

Chapter 3

The effectiveness of the Competition and Consumer Act 2010

3.1 In establishing the Select Committee on Australia's Food Processing Sector, the Senate identified 'the impact of Australia's competition regime and the food retail sector, on the food processing sector, including the effectiveness of the *Competition and Consumer Act 2010*' as one of the inquiry's terms of reference.¹ Throughout its inquiry, the committee sought to investigate whether the current market is characterised by competition that will have positive outcomes for consumers or if the market is such that the long term viability of Australia's food processing sector is at risk.

Background

The Competition and Consumer Act 2010

3.2 The *Competition and Consumer Act 2010*² (the CCA) contains Australia's core legislation for addressing anti-competitive conduct. The object of the CCA is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. The Act does this through a legislative framework that makes certain conduct and practices unlawful, while ensuring that an environment that facilitates competition remains. In its submission to the inquiry, Treasury explained how the CCA achieves this:

Competition laws are intended to protect the competitive process in our markets, which will generally deliver greater efficiency and productivity, and better outcomes for consumers...In some cases, however, conduct may be authorised where it may nonetheless produce a net public benefit.³

3.3 It is important to note that a feature of Australia's competition framework is that the laws are 'principally concerned with protecting the competitive process, not individual competitors. They are not designed to protect competitors from rigorous competitive behaviour, not to force businesses to compete'.⁴

3.4 The competition rules of the Act cover a range of conduct including cartel conduct, misuse of market power, anti-competitive agreements and exclusive dealing, as well as prohibiting mergers and acquisitions of companies that would result in a substantial lessening of competition. The consumer protection provisions include rules

1 *Journals of the Senate*, 2010–11, no. 27, 24 March 2011, pp. 774–775.

2 Prior to 1 January 2011, these provisions were contained in the *Trade Practices Act 1974*.

3 Department of the Treasury, *Submission 18*, p. 7.

4 Department of the Treasury, *Submission 18*, p. 7.

regarding 'country of origin labels', which set parameters for claiming that a product was produced, for example, in Australia, as well as other provisions. The consumer protection provisions of the CCA are explored in Chapter 5 of the report.

Reviews/inquiries into the CCA

3.5 Questions about the effectiveness of the CCA have been the subject of much inquiry in recent times. In January 2008, the Australian Competition and Consumer Commission (ACCC), which is responsible for enforcing the CCA, was referred an inquiry into the competitiveness of retail prices for standard groceries⁵ in response to community concerns about the rising cost of food.⁶ The ACCC's report was presented to the Minister for Competition Policy and Consumer Affairs on 31 July 2008.

3.6 In its report, the ACCC concluded that the changes in retail price reflect changes in the farm-gate/wholesale price⁷ and advised the government that '[e]vidence...does not support the proposition that retail prices have risen while farm gate prices have stagnated or declined'.⁸ Rather, it concluded that 'a range of domestic and international factors have substantially contributed to the recent increases in food prices in Australia' including:

- the current drought, which has reduced the supply of many agricultural products and increased the costs of farming;
- natural disasters such as cyclones and floods, which in combination with quarantine restrictions have caused considerable supply disruptions for some fruit and vegetable products; and
- the international commodities boom, which has: increased the cost of commodities (such as fertiliser and petrol) used to produce and transport many Australian food products; [and] increased the prices some Australian farmers and food producers can sell their products for in export markets, leading to higher domestic prices.⁹

3.7 The ACCC went on to explain that although:

5 In conducting the inquiry the ACCC received 250 submissions and held 22 hearings with a total of 77 witnesses, and also conducted a grocery consumer behaviour survey for which there were 1500 respondents.

6 Department of Agriculture, Fisheries and Forestry, *Issues paper to inform development of a national food plan*, June 2011, p. 31.

7 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 305.

8 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. xiv.

9 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 39.

[i]t is difficult to be certain about the extent to which the above domestic and international factors account for the observed increases in food prices...any potential contribution resulting from increased margins of major grocery retailers and wholesalers is small relative to the overall increase in food prices.¹⁰

3.8 The ACCC's 2008 grocery prices report did, however, result in the introduction of unit pricing, as well as changes to the Horticulture Code of Conduct¹¹ and planning laws to prevent restrictive covenants in leases and enable market access for new entrants.

3.9 Following the ACCC's 2008 report, the operation of the provisions within the CCA in the context of the grocery sector was again the focus of inquiry through the Senate Economics References Committee's inquiry into *The impacts of supermarket price decisions on the dairy industry*.¹² That inquiry, which concluded in November 2011, arose following a decision of the major grocery retailers to reduce the retail price of their own brand (private label) milk to \$1 a litre.¹³ Although the Senate Economics References Committee's inquiry concentrated on only one sector of the food industry—the dairy industry—the committee recommended that the government initiate an independent review of the competition provisions of the CCA.¹⁴

3.10 The establishment of the Senate Select Committee on Australia's Food Processing Sector follows on from these earlier inquiries and was tasked with investigating the numerous pressures that are confronting the industry. The committee considers that determining the effectiveness of the operation of the CCA from the perspective of the food processing sector requires consideration of the entire food supply chain—from the cost of primary inputs to the competitiveness of the retail sector as the point of supply to Australian families.¹⁵

3.11 In its *Issues paper to inform development of a national food plan*, the government identified competition in the food sector as being 'essential to ensuring

10 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 39.

11 The Horticulture Code of Conduct regulates trade between growers and traders of fresh fruit and vegetables. The Code aims to promote transparency and improved business practice. The ACCC is responsible for enforcing the Code, and promoting awareness of the Code through, for example, guidelines, articles and fact sheets.

12 This inquiry of the Senate Economics Reference Committee followed an earlier inquiry into the dairy industry by the same committee in 2009–10.

13 Senate Economics References Committee, *The impacts of supermarket price decisions on the dairy industry*, November 2011, p. xiii.

14 Senate Economics References Committee, *The impacts of supermarket price decisions on the dairy industry*, November 2011, p. xvi.

15 Senator the Hon. Richard Colbeck, *Media Release*, 8 July 2011, Inquiry into Australia's food processing sector, p. 1.

efficient use of resources and encouraging rapid uptake of new technologies in food production and services'.¹⁶ In that paper, the government also identified that the current level of competition in the grocery sector is a matter causing concern to some stakeholders:

Recent strong price competition between major supermarkets, which is placing downward pressure on grocery prices, is raising some stakeholder concerns about the impact on prices received by food processors.¹⁷

3.12 Although the government explains that a competitive food sector benefits consumers through 'improvements in food quality, greater consumer choice, competitive grocery pricing, and sufficient growth in food supplies to meet expanding demand',¹⁸ this committee has received evidence that suggests the current characteristics of the marketplace are threatening the ongoing viability of Australia's food processors. This chapter explores the evidence that the committee received.

The current market

Overview

3.13 According to Treasury, the current market in the Australian food processing industry is generally consistent with international markets which also tend 'to be concentrated, with two or three key players in each product type and a number of smaller competitors'.¹⁹

3.14 The food processing sector is dominated by two major retailers, Coles and Woolworths. Estimates of their combined share of the food retail market have been consistently high. In 2005, it was estimated that Coles and Woolworths had a combined market share of 76 per cent.²⁰ In 2008, the ACCC estimated the combined share to be 70 per cent of the national supermarket packaged grocery market and

16 Department of Agriculture, Fisheries and Forestry, *Issues paper to inform development of a national food plan*, June 2011, p. 31.

17 Department of Agriculture, Fisheries and Forestry, *Issues paper to inform development of a national food plan*, June 2011, p. 31.

18 Department of Agriculture, Fisheries and Forestry, *Issues paper to inform development of a national food plan*, June 2011, p. 31.

19 Department of the Treasury, *Submission 18*, p. 4.

20 ABARES, Andrew Jacenko and Don Gunasekera, *ABARE conference paper 05.11 – Australia's retail food sector: some preliminary observations*, May 2005, p. 3, http://www.abare.gov.au/publications_html/conference/conference_05/CP05_11.pdf (accessed 2 August 2011).

approximately 50 per cent of fresh product sales.²¹ Again, in 2010, IBISWorld also estimated the combined market share to be 70 per cent.²²

A concentrated market

3.15 The lack of competition between the two large supermarkets was consistently identified as a concern by submitters and witnesses who appeared before the committee.

