occurring in Australia to stamp out any outbreak of competition, it is little surprise that Australia has the developed world’s highest food inflation.

Could the failure of Australia Trade Practices Act to outlaw Geographic Price Discrimination, such as Canada and California have, have something to do with Australia having the developed world’s highest food inflation ?

If the purpose of the Trade Practices Act <sup>16</sup> is *‘to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection’* then if you live at Leichhardt or Moorebank (and probably

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<sup>16</sup> Section 2 – the Purpose of the *Trade Practices Act*, was inserted in 1995 at the recommendation of the ‘Independent Committee’ headed by Westfield Director Fred Hilmer. We note that Mr. Hilmer committee’s neglected to include in the words “equitable opportunity” in the purpose of the Act. In contrast, the purpose of the Canadian version of the Trade Practices Act the *Canadian Competition Act*, states.

*“The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy... in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy...”*

The word’s “equitable opportunity” are nowhere to be found in any section of the Australian Trade Practices Act. We further note that Canada, with its many similarities to Australia, is outperforming Australia in just about every economic indicator, including interest rates which are a full 2 percentage lower than Australia, and while Australia continues to rack to up trade deficits month after month, (even despite a once in century in mineral boom) adding to our mountain of foreign debt, Canada is running a trade surplus. Perhaps we need to take a lesson from Canada’s competition laws.



100's of other towns and suburbs around Australia) then the Trade Practices Act has let you down badly.

## **5. A RAMPANT DUOPOLOY EXTRACTING MONOPOLY PROFITS ?**

Have Australian consumers suffered from the developed world's highest food inflation since 1990, with food prices spiraling out of control, simply because the major supermarket chains have been extracting profits margins (EBIT%) well above international averages ??

Well not according to our major supermarkets.

*"In Comparison to grocery retailers overseas, Woolworths operates on very low margins"*

**Woolworths Submission to the Senate Committee.**

*"Australian Supermarket margins are significantly lower than EBITDA margins of international supermarkets."*

**Coles Submission to the Senate Committee**

*"The Committee was told that margins are accordingly low in comparison with the retail grocery industry in other countries"*

**Dawson Committee Report (Trade Practices Act Review) 2003**

But then we must remember that the major supermarkets claimed to be "lowering prices" – so every utterance they make must (in words of Adam Smith) be "long and carefully examined not only with the most scrupulous, but with the most suspicious attention" – as perhaps they are attempting to hoodwink the public on profit margins as well.

## **The Importance of Profits**

But first, profits are important – we need profitable firms in Australia, as it only through profits that firms have the ability to re-invest to drive future growth and prosperity.

The drive for profits is the basis of our free market economy - one firm may set the pace, and through superior innovation, products and customer service, they may be rewarded with high profits, as they take business from less efficient firms.

The less efficient firms, seeing their profits margins fall, are encouraged to lift their game, and to fight to take back some of the profits from the leading firm. This is the essence of competition.

However, the only thing that keeps firms from exploiting consumers is competition from other firms – and a clear indication of lack of competition in a market, (especially a mature market such as grocery retailing) is if the majority of the firms in the market are making excessive profits well above international averages of

similar markets - and all continue to raise their profit margins at the same time over a substantial period of time.

## 5.1 Comparing Profit Margins in Different Retailing Sectors

For any comparison to be relevant, it must be a comparison of apples with apples – and this applies in comparing profits of different retailers.

Different retailing sectors traditionally all have different EBIT%'s - which are often related to varying stock-turns.

Petrol retailing has the lowest EBIT%'s as they have the highest stockturns –this is followed by Grocery/Supermarket Retailing which the next lowest EBIT%

Other types of retailing such as Fashion, Homewares, Furniture, Footwear, Electronics, Toys, Jewellery, Sporting Goods, Hardware etc) all have a **higher EBIT%'s** than Grocery's – but they need to because they have lower stock turns.

*Therefore comparing Profit margins of Australian supermarkets <sup>17</sup>- any comparison must be made with like grocery retailers – not department stores, or hardware stores – and this is a mistake many commentators make in Australia.*

## 5.2 Comparisons with Wal-Mart

Many ill-informed commentators mistakenly use Wal-marts EBIT% as “evidence” in an attempt to show EBIT%'s in Australian grocery retailing are low.