3.16 The Australian Olive Association told the committee:

Coles and Woolworths control 82% of a farmer's/producer's access to a consumer. The combined market share of this duopoly is the highest in the world. The situation is making it nearly impossible for any producer to make a profit from dealing with supermarkets in Australia.²³

3.17 Similarly, the Winemakers' Federation of Australia (WFA) expressed concern that the retail market has become highly concentrated. It cited the market power of Coles and Woolworths (who are now the two major liquor retailers) as a major concern for their industry. The WFA explained that the 2011 Woolworths acquisition of Cellarmasters, an online wine retailer, has given it 'full vertical ownership through the wine supply and value chain' as it included the ownership of Dorrien Estate, Australia's largest small-batch winery, and Vinpac, with bottling, packaging, storage, filtration and testing services.²⁴

3.18 The Australian Food and Grocery Council (AFGC) is also concerned by the current level of supermarket concentration in Australia:²⁵

We have gone from a scenario where, in 1975, Coles and Woolworths had 38 per cent of the market to one where, last year, they had nearly 80 per cent.²⁶

3.19 When the criticisms of the current level of concentration in the supermarket retail sector were raised with the Treasury, the department acknowledged that the focus of the CCA is the consumer rather than the competitors within a market:

21 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 51.

22 IBISWorld, *Supermarkets and other grocery stores in Australia*, 2010, p. 23, as cited in Bronwyn Gallacher, 'Emerging characteristics of Australia's supermarket industry – a case study for the ACCC's first ex-post assessment', (2011) 39 ABLR 147, 149.

23 Australian Olive Association, *Submission 68*, p. 4.

24 Winemakers' Federation of Australia, *Submission 35*, p. 5.

25 Ms Kate Carnell, Chief Executive Officer, Australian Food and Grocery Council, *Committee Hansard*, 13 December 2011, p. 19.

26 Ms Kate Carnell, AFGC, *Committee Hansard*, 13 December 2011, p. 27.

Competition law plays an important part in prohibit[ing] anti-competitive conduct. Competition laws are principally concerned with protecting the competitive process in the interests of consumers not individual competitors or firms in the industries.²⁷

3.20 When asked about how it ensures policy settings achieve the right balance between consumers and competition, Treasury responded:

...the way that Australia and most other comparable nations have addressed that issue is that we have passed a set of competition laws that proscribe certain forms of behaviour and then we have some factors that the competition regulator takes into account if there is an allegation that there are anticompetitive practices going on.²⁸

3.21 Treasury explained, however, that it 'does not have a role in judging whether markets are competitive or not' but that that role rests with the independent regulator—the ACCC.²⁹

Mergers and acquisitions and current levels of market concentration

3.22 There is no doubt that concentration in the Australian grocery retail sector is at unprecedented levels. The committee heard evidence that suggests this has occurred over time as a result of 'creeping acquisitions'. Creeping acquisitions are a series of small-scale acquisitions that, individually, do not 'substantially lessen competition' in a market, but collectively may do so over time.³⁰ Supermarkets have bought up 'small brands which on their own do not appear to be much' but which over time have built up to be 'quite substantial ownership of market power'.³¹ Each of these small acquisitions is not in breach of section 50, and the series of acquisitions are therefore permissible by law.

3.23 In December 2011, federal parliament passed a law amending the section 50 test to refer to 'a substantial lessening of competition in *any* market' (as opposed to 'a market'). The bill also amended section 50(6) of the CCA, omitting the word 'substantial' in definition a 'market' for purposes of section 50. The intended effect of both amendments was to clarify that the ACCC and the courts can examine local

27 Mr Bruce Paine, Principal Adviser, Infrastructure, Competition and Consumer Division, Treasury, *Committee Hansard*, 13 December 2011, p. 29.

28 Mr Bruce Paine, Department of the Treasury, *Committee Hansard*, 13 December 2011, p. 30.

29 Mr Bruce Paine, Department of the Treasury, *Committee Hansard*, 13 December 2011, p. 30.

30 Competition and Consumer Legislation Amendment Bill 2011, *Explanatory Memorandum*, p. 7.

31 Mr Andrew Wilshire, General Manager, Policy and Government Affairs, Winemakers' Federation of Australia, *Committee Hansard*, 13 December 2011, p. 15.

markets which may be small geographically but where creeping acquisitions concerns arise.³²

3.24 The Australian Manufacturing Workers' Union (AMWU) questioned the effectiveness of the current legislative provisions given that, in their view, creeping acquisitions that are not illegal have led to the market dominance of the two large retailers:

We have said consistently that the anticompetitive parts of the legislation need to be toughened up and expanded to include the types of behaviour that are taking place. There also needs to be a greater oversight of the industry. As you say, according to the [current] legislation and the [publicly known] facts, there has been nothing illegal about the creeping acquisitions that have led to a duopoly having 80 per cent control of the retail food and grocery market. However, the anticompetitive practices that have now arisen from that are systematically destroying the industry.³³

3.25 In recognition that the CCA through section 50 prohibits mergers and acquisitions that would 'have the effect, or be likely to have the effect, of substantially lessening competition in any market'³⁴ the committee, through its inquiry, sought to investigate the administration of these provisions given the evidence it had received concerning the apparent market power of the major retailers.³⁵

3.26 In its submission to the committee, Treasury explained the role of section 50 of the CCA, identifying that there will be times when merger activity can be of benefit to consumers:

32 Competition and Consumer Legislation Amendment Bill 2011, *Explanatory Memorandum*, p. 9.

33 Ms Jennifer Dowell, National Secretary, Food and Confectionery Division, Australian Manufacturing Workers Union, *Committee Hansard*, 10 February 2012, p. 4.

34 Section 50, *Competition and Consumer Act 2010*. The use of the substantially lessening competition (SLC) test is consistent with international practice as the same test is used in many other Organisation for Economic Cooperation and Development (OECD) countries including the United States, Canada, United Kingdom and New Zealand.

35 Prior to amendments made by the government in 2011, subsection 50(1) of the CCA prohibited a corporation from 'directly or indirectly acquiring shares in the capital of a body corporate or acquiring any assets of a person if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market'. Subsection 50(3) of the CCA then provides a non-exhaustive list of factors that may be taken into account when considering the impact of a merger or acquisition on a market, including the height of barriers to entry and the actual and potential level of import competition in the market. A market is defined by subsection 50(6) of the CCA. This subsection previously stated that a 'market means a substantial market for goods or services in Australia or a State or a Territory or a region of Australia'. The government's recent amendments to subsection 50(1) of the CCA allow the impacts of a merger or acquisition to be considered within the context of 'any market' instead of 'a market'. The government also amended subsection 50(6) by removing the requirement that the market being considered be a substantial market.

The role of a merger provision is to distinguish between welfare enhancing and welfare reducing mergers and acquisitions ... Mergers between firms can be an effective way of developing competitive advantage, optimising the benefits of complementary strengths and taking advantage of economies of scale and scope. Mergers can also operate as an important discipline upon poorly performing management. Merger activity can thus improve efficiency to the benefit of consumers and the community generally.³⁶

3.27 However, given the level of concentration in the grocery retail sector the committee questioned Treasury about its role and that of the ACCC in monitoring merger activity to ensure concentration levels as a result of creeping acquisitions do not get to such a level as to cause concern to government:

Mr Paine: [We] provide advice [and analysis] from a whole of economy perspective and from a whole of Australia perspective on a wide range of factors, You talked about a particular measure of concentration. In fact I do not think it was with respect to market concentration. It was the number of outlets. We would also supplement our advice about how a particular indicator might not provide the full picture. For example, even measures of concentration are not necessarily reflective of a firms', or one or two large chains', market power.

Senator XENOPHON: Say that again. You are saying that the fact that Coles and Woolworths have 80 per cent of the dry grocery market is not itself a significant determinative factor.

Mr Paine: What I said was that, by themselves, a measure of concentration... by itself is not necessarily a measure of firms' market power. Even if it were, from a competition perspective the issue is about what a firm or firms do with that market power. But let us just go back to the previous point, which is [what] firms' market power reflects is not determined by concentration, because, for example, there are other factors, including how difficult it is for competitors to enter the market.³⁷

3.28 Treasury added that international supermarket chains such as ALDI and Costco are emerging as a new source of competition.³⁸ It also explained that concentration alone does not mean a market is anti-competitive or that the current competition laws that apply are ineffective:³⁹

High market concentration, however, does not necessarily indicate that incumbent firms have market power. When assessing the level of competition in a market, it is also important to assess other factors, such as the presence of barriers to entry or expansion, competition from imports,

36 Department of the Treasury, *Submission 18*, p. 9.

37 Mr Bruce Paine, Department of the Treasury, *Committee Hansard*, 13 December 2011, p. 35.

38 Department of the Treasury, *Submission 18*, p. 5.

39 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 51.

the level of countervailing power held by buyers, the nature of key competitors, and the availability of substitute products or services.⁴⁰

3.29 The committee notes, however, that not all submitters viewed the entrance of ALDI and Costco into the Australian market as a positive one. Dick Smith wrote in his submission that:

At the time ALDI commenced in Australia I was openly critical of the lack of discussion of the downside having made myself familiar with its vast operations overseas. I predicted that ALDI would take substantial profits out of Australia and make a fortune for their German owner, already one of the wealthiest billionaires in the world however the business model used by ALDI would completely change the food processing, manufacturing and retailing industry in Australia. I have continued over the past ten years to express my concerns.⁴¹

Committee view

3.30 The committee is concerned by the concentration of the grocery retail sector and finds Treasury's assessment of the situation, that 'high market concentration does not necessarily indicate that incumbent firms have market power', less than reassuring.

3.31 In recent years much of the increase in concentration has come about through creeping acquisitions. Although the committee acknowledges the government's recent minor amendments to certain elements of section 50 of the CCA, it takes the view that those changes were placebo provisions and will not achieve much. The review of the CCA should consider whether section 50 ensures that the cumulative effect of acquisitions over time is taken into account by the ACCC.

Loss of market diversity

3.32 As retail concentration increases, it results in a reduction in the diversity of markets into which participants in the food industry sector can sell their products. The committee heard evidence from Professor David Hughes, Emeritus Professor of Food Marketing at the Imperial College of London, that this result occurs in all markets that are highly concentrated. Professor Hughes explained, however, that in such conditions the ability to find new buyers for products can be 'devastating' for businesses if they lose a customer:

When you have a couple of players with that proportion of the market then, clearly, they are going to have an enormous influence on the market. ...If you are dealing with—as in our particular case Tesco's, Sainsbury's and Marks and Spencer—just three customers, they would be well over half our total turnover. If you upset, or if you are dropped or if market conditions change and you lose one of those customers, then it can be damaging. Within your context where you only have two principal retailers, it can be

40 Department of the Treasury, *Submission 18*, p. 5.

41 Dick Smith, *Submission 63*, p. 4.

devastating for the business. If you are suddenly dropped by Coles and then dropped by Woolworths, it makes for a very difficult business environment.⁴²

3.33 Professor Hughes explained that suppliers need to look for diversity in markets to ensure they have choice in situations where the market is concentrated with only a small number of competitors:

The more competition in the market the better it is for suppliers. That just seems to me to make common sense. In South Africa at the Global Table Grape Congress I was talking to major exporters from South Africa and Chile and ... they said what was encouraging from their perspective was growth in emerging markets because the emerging markets in [places like] , India or China were just starting to get to income levels where they saw markets for grapes within their own countries. Now, when they are pushed by the Tescos and the Walmarts of this world—remember, they are trained to get the best deal—they could say, 'We'd love to sell you more at low prices but actually we've got more customers and they are willing to pay a little more.' ...For us, we have the latitude in that there are five or six principal buyers. We do not have just one model. There is the Tesco model, [for example] [There is] the Walmart model towards dealing directly with growers.... That is a little threatening to suppliers who are aggregators....⁴³

3.34 Professor Hughes explained that for countries like Australia, the opportunities that are presented by export markets could perhaps provide some protection to suppliers if they did not want to deal with either of the two major supermarkets:

Within an Australian context, it is more challenging for large-scale suppliers who do not have the export market and who could lose that volume if they dropped a major customer like Coles or Woolworths.

But if you want me to just pitch in on the food manufacturing end, it is really encouraging, isn't it, when Australian processors and manufacturers have that export option? I would say, subjective though it may be, but I have been working with food manufacturers and processors in Australia for the last 15 years or so, that I am often surprised at the proportion of Australian processors and manufacturers who are inward looking and do not have an export view of the world.⁴⁴

Committee view

3.35 The committee supports the view of Professor Hughes and recognises that having a diversity of markets available is of significant benefit to processors and suppliers. The committee recognises, however, that due to market concentration in

42 Professor David Hughes, Emeritus Professor of Food Marketing, Imperial College London, *Committee Hansard*, 15 May 2012, pp. 72–73.

43 Professor David Hughes, *Committee Hansard*, 15 May 2012, p. 74.

44 Professor David Hughes, *Committee Hansard*, 15 May 2012, p. 74

Australia and the current high Australian dollar, there are limited options in the market for processors and suppliers at this time.

3.36 Evidence provided to the inquiry also supported this view. For example, the meat industry representatives took a very different attitude to supermarkets than other witnesses because they had export market alternatives if domestic retail prices and conditions became unsuitable.

Sensitivity to price

3.37 While hearing that the ability of food processors to find alternative domestic destinations for their products was declining, given the increasingly concentrated retail sector, the committee also heard that the sector is also becoming increasingly price sensitive.

3.38 The AFGC pointed out that the Australian grocery market is a price based market, so if Coles and Woolworths cannot get a product for the price they want in Australia they will source it from overseas. The AFGC added that this is occurring for products such as canned pineapple, tuna and frozen fruit and vegetables, which are significantly cheaper when sourced offshore.⁴⁵

3.39 The committee explored what changes have led to this situation. Dr Geoffrey Annison, Deputy Chief Executive of AFGC, offered his view:

I think the fundamental reason is because the asymmetry in the power between the retailers and the branded manufacturers has grown. Whereas 15 years ago they [branded manufacturers] were powerful, they are not nearly as powerful as they are now. So there was more power with the branded manufacturers to resist and say, 'We are not going to give you that product.'⁴⁶

3.40 Dr Annison explained to the committee that change is the result of the level of concentration and subsequent reduction in retailers, as well as the shift of those retailers into private label products:

A number of the other retailers have gone by the board. I think also there has been some shifting of the position within the branded manufacturers so they have not maintained that differentiation between their private label manufacturing and the branded products that they were offering. That is reflected, I think, mainly because of the power that the supermarkets now have in terms of the ability to de-list products and take products off the shelf.⁴⁷

45 Ms Kate Carnell, AFGC, *Committee Hansard*, 13 December 2011, p. 20.

46 Dr Geoffrey Annison, Deputy Chief Executive, AFGC, *Committee Hansard*, 13 December 2011, p. 21.

47 Ms Kate Carnell, *Committee Hansard*, 13 December 2012, p. 21.

The rise of the private label product

3.41 Over the past ten years, there has been a significant increase in the private label range of products carried by the supermarkets. The AFGC informed the committee that the market share of private labels grew from 15 per cent in 2003 to 25 per cent in 2010 and that both Coles and Woolworths are looking at doubling their private label market share.⁴⁸

3.42 Treasury explained the rising growth in private label products to new entrants such as ALDI and Costco:

At the retail end of the food supply chain, the range of products available in supermarkets has evolved significantly in recent years, partly due to the introduction and growth of private label products. New entrants such as ALDI and Costco, both with private label brands, are in part also motivating the major supermarket chains to turn to private label brands as a competitive response.⁴⁹

3.43 However, Treasury informed the committee that although private label goods are growing and expanding into 'less traditional categories such as shelf stable fruit', in comparison to international markets, private label goods in Australia hold substantially less market share.⁵⁰ Treasury also explained that the rise in private labels is good for consumers.

Treasury notes that at the retail end of the supply chain the range of products available in supermarkets has evolved significantly in recent years partly due to the introduction of and growth in private-label products. We also note the concerns of food processors, however, on the other hand, private-label products do also provide consumers with alternative, more affordable options and increased competition and choice, while potentially placing pressure on parts of the operations of food processors is of direct benefit to consumers and to the economy more generally, for example, by effectively raising household disposable income.⁵¹

3.44 Ms Kate Carnell, Chief Executive of the AFGC, explained the attractiveness of private label products to the large retailers:

A grocery line needs to turn over about 50 per cent more stock to be more lucrative than a private label product. The reason for that is quite clear. Private label products do not have to build a brand, they do not have to do R&D, they do not have to buy shelf space and they do not have to do

48 Ms Kate Carnell, *Committee Hansard*, 13 December 2011, p. 20.

49 Department of the Treasury, *Submission 18*, p. 6.

50 Department of the Treasury, *Submission 18*, p. 6.

51 Mr Bruce Paine, Principal Adviser, Infrastructure, Competition and Consumer Division, Treasury, *Committee Hansard*, 13 December 2011, p. 29.

advertising. All of that is already done by the brand manufacturer, who has actually created the market share for the particular product.⁵²