A typical Wal-Mart sells a huge range of products such as; cosmetics, clothing, computers, electrical, furniture, homewares, toys, garden supplies, etc, etc. and these products all traditionally have a much higher EBIT%'s than grocery's.

Wal-Mart are not a traditional grocery retailer, they have been trading since 1962 but only started selling grocery's in 1988 – and in USA their grocery sales are estimated at around 25%-33% of total turnover

Wal-mart do not disclose any figures to show separate EBIT% for groceries (Food & Liquor) but only a combined EBIT% for all goods.

	2006	2005	2004
<b>Nett Sales US\$M</b>	\$312,427	\$28,522	\$256,329
<b>EBIT US\$M</b>	\$18,530	\$17,091	\$15,025
<b>EBIT %</b>	5.93%	5.99%	5.86%

<sup>17</sup> Measurements of “Gross Profit” are next to useless as they are distorted by rebates, advertising allowances, extended payment terms, etc. Any reference to Gross Profit for comparisons should be dismissed as meaningless.

Further, much of Wal-Mart's relatively high EBIT%'s could be the result of their direct importing from China where their EBIT% includes that as both importer and retailer.

Therefore at best it is ill-informed or at worst deliberately misleading to use Wal-Mart's overall EBIT% across all product categories in attempt to make any statement about the profits margins of the major supermarkets in Australia.

### 5.3 International Studies of EBIT% for Grocery Retailers

The most accurate international averages of EBIT% in grocery/supermarket retailing (food & liquor) come studies conducted by the Washington DC based Food & Marketing Institute (FMI)

The FMI conduct a yearly study that analyses the profit margins of their members which consist of over 2,300 companies (not stores) spread over 60 countries in the grocery/supermarket sector. In the USA alone, data comes from 26,000 retail food stores with combined sales of US\$340 billion (75% of all grocery retail sales in the USA). This study has been undertaken every year since 1974.

The results of this study from the FMI are the only relevant figures to make any informed comparison with the profits margins of the major Australian supermarkets.

The Food & Marketing Institute state<sup>18</sup>:

***The intense competition among food retailers for the consumer dollar is best demonstrated by profit margins that continue to be 1% of sales [1.5% EBIT%] ...this has remained in the 1% range throughout the industries history”<sup>1</sup>***

So what is going on Australia where our two major supermarkets have EBIT% of 4% and 6% ??

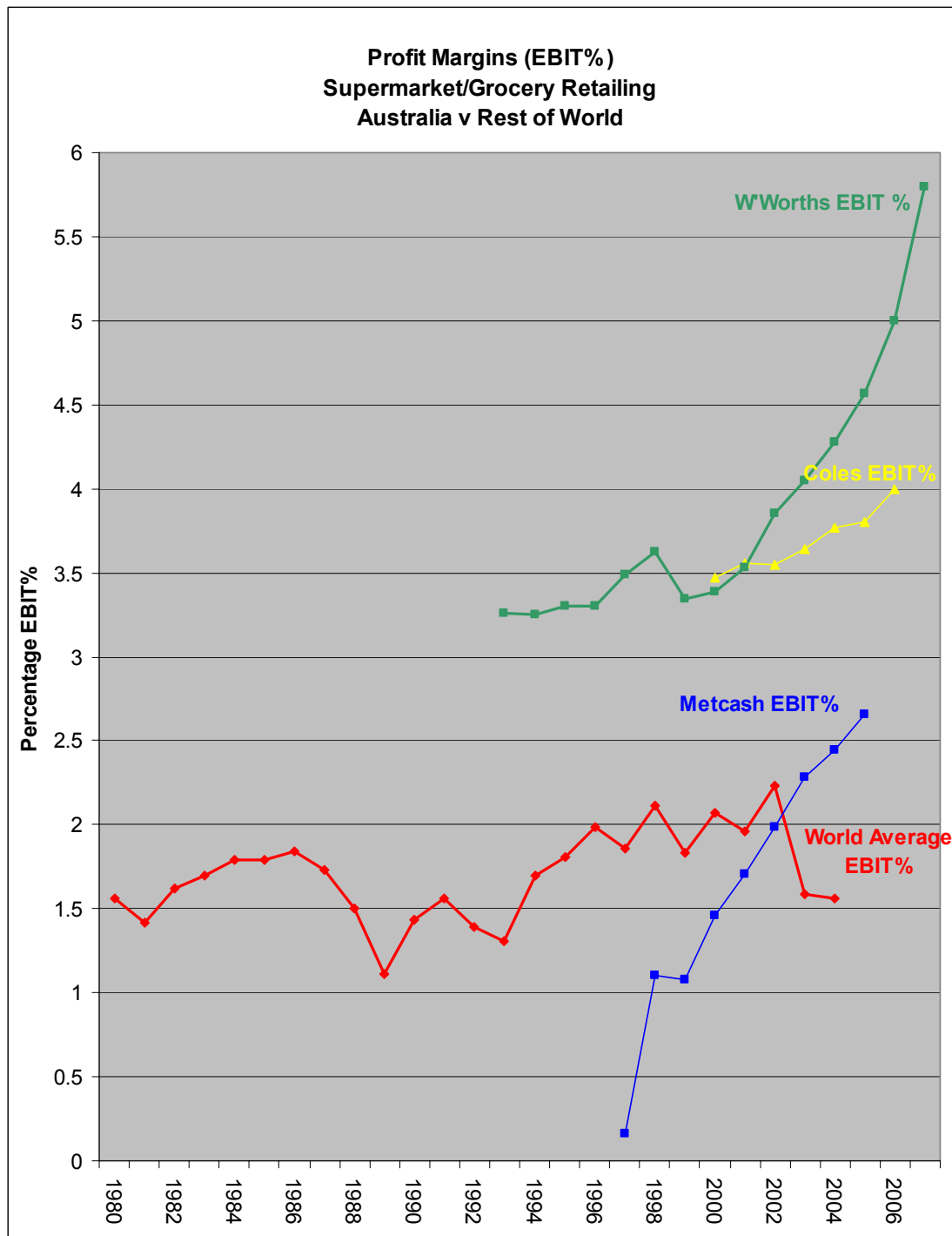
Yet again the ARNA have shot themselves in the foot, through their failure to do their homework - with their recent claim;