3.45 Ms Carnell elaborated on the difficulties faced by branded products in competing with these private label products:

So what you see is a scenario where Coles and Woolworths own 80 per cent of the supermarket shelf space in this country. You can look at it almost like real estate. ... You need to be able to get onto that shelf to grow your product and to have the economies of scale that you need to be able to compete with those cheap imports. The dilemma is that, of that 80 per cent, more of that 'real estate' is being taken up by private label products, which means that the real estate that is left for Australian branded products is decreasing quite significantly. That means that access to customer is becoming significantly harder. Also, the other issue is that, unless you deal with Coles and Woolworths—that 80 per cent of the shelf space—your capacity to get your product in front of enough consumers to achieve the economies of scale you need to achieve to compete in this market goes down significantly.⁵³

3.46 Campbell Arnott's also raised concerns about the growing trend towards private label brands on supermarket shelves:

In terms of retail, there is a growth strategy around private label. They certainly want to make private label—and I think they have both gone on record as saying this—a greater proportion of the food spend. The challenge we have is to ensure that, when consumers have that choice at the market shelf, they buy an Arnott's or a Campbell's product and not a private label product. We will ensure that we have products there that will stay ahead of the private label game and tempt those consumers.⁵⁴

3.47 As the market share of private label products increases, and the shelf space available to branded goods decreases, there are concerns among the industry that consumer choice will decrease and that this result is already evident:

[B]efore it might have been private label plus four or five other brands, with the limiting of the number of brands that are actually being given access to shelf space, particularly because of private label growth, ... the power is greater now within the retailers of denying that access.⁵⁵

3.48 The WFA echoed these concerns stating that the result of increasing private label products, particularly in goods such as wine, will be a reduction in consumer choice:

52 Ms Kate Carnell, *Committee Hansard*, 13 December 2011, p. 20.

53 Ms Kate Carnell, *Committee Hansard*, 13 December 2011, p. 20.

54 Mr Craig Funnell, Vice-President, Supply Chain, Asia Pacific, Campbell Arnott's, *Committee Hansard*, 10 February 2012, p. 60.

55 Dr Geoffrey Annison, *Committee Hansard*, 13 December 2011, p. 22.

The retailers have brought in their own brands and their brands look very similar to existing brands—and in some cases very similar. So from the consumer's perspective there is no discernible difference between what was a brand is now an own brand. As the product gets homogenised, we are seeing the gravity moving towards the owners of the own brands because for existing brand owners to come into the marketplace they have to see their product sit on the shelf at a place that is not where the foot traffic goes and they have to do it at a price that is dictated to them by the retailers. That is the problem that we are seeing at that bottom end. We are now seeing it starting to creep into the premium part of the business. It is our view that if we get to a point where the retailers have such dominance in terms of the production and supply of the product that will give them a great deal more latitude to increase price in the long term and it will compromise a lot of the systems and the integrity that we put into the production of our wine. [This] will affect the product that [consumers] will be getting and their ability to have choice as to that product.⁵⁶

3.49 Mr Dean Rochfort, General Manager of Sustainable Development at Greater Shepparton City Council, suggested that with the shift to private labels, domestic manufacturers need assistance to develop brand equity and brand loyalty:

The main focus of many of our manufacturers is on the domestic market where they are competing on private label brands. [and] strong brand equity in some of their private label lines [is now growing quite significantly]. ...What our manufacturers are telling us is that there needs to be some initiative and leadership in helping them develop a sense of brand equity and brand loyalty around Australian manufactured produce because they do not have a level playing field. They are competing with cheap imported products and they are finding it very difficult.⁵⁷

3.50 In its submission to the inquiry, Treasury recognised that 'concerns have been raised about the impact of private label products on competition in the retail grocery market and on the viability of branded products'.⁵⁸ Treasury also noted that the ACCC, in its 2008 Grocery Report, reported that:

...the introduction and growth of private label products has the potential to enhance the buying power of major retail chains and decrease the competitiveness within vertical supply chains.⁵⁹

3.51 Treasury went on to explain that although 'private label products may increase competition by motivating suppliers of branded products to be more competitive', there may be other detrimental impacts:

56 Mr Stephen Strachan, *Committee Hansard*, 13 December 2011, p. 14.

57 Mr Dean Rochfort, *Committee Hansard*, 8 March 2012, p. 8.

58 Treasury, *Submission 18*, p. 6.

59 Treasury, *Submission 18*, p. 6.

While generally increased use of private label brands is likely to put downward pressure on prices, which benefits consumers, there may also be other effects such as a crowding out of shelf space which impacts on producers of branded products. As the ACCC Grocery Report highlighted, concerns have been raised that the growth of private label products is lessening consumer choice by narrowing the range of branded products available.⁶⁰

3.52 Treasury explained, however, that ultimately the market will decide as consumers make their choices.⁶¹

3.53 As acknowledged by Treasury, the ability of retailers to sell private label products may crowd out branded items. Food South Australia Inc. expressed concern about the ability of the supermarkets, through their private labels, to act in both the capacity of a supplier and retailer, arguing that private labels 'just permeate the shelf and the consumers do not have the choice they used to have':⁶²

Consumers do want choice, and the permeation of home brand damages the opportunity for food manufacturers to build brands and brand loyalty. There is something inherently wrong with a customer being a competitor. Retailers can capitalise on the leading brands' innovation without the risk and expense of developing the intellectual property.⁶³

3.54 The AMWU explained to the committee how private label products dampen competition:

Essentially, the supermarkets have taken a decision to reduce the number of products on the shelves ... and gone out to the food manufacturers and said, 'We're going to have our label and one other. You may be the one other. If you do exactly what we want you to do, you will be the preferred supplier for as long as we feel free to have you there.' Those negotiations generally require the person who is going to be the 'one other' to produce the private label product. Manufacturers are saying to us that they are damned if they do and damned if they do not. If they refuse a Coles or Woolworths private label, which is in direct competition with their own product, they find theirs taken off the shelves and there are all sorts of accidents and blockages to selling their product.⁶⁴

3.55 The AMWU also expressed concerns about the ability of the major supermarkets to act as both a customer and competitor, arguing that they are

60 Treasury, *Submission 18*, p. 6.

61 Treasury, *Submission 18*, p. 6.

62 Ms Catherine Barnett, Chief Executive Officer, Food South Australia Inc., *Committee Hansard*, 10 February 2012, p. 19.

63 Ms Catherine Barnett, Food South Australia Inc., *Committee Hansard*, 10 February 2012, p. 17.

64 Ms Jennifer Dowell, Australian Manufacturing Workers Union, *Committee Hansard*, 10 February 2012, p. 5.

increasingly sourcing the private label products from lower-cost overseas processors.⁶⁵

3.56 The committee raised these matters with both Coles and Woolworths.

3.57 When discussing their private label products, Coles were categorical in refuting that they have specific strategies to increase their private brands at the expense of branded goods. Coles explained to the committee:

At no stage have we adopted a target around the proportion of private label sales. Indeed, branded products continue to represent 75 per cent of overall sales in our supermarkets. Our strong view is that customers will ultimately decide what level of private label products they will buy, based on the quality and the value of the product offering. There is another document that shows how we make our decisions on shelf ranging. These are pictorial documents and they show that actually we make decisions on products on shelves based on sophisticated customer preference modelling and volume of sales. There is no strategy to replace branded products with private label.⁶⁶

3.58 Woolworths view private label products as providing consumers with choice:

In developing our own brand lines our aim is to increase choice and value for our customers. [This] was recognised by the Australian Competition and Consumer Commission, who found in their 2008 Grocery inquiry that the introduction of private label products offers consumers additional choice and in precompetitive. ...Our customer research tells us loud and clear consumers love the value and quality offered by own brands.⁶⁷

3.59 In fact, research shows that the trend towards private label products is occurring internationally as shoppers seek out savings in their household budgets. In the United States for example, research has shown that the number of people feeling 'self-conscious' or 'embarrassed' when purchasing private brand products is declining as private label goods are increasingly viewed as the 'normal' choice when shopping 'rather than a solely budget-conscious option':

Of the surveyed shoppers, 51% reported feeling savvy when purchasing private brand products. Only 11% claimed to feel self-conscious, and 3% embarrassed, at being seen buying private brand products.⁶⁸

65 Ms Jennifer Dowell, Australian Manufacturing Workers Union, *Committee Hansard*, 10 February 2012, pp. 1–2.

66 John Durkan, Coles Group, *Committee Hansard*, 15 May 2012, p. 2.

67 Woolworths Limited, *Submission 70*, p. 11.

68 Brown, A., 4 June 2012, Private brands favoured in the U.S., AFN Thought for Food, http://www.ausfoodnews.com.au/2012/06/04/private-brands-favoured-in-the-u-s.html?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+AustralianFoodNews+%28Australian+Food+News%29 (accessed 25 June 2012).