*“The competitive nature of the retail sector in Australia also puts strong downward pressure of prices – major supermarkets are making less than 5 cents in the dollar”*

This begs the question - If worldwide “intense competition among food retailers has resulted in profit margins at **1 cent in the dollar**” – what is going on in Australia where major supermarkets are cashing in making **5 cents in the dollar**. ??

<sup>18</sup> [http://www.fmi.org/facts\\_figs/CompetitionandProfit.pdf](http://www.fmi.org/facts_figs/CompetitionandProfit.pdf)

And further, what is going on in Australia when all the major supermarkets EBIT% have continued to march upwards year after year – when the FMI state profits margins have remained in a 1.5% EBIT% range – “throughout the industries history” ??



Source : SSRA Analysis of FMI survey, and Annual Reports

Even the so-called third player – Metcash Ltd, the wholesaler supplier for many independent supermarkets stores, seems also to have benefited greatly from the current status quo.

It seems obvious that given Metcash's recent profit spike, that repairing the Trade Practices Act could risk upsetting the comfortable status quo that they seem to be benefiting from.

With **all** major players in the market increasing EBIT% **all** at the same time, talk of 'vigorous competition' as claimed by the major supermarkets and their apologists (including the ACCC) is exposed just a complete nonsense.

With EBIT%'s for both our major supermarket retailers in Australia 3 to 4 times higher than world wide average - is it any wonder that retail prices are spiraling out of control and Australian consumers are being punished by having to live with the developed world's highest food inflation for the last 17 years ?

The only conclusion one can reach is that the Australian consumers are being taken from ride by a rampant duopoly, and the major supermarkets are laughing at the government and how they have successfully hoodwinked them, in a deliberate attempt maintain the status quo of the Trade Practices Act remaining an empty shell.

## 6. The Alternate Arguments

Of course, we acknowledge that there is another possibility – that perhaps the statisticians at Australian Bureau of Statistics and the Organisation of Economic Development & Cooperation (OECD) and the Food & Marketing Institute (FMI) simply have it all wrong.

And instead – it's the spin doctors from advertising departments of the major supermarkets that have it right – and that across Australia;

\* retail prices are lower !!

\* In comparison to grocery retailers overseas Australian grocery retailers really do operate on very low margins !!

\* Australia consumers are benefiting from vigorous competition in the grocery retailing sector – and thus prices are lower !!

Let's hope that the ABS, the OCED and the FMI all have it wrong, because if they are right, and the major supermarkets have engaged in a hoodwink - we need to start looking at Trade Practices Act all over again.