3.60 Although some submitters view the growth in private label as a threat to their ongoing viability, this view is not shared by the retailers who informed the committee of their preference to source their private label products locally in recognition that customers 'place a purchasing preference on Australian grown and made products.'⁶⁹

3.61 Coles explained their 'Australian first' sourcing policy and detailed the recent expansion opportunities it had given producers through long-term supply contracts:

The best example in recent times was a decision to award Bega Cheese a five-year contract to produce Coles brand cheese, which was formerly sourced from New Zealand. The Bega Cheese contract means Australian dairy farmers will be supplying an additional 70 million litres of milk for Coles every year. Other recent Coles brand announcements that will help Australian farmers and food producers include an extension of our 100 per cent Australian grown frozen veg range, the majority of which is grown in Tasmania and processed by Simplot in Devonport ...The range is worth nearly \$40 million a year to Tasmanian vegetable growers and supports hundreds of jobs

On the weekend we also announced an exclusive five-year agreement with a leading Tasmanian business, Tamar Valley Dairy, to produce Coles brand yoghurt for our supermarkets nationally.... The expansion of yoghurt production will increase demand for Tasmanian milk, which will help to underpin the growth of this key farming sector.⁷⁰

3.62 Woolworths similarly explained their 'strong bias of support for Australian supply of our own brand ranges':

Woolworths invests heavily in cooperating with suppliers on new product development... This has seen considerable investment by us in small- and medium-sized manufacturing all around Australia. Good evidence of this sort of approach is our Macro range [which] ... is now made up of some 350 products, almost 90 per cent of which are sourced from Australian suppliers.⁷¹

3.63 Mr Dunn explained that buying locally is preferred but identified availability has forced Woolworths to source some products for their private label brands, particularly frozen vegetables, internationally:

We would absolutely look to buy first in the local market, if we possibly can. Apart from anything else, it is much easier to do business that way than to necessarily contract for supply and ship it from overseas. The other issue is in terms of availability of local produce at any price. We note the

69 Mr John Durkan, Merchandise Director, Coles Group Limited, *Committee Hansard*, 15 May 2012, p. 2.

70 Mr John Durkan, Merchandise Director, Coles Group Ltd, *Committee Hansard*, 15 May 2012, p. 2.

71 Mr Ian Dunn, Head of Trade Relations, Woolworths Ltd, *Committee Hansard*, 15 May 2012, p. 22.

sourcing arrangements for frozen vegetables. We would like to be able to obtain the same level of supply and we cannot. At the moment Woolworths, in terms of frozen vegetables, have a very limited amount of Australian product. The business is split almost equally between New Zealand and other countries around the world.⁷²

3.64 Woolworths is hopeful, however, that this will change and that their goal is to source 30 per cent of frozen vegetables locally:

We expect to increase that proportion substantially over the next 18 months. The projection at this stage is to have some 30 per cent of frozen vegetables sourced locally, about 60 per cent from New Zealand and only 10 per cent from other parts of the world. But that is dependent on being able to obtain supply.⁷³

Committee view

3.65 The committee considers that while the growth in private label products represents a threat to Australian food processors, it also has the potential to provide opportunity for processors.

3.66 The sale of private label goods plays a role in consumers being provided with choice, and as trends indicate that growth in private label consumption is likely to continue, food processors should seek to take advantage of the declarations of both Woolworths and Coles to preference sourcing the food products for their private label goods locally.

3.67 The committee does note with concern the suggestion that growth in private labels will occur at the expense of investment in research and development and product innovation. The committee takes the view that retailers must recognise the value and importance of such investment and continue to encourage local suppliers who are investing in research and development led innovation. The committee is concerned by the suggestion that the large retailers are able to take advantage of other companies' product research and development. It would be uneasy if the growth of private label products occurred at the expense of a vibrant forward-looking local food processing sector.

3.68 While the growth in supermarket private label products is a phenomenon that is not unique to Australia and does present opportunities to the sector, the committee suggests that the CCA is not effectively addressing the negative consequences of the growth or considering the long-term interests of consumers. The committee acknowledges the need for the CCA to protect and promote the interests of consumers and ensure food remains affordable. However, it is concerned that soon the 'pendulum'

72 Mr Ian Dunn, Head of Trade Relations, Woolworths Ltd, *Committee Hansard*, 15 May 2012, p. 24.

73 Mr Ian Dunn, Head of Trade Relations, Woolworths Ltd, *Committee Hansard*, 15 May 2012, p. 24.

might swing so far in favour of the short-term interests of consumers that research and development, innovation and diversity will be lost in the market place and consumers begin to lack choice and may face increased prices.

3.69 The committee expresses concern that through private label investment, the major supermarkets are increasing their ownership across the supply chain, reducing the number and diversity of food suppliers and processors in Australia. It notes the following comment of the AMWU:

The common argument that the current domestic market situation is all about competition and if you are unable to successfully compete in the competitive domestic market it must be because your company is not as efficient or competitive is disingenuous.

Coles and Woolworths are not generally thought of in terms of being food processors, but through their use of their private brands they are in effect, if not in name, major processors.

They do not own a single factory or employ a single person; they produce their private labels through the use of contractors. Essentially they are no different from any other manufacturer. Other manufacturers might use third party contractors to supply them with products from time to time, but in so doing it does not mean that they are any less of a manufacturer or processor.⁷⁴

Relationships in the supply chain and bargaining power

3.70 The nature of Australia's retail sector was examined by the ACCC in its 2008 grocery prices report.⁷⁵ In its submission to the inquiry, Treasury drew the committee's attention to the ACCC's analysis of the food supply chain in Australia and the Commission's observation that the chain, from production to retail, differs for different categories of food:

...food and grocery processors engage with supermarket chains to achieve broad distribution of their products through supermarkets by increasing their product range or establishing direct supply contracts with market entrants such as ALDI... competition between brands for limited shelf space helps to constrain prices at which suppliers can sell their products.⁷⁶

3.71 Given the nature of the food supply chain in Australia, the relationships between market participants are therefore very important. In its submission, Treasury identified a number of factors that 'impact on the relationships between food manufacturers and retailers':

74 Australian Manufacturing Workers' Union, *Submission 21*, p. 3.

75 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 209.

76 Department of the Treasury, *Submission 18*, p. 5.

- shelf space allocations are an important point of negotiation between retailers and manufacturers and wholesalers;
- in some instances, food retailers are also seeking to import branded products through lower cost international supply channels (so-called 'parallel importation');
- increased market penetration of retailers' 'private label' products; and
- the entrance of new players in the retail grocery sector (particularly multinational retailers such as ALDI and Costco).⁷⁷

Terms of Trade

3.72 The committee has received evidence that suggests the relationships between participants in the food supply chain are characterised by an imbalance in bargaining power. The WFA explained how control over 70 per cent of the market gives Coles and Woolworths 'quite a degree of influence over the practices and activities of our members in terms of their sales through those channels' and that Coles and Woolworths are able to use that power 'in such a way that it takes any of the negotiation out of the hands of our members'.⁷⁸

3.73 Food processors spoke of the way trading terms were being used by the major retailers in their contract negotiations with food processors.

3.74 Mr Stephen Strachan, Chief Executive of the WFA, gave anecdotal evidence of what can happen to his members in their negotiations with Coles and Woolworths:

The situation that our members will talk about to me but not publicly is that, in negotiations with the retailers, it is pretty much a spreadsheet based approach towards pricing that demonstrates that they have been able to benchmark lowest-cost production across a whole range of producers. They have, obviously, access to all of that information. In doing so, where any producer does not meet best practice then the attitude and the position of those retailers is, 'Well, that comes off your margin; it's not our problem.' So, in a market forces sense, it makes a degree of sense, but in a practical sense it has major implications because there are practical reasons why some can benchmark at lower levels than others, such as proximity or any other number of factors. They are using that very much to their advantage in terms of driving down cost...

And then of course we have the situation, being in an oversupplied market, where there are any number of producers lining up to sell to them because they have distressed product that they need to sell into the marketplace. We know that the oversupply will not last forever, but our big fear is that, once they entrench their own brands in the marketplace—at the same time devaluing the existing brands or those brands that have been in the marketplace and turning it into a homogenous price based product—then

77 Department of the Treasury, *Submission 18*, p. 5.

78 Mr Stephen Strachan, *Committee Hansard*, 13 December 2011, p. 12

they will have a foothold in that we will not be able to back away from that.⁷⁹

3.75 Although both Coles and Woolworths advised the committee that where suppliers express discontent in negotiations the relationship between the retailer and the supplier is not affected, submitters suggest in fact that such occurrences result in delisting of products without consultation and at a cost to the supplier.⁸⁰ Such experiences are said to have led to the current situation where processors are reluctant to speak publicly due to a fear of retribution.

3.76 When concerns about pressure to accept trading terms including additional fees, were raised with the retailers, Woolworths explained that negotiations although tough, were fair:

I would say that we are tough negotiators... We negotiate fairly in the marketplace on behalf of our customers. If we agree to an increase or a change in trading terms with a supplier, it will be because they see a benefit in doing so.⁸¹

3.77 Woolworths went on to explain that 'rise and fall' clauses are not unilaterally altered if the retailer matches a competitor's promotion:

We would not see that circumstance as part of trading terms—that is, day-to-day product and price negotiation. We would undertake that negotiation with the vendor not in arrears but ahead of any development in the marketplace. We would not unilaterally take money in any way, shape or form. But we would not see that as something we would describe as trading terms; we would see that as normal day-to-day price negotiation. Trading terms is a framework that we set out under which the two parties agree to do business. ...There is a long-term agreement to do business between two parties and then that business is done on a daily transactional basis.⁸²

3.78 Woolworths explained that:

We have those [rise and fall clauses] and they typically apply to circumstances such as fresh milk supply and things that go over a period of time when there may be changes to market conditions. On packaged goods and normal package buying, it really is a matter of a price that is accepted for a period of time until such time as another price is negotiated with the supplier.⁸³

79 Mr Stephen Strachan, *Committee Hansard*, 13 December 2011, p. 13.

80 *Confidential submission*.

81 Mr Ian Dunn, Woolworths Ltd, *Committee Hansard*, 15 May 2012, p. 28.

82 Mr Ian Dunn, Woolworths Ltd, *Committee Hansard*, 15 May 2012, p. 29.

83 Mr Ian Dunn, Woolworths Ltd, *Committee Hansard*, 15 May 2012, p. 29.

3.79 Mr Dunn told the committee that in those cases where a competitor announces a price promotion and Woolworths matches the price in the market, they will ask a supplier if they can contribute to the discount but they do not alter trading terms:

That would generally involve a telephone call and a discussion with the supplier to say: 'I am now selling at a lower margin in the marketplace on this particular product. Are you in a position to help me? I can do this, this and this if you are able to do that, that and that.' If it happens, that is fine; if it does not happen, we match the price anyway and we trade as we are.⁸⁴

3.80 In responding to the committee's concerns about trading terms, Coles explained that its trading terms are complex and involve a variety of terms, 'probably well over 100'. When asked about their top five trading terms, Mr Durkan said:

In as many instances as you could have we would prefer to have net cost prices, so no trading terms at all apply to our cost prices. If I take most of our fresh areas, they are net prices. Where we get into complex terms tends to be in our groceries and more on our branded side than on our private label side. Those terms are so varied and there would be no commonality around them, and in many cases designed by the food manufacturers rather than—

3.81 Mr Durkan said that the shape of their trading terms are decided by the food manufacturers and explained that:

...Our trading terms are built over many, many, many years. These are not trading terms that have just evolved in the last two, three, four, five years. If we could, Coles would have net trading terms. We would have a net price and we would be done with it. There are variable elements, depending on how much marketing spend the manufacturers wish to make in a year.⁸⁵

3.82 When asked to explain their trading terms 'in one sentence', Coles stated:

There are a range of terms; when a supplier wants to promote products, they have terms around promotions.⁸⁶

3.83 Coles explained that suppliers of fresh food such as bananas would not be charged a marketing expense, ullage expense, or freight expense as fresh food items are 'net trading terms', whereas trading terms on branded products may require a supplier to invest a promotional percentage with Coles.⁸⁷

3.84 Despite Coles' and Woolworths' assurances that their negotiation processes are fair, the committee heard repeatedly throughout its inquiry that food manufacturers were reluctant to speak publicly about specific instances of abuse of market power by

84 Mr Ian Dunn, Woolworths Ltd, *Committee Hansard*, 15 May 2012, p. 29.

85 Mr John Durkan, Coles Group Ltd, *Committee Hansard*, 15 May 2012, p. 7.

86 Mr John Durkan, Coles Group Ltd, *Committee Hansard*, 15 May 2012, p. 7.

87 Mr John Durkan, Coles Group Ltd, *Committee Hansard*, 15 May 2012, p. 7.

the major supermarkets. The committee encountered a genuine reluctance for witnesses to come forward and give evidence on these matters, even on a confidential basis. For example, Food South Australia Inc. referred to a 'fear of retribution' and characterised the situation of 'very lopsided contract processes' as being 'somewhat David and Goliath'.⁸⁸

3.85 Ms Barnett from Food South Australia cited the experience of a food supplier going into decline as a result of dealings with a major supermarket:

[A] supplier three years ago supplied 14 products across Australia to one of the major supermarkets, to anywhere between 450 and 700 stores. Today they have no national distribution. This is largely because of new agreements proposed around waste and mark-down that were in addition to the trading terms that existed. They have now been replaced by imported product.⁸⁹

3.86 She gave other examples of suppliers' negotiations with the grocery retailers, illustrating the difficulties arising from contract arrangements on prices:

Example two is where the input costs of a business have increased to 40 per cent higher than they were three years ago. After 12 months of negotiation a price increase was granted. This has impacted its ability to manage price rises with other retailers and margin that it has never been able to recoup. The trend has been to apply additional trading terms which in turn provide more margin to the retailer but not to the supplier.

Example three is, again, of increased input costs year on year and an inability to increase prices. Other retail businesses want the same prices as the majors, and the result has been losing margin to retain and grow the business while absorbing increased costs. [Because] the lines are being decreased[new products] are no longer being taken up. A reduction of listings and promotional expectations, despite co-op funds in the trading terms, is leading to an unsustainable business.

My fourth example is where the costs of fuel, freight, gas, labour, raw materials, packaging, trading terms and utilities have all increased. ...Nearly 50 branded products were on the shelves five years ago nationally, and they are now down to approximately 15. Own-brand competition is priced, obviously, at a medium to low level—and they are generally imported. There is less choice of branded product for consumers, and there is a lack of negotiation with suppliers regarding changing terms. My last example is of an over 20 per cent decrease in recommended retail price over the last five years. There has been an increase in promotional spend expectation of nearly 50 per cent.⁹⁰

88 Ms Catherine Barnett, Food South Australia Inc., *Committee Hansard*, 10 February 2012, p. 18.

89 Ms Catherine Barnett, Food South Australia Inc., *Committee Hansard*, 10 February 2012, p. 17.

90 Ms Catherine Barnett, Food South Australia Inc., *Committee Hansard*, 10 February 2012, p. 18.

3.87 Mr Roger Lenne of Fruit Growers Victoria Ltd detailed the reluctance of the organisation to deal directly with the supermarkets despite being a collective:

...I have not personally approached them. ...Individuals like us would not even get through the door...I have had it said to me before, ..., 'We'll buy our food from overseas; from other countries.' I hope that they do not believe it.⁹¹

3.88 Mr John Wilson of Fruit Growers Victoria Ltd suggested that 'the majors have an aversion to talking to industry associations' as it costs money and by dealing with a 'preferred supplier chain they can play one off against the other'.⁹² Mr Wilson further explained the difficulty of negotiating as a collective:

They will resist and go straight to the Trade Practices Act, which says that it is anticompetitive to deal only with collectives. We make approaches to and work with major packers on the fresh fruit side to try and maintain some sense in the marketplace. But it is very difficult, because all you need is one player who, under financial pressure, succumbs and then you will have a cave-in effect. That has happened recently with the Coles campaign for cheaper permanent prices for produce.⁹³

3.89 Professor David Hughes explained that some firms will have the ability to push back but that that is dependent on size and 'countervailing power'.⁹⁴

3.90 Again, when these concerns were raised with both Coles and Woolworths, they detailed that there was no possibility that such behaviour should be occurring and emphasised to the committee the value they place on developing their relationships within the supply chain.⁹⁵

Committee view

3.91 The committee is concerned by the evidence that it received throughout the duration of its inquiry, particularly the conflicting evidence from processors and retailers concerning the negotiation process. The committee recognises the need to find an effective means of investigating and resolving the types of allegations made to the inquiry. Importantly, the committee notes the current process being undertaken by the ACCC to look more closely at market structures in the supermarket sector and appeals to suppliers to approach the ACCC with their evidence.

91 Mr Roger Lenne, Fruit Growers Victoria Ltd, *Committee Hansard*, 8 February 2012, pp. 6–7.

92 Mr John Wilson, Fruit Growers Victoria Ltd, *Committee Hansard*, 8 March 2012, pp. 6–7.

93 Mr John Wilson, Fruit Growers Victoria Ltd, *Committee Hansard*, 8 March 2012, pp. 6–7.

94 Professor David Hughes, *Committee Hansard*, 15 May 2012, p. 73.

95 Refer to answers to questions on notice 31–34 received from Coles on 1 June 2012. Refer to Woolworths Limited, *Submission 70*, pp. 6–8.

Unconscionable conduct and misuse of market power

3.92 Treasury explained to section 46 of the CCA, relating to the misuse of market power, in the following terms:

There are three elements that must be proven in order to establish a breach of the misuse of market power prohibition in subsection 46(1), that:

- the respondent has a substantial degree of power in a market (which has essentially been interpreted as a freedom from competitive constraint);
- the respondent took advantage of that power (acted in a manner that it would not have acted were it subject to competitive pressures); and
- the conduct had the purpose of:
 - eliminating or substantially damaging a competitor;
 - preventing entry to a market; or
 - preventing or deterring a person from engaging in competitive conduct in that or any other market.⁹⁶

3.93 The ACCC noted the unconscionable conduct provisions in the CCA, which prohibit a corporation from engaging in conduct that is 'in all the circumstances' 'unconscionable':

Amendments taking effect from 1 January 2012 unified sections 21 and 22 of the Australian Consumer Law (formerly sections 51AB and 51AC of the *Trade Practices Act 1974*) into a new consolidated section of the Australian Consumer Law and inserted a list of interpretative principles. In relation to the former section 51AC the ACCC has in recent years had a number of successful cases before the courts.⁹⁷

3.94 The ACCC further explained that the amendments will assist its ability to investigate 'systemic or widespread unconscionable conduct concerns', but that as the amendments are 'relatively recent it may take some time for concerns to arise and matters to then be brought before the courts'.⁹⁸

3.95 Not all submitters to the inquiry shared Treasury's view that concentration does not 'necessarily indicate that incumbent firms have market power.'⁹⁹ In fact, Ms Kate Carnell, Chief Executive of the AFGC, went as far as to suggest that:

96 Treasury, *Submission 18*, p. 8.

97 Australian Competition and Consumer Commission, answer to question on notice 2f – 15 May 2012, received 22 May 2012.

98 Australian Competition and Consumer Commission, answer to question on notice 2f – 15 May 2012, received 22 May 2012.

99 Treasury, *Submission 18*, p. 5.

...there is market failure in this space at the moment. One of the things about market failure is that, where you have such an imbalance in power, the people with no power are not game to say anything. ... At the moment, with the ACCC legislation, unconscionable conduct is almost impossible to prove unless you can prove they actually set out to send you broke. Coles and Woolies are [not] setting out to send our members broke, [so] it is almost impossible for our members to win.¹⁰⁰

3.96 She also emphasised the need for action:

...In five years' time,, we will be talking about when we used to have a food manufacturing industry in Australia and how unfortunate it was that it closed. ...We have got a good example of what happens if you take your eye off the ball.¹⁰¹

3.97 When asked if it is inevitable that once a certain level of concentration among a few players is reached, it leads to behaviour that would be seen as unfair, or a misuse of market power, Professor Hughes stated:

I do not think there is a point when you suddenly tip into that position... this is not academic or scientific... as companies, whether they be suppliers or retailers, gain more market power then often as not that becomes associated with arrogance—the arrogance of market power—and there is likely a predilection for abuses. ...My view is that, wherever you have intense retail concentration, you will have abuses. Large scale retailers consist of individuals, buyers and if you give individuals a lot of market power on occasions they will abuse that power. That is exactly why there should be regulations.¹⁰²

3.98 Professor Hughes remarked that the question of what is an acceptable level of retail concentration is a 'constant topic of conversation' at the political level.¹⁰³

3.99 The effect of vertical integration on horizontal competition was considered by the ACCC in its 2008 Grocery inquiry. The report stated:

The ACCC considers that competition and efficiency concerns are only likely if horizontal competition is weak at any of the vertical stages, resulting in sellers having market power at that stage.¹⁰⁴

3.100 The ACCC went on to explain that at that time, in 2008, it had:

...received little firm evidence of such a situation prevailing at any level below the retail level, but has not been able to investigate all market

100 Ms Kate Carnell, *Committee Hansard*, 13 December 2012, p. 28.

101 Ms Kate Carnell, *Committee Hansard*, 13 December 2012, p. 28.

102 Professor David Hughes, *Committee Hansard*, 15 May 2012, pp. 72–74.

103 Professor David Hughes, *Committee Hansard*, 15 May 2012, pp. 72–73.

104 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 225.

participants involved with the supply chains for the thousands of standard grocery products.¹⁰⁵

3.101 The committee notes the ACCC's findings, as set out in the 2008 report:

In assessing the efficiency of the supply chain, the ACCC has therefore examined the horizontal competition at the various functional levels as well as the vertical relationships between parties in different functional levels... the ACCC considers that concerns about potential impediments to the efficient supply of groceries to consumers are only likely to be realised if market power exists in any of the functional levels of the supply chain. Market power is more likely to exist where there are high barriers to entry, high levels of concentration and limited import competition. In the absence of market power, the ACCC is confident that the supply chain would deliver groceries to consumers in an efficient manner, which would result in greater choice and lower prices for consumers.¹⁰⁶

Is legislative change required?

3.102 The committee asked various industry participants what they would like to see done to address their concerns that the big retailers are engaging in anti-competitive practices in grocery retailing. Witnesses suggested that the CCA urgently needed reform.

3.103 The AMWU's view was that the current legislation needed to be toughened to address what it viewed as anti-competitive practices within the supermarket duopoly.¹⁰⁷ While acknowledging there was 'nothing illegal' about the creeping acquisitions which had given rise to Coles and Woolworths controlling around 80 per cent of the retail food and grocery market, the supermarkets' current practices were said to be 'systematically destroying the industry'.¹⁰⁸

3.104 Raising concern about how creeping acquisitions were affecting not just the food industry but other sectors, the AMWU commented:

...the duopoly is moving into other areas at a rapid pace, so the same effect that is occurring in the food industry will occur in those other industries that they are moving into—petrol, hotels, pharmaceuticals and all of those areas—unless there is some sort of consideration given to how you stop the

105 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 225.

106 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, 2008, p. 218.

107 Ms Jennifer Dowell, Australian Manufacturing Workers Union, *Committee Hansard*, 10 February 2012, p. 3.

108 Ms Jennifer Dowell, Australian Manufacturing Workers Union, *Committee Hansard*, 10 February 2012, p. 4.

process of creeping acquisitions ending up in the situation where you no longer have effective competition in a sector of industry.¹⁰⁹

3.105 The WFA also suggested that the government could look at the issue of creeping acquisitions:

Consolidation by Coles and Woolworths has occurred by creeping acquisitions. In the European Union, for example, two major retailers wanted to join forces and it was disallowed because it would have given them a market share of 60 per cent. If it was 10 per cent here and 10 per cent there it would have been over the 60 per cent. So it is just a matter of how those creeping acquisitions build to a larger one.¹¹⁰

3.106 The WFA also highlighted the CCA's heavy emphasis on the consumer and suggested that perhaps the 'pendulum' has shifted too far in favour of the consumer:

...the Competition and Consumer Act is very heavily dominated towards consumers, to ensure that consumers get the best deal—which we understand and respect. However, as I said earlier, there are big question marks over the nature of the product as it comes through and it does start to undermine some of the integrity that we have set up around the manufacture of our product and it does ultimately affect choice in terms of the product going through to consumers. I guess the other point to make is that there are industries that sit behind the value chain and they are suffering because of the domination of the major retailers.... We think that the balance has shifted. The pendulum has shifted way too much in favour of those consumer issues. That plays right into the hands of the major retailers and so the industry issues are not being considered adequately.¹¹¹

3.107 The Australian Dairy Industry Council (ADIC) similarly suggested that changes to the CCA were necessary and suggested that 'a definition of unconscionable conduct be inserted into the Act...an 'effects' test be reintroduced; and a statutory duty of good faith be enacted as part of the Act'.¹¹²

Committee view

3.108 The committee notes the recent amendments to consumer law that will enhance the ability of the ACCC to investigate claims of unconscionable conduct. However, the committee maintains that these provisions within the CCA, particularly the provisions relating to misuse of market power, should be given specific attention in a review of the CCA.

109 Ms Jennifer Dowell, Australian Manufacturing Workers Union, *Committee Hansard*, 10 February 2012, p. 4.

110 Mr Andrew Wilshire, *Committee Hansard*, 13 December 2011, p. 15.

111 Mr Stephen Strachan, *Committee Hansard*, 13 December 2011, pp. 14–15.

112 Mr Chris Griffin, Chairman, Australian Dairy Industry Council, *Committee Hansard*, 9 March 2012, p. 20.

3.109 The review of the CCA should consider the inclusion of the functions of a food supply chain ombudsman within the ongoing role of the ACCC.

Calls for a mandatory code of conduct

3.110 In addition to suggestions that the CCA be amended, the committee heard calls for a mandatory code of conduct to apply to grocery retailers.

3.111 The AFGC suggested the introduction of such a code, with oversight by a supermarket ombudsman:

AFGC considers a greater commitment to fair business practices and equitable risk and return along the supply chain would be enhanced by introducing a co-regulatory Supermarket Fair Trading Code of Conduct overseen by a Supermarket Ombudsman. The Code would provide guidance on acceptable approaches for negotiating trading terms and contracts. Applicable to retailers with greater than \$1b p.a. turnover it would limit the power of the supermarkets to extract unreasonable additional funds from suppliers beyond original contractual agreements. The Ombudsman would arbitrate disputes arising from trading practices not consistent with the Code of Conduct.¹¹³

3.112 Mr Chris Griffin, Chairman of the Australian Dairy Industry Council, supported the AFGC's calls for a mandatory code of conduct,¹¹⁴ as did Food South Australia Inc.:

I think transparency is really a key issue in all of this. You have your input costs going up and your retail prices or margins are sustained, but it is that middle manufacturing and processing area that is losing out. I think any code of conduct probably needs to be mandatory. I think voluntary codes of conduct do not appear to be working. For example in the olive oil industry ...[T]here has to be an efficient mechanism by which there is the transparency and that gives food manufacturers a fair go.¹¹⁵

3.113 When asked about the AFGC proposal for a mandatory code of conduct, Treasury responded:

As you would be aware, mandatory or voluntary codes can be prescribed in the CCA. Our experience—and we have some reasonably firsthand experience—is that it is generally better if the industry itself can come to some sort of arrangement rather than the government first proposing it and the parliament, if they agree, passing laws to have such prescribed codes. Some of the reasons why there is likely to be a greater net benefit in self-regulation are that the participants can tailor-make the codes to their own business conditions and practices. Self-regulation is likely to lead to lower

113 Australian Food and Grocery Council, *Submission 12*, pp. 4–5, pp. 12–14.

114 Mr Chris Griffin, Australian Dairy Industry Council, *Committee Hansard*, 9 March 2012, p. 20.

115 Ms Catherine Barnett, Food South Australia Inc., *Committee Hansard*, 10 February 2012, p. 19.

compliance costs on the businesses than if bureaucrats, the government and the parliament, in its greater wisdom, impose a set of conditions on them. It is likely to be more flexible. Another reason is that self-regulation does not impose costs on the public purse, essentially, which have obviously got to be funded by taxpayers eventually.¹¹⁶

Committee view

3.114 The committee notes the evidence it received from the Product and Grocery Industry Ombudsman (PGIO) and suggests that the effectiveness of the Code and the PGIO is somewhat limited. The committee took evidence that there is strong support from agribusiness, processing and manufacturing industries for a mandatory Supermarket Fair Trading Code of Conduct or similar, overseen by a Supermarket Ombudsman. In this context, it notes the following comments from the National Secretary of the AMWU:

In the short term we would certainly like to see the ACCC be given the powers to deal with the issues when they collect the evidence. People in the industry who are already reluctant to give evidence because of the impact it may have on their businesses will certainly not give evidence when they know that, even if they do, no constructive action can be taken arising from that evidence. So we would like to see some changes to that legislation in the short term to allow the ACCC to deal with those issues.

...There have been proposals for industry ombudsmen and a number of other suggestions. We are open to any of those suggestions which would allow for greater oversight of what goes on in the industry—the exposure of the practices that take place on a daily basis, which are threatening not only jobs and the manufacturing industry itself but also our ability as a nation to feed ourselves.¹¹⁷

3.115 The committee takes the view that the introduction of a mandatory code and an ombudsman, without first investigating why the existing ombudsman is not effective, would simply add cost and regulatory burden to the industry.

Concluding committee comments

3.116 Despite the challenges confronting the industry, the committee considers that there are opportunities for processors and suppliers. The committee agrees with the view of Professor Hughes that suppliers have a responsibility to know a lot more about consumers and their shoppers than they do at the moment and should develop more export expertise. The committee acknowledges that this is not always easy as it requires resources that may not be available to smaller companies. However, this investment may help balance out the power within the supply chain and provide diversity, giving food processors much needed countervailing power. The committee

116 Mr Bruce Paine, Treasury, *Committee Hansard*, 13 December 2011, p. 33.

117 Ms Jennifer Dowell, National Secretary, Australian Manufacturing Workers' Union, *Committee Hansard*, 10 February 2012, pp 3–6.

suggests that the ability of the food processing sector to keep in-step with the continually evolving market would also be aided by such investment.

3.117 The ACCC advised the committee that the behaviour of the supermarkets is currently an area of interest to it, although it is still in the process of forming a view in relation to issues that have been raised and the relevant legislative provisions:

Since our last appearance our chairman, Rod Sims, has publicly commented on our interest in matters concerning supermarkets in particular, and that is reflected in the new compliance and enforcement policy that was published earlier this year where we set out a number of priorities for the ACCC over the next period. They included considering competition and consumer issues in highly concentrated sectors. We particularly named supermarkets as being an area of interest.

We have sought in various forums people to come forward, particularly suppliers, even on a confidential or anonymous basis, to assist us to get a better feel for the issues out there. I am happy to note that we have had a number of approaches in light of those calls. That is greatly assisting the ACCC to get on top of the issues that we have seen in the marketplace and that we have commented on publicly. We are turning our minds to those issues to see, first of all, whether they can be considered under the provisions of the Competition and Consumer Act. Even more generally, we are just forming a view in relation to the provisions.¹¹⁸

3.118 The committee welcomes this recent development and eagerly awaits the ACCC's announcements concerning its activities. In light of the ACCC's announcement, the committee considers that the time for processors to present their concerns to the ACCC is now. The committee accordingly urges food processors to approach the ACCC and provide evidence of the concerns they have raised with the committee to the ACCC so that the anecdotal evidence that has been provided to the committee can be investigated.

3.119 The committee notes that the Senate Economics References Committee's report on *The impacts of supermarket price decisions on the dairy industry*, recommended that the government initiate an independent review of the competition provisions of the *Competition and Consumer Act 2010*. The government, however, declined to initiate a review until the law is further tested by the ACCC in the courts. While the committee supports further action by the ACCC, it considers that the experiences of the food processing sector since the release of the Dawson Report in 2003 make the case for a review even stronger.

118 Mr Scott Gregson, Group General Manager, Enforcement Operations Group, Australian Competition and Consumer Commission, *Committee Hansard*, 15 May 2012, p. 63.

Recommendation 4

3.120 The committee recommends that the government initiate an independent review of the competition provisions of the *Competition and Consumer Act 2010*. The committee recommends that the review should include consideration of:

- the misuse of market power;
- creeping acquisitions;
- predatory pricing; and
- unconscionable conduct.

Recommendation 5

3.121 The committee recommends that the review of the CCA consider the inclusion of the functions of a food supply chain ombudsman within the ongoing role of the ACCC.

3.122 The committee notes that over recent years, supermarkets have published and expected suppliers to comply with corporate and social responsibility standards. It is appropriate that supermarkets also comply with standards as they relate to the treatment and satisfaction of those who supply them with their products. The committee recommends that the major supermarkets in Australia voluntarily compile and establish benchmarks within their corporate social responsibility documents to measure the level of satisfaction of their suppliers in dealing with the supermarkets. This framework needs to be supported by the use of external agencies to conduct regular supplier satisfaction surveys, the results of which should be publicised by the supermarkets in their regular reporting cycles. The committee believes that such a system would not only highlight the importance of the supermarkets' treatment of their suppliers; it would also encourage the supermarkets to value and respect their relationship with suppliers and to respond constructively to their suppliers' feedback.

Recommendation 6

3.123 The committee recommends that the major supermarkets in Australia voluntarily compile and establish benchmarks within their corporate social responsibility documents to measure the level of satisfaction of their suppliers in dealing with the supermarkets. External agencies should be engaged to conduct regular supplier satisfaction surveys, the results of which should be publicised by the supermarkets in their regular reporting cycles.