

Public Submission to ACCC Grocery Inquiry II

By Dee Margetts 10 March 2008

Introduction

As I mentioned in my preliminary submission, I am currently undertaking research for a PhD on the impacts of National Competition Policy (NCP). The first case study for my PhD was on the impacts of NCP on the dairy industry and I am currently researching the impacts of NCP on Australia's retail sector, so the following submission contains elements of both.

In the recent past, evaluation of changes to Australia's retail sector have tended to be based on short-term expectations with little consideration of the medium to long term impacts of corporate domination on consumer choice or on the impacts on Australia's supply and manufacturing sectors, and by association, Australia's economic future including our balance of trade. It is hoped that the ACCC will recognise the need to look at down-the-line impacts of market policy changes.

A. Structure of the grocery industry

Q 1. What have been the major causes of rising food prices in Australia (e.g. drought, transport costs etc)? In particular, what have been the major causes of the rising prices of products such as milk, cheese, fruit and vegetables?

I attached my two recent publications on the impacts of National Competition Policy on the Australian dairy industry. Since their publication (both in December 2007), as well as many dairy producers, I have received feedback from representatives from a range of other primary sectors in Australia including fruit and vegetable growers and pork and beef producers who have indicated to me that there are considerable parallels within their own sectors in relation to the unfair pricing treatment from the major supermarket chains.

The impacts on the dairy industry of farmgate prices disconnected to retail pricing, which fail to cover the cost of production are not confined to immediate consumer outcomes, but appear to be leading to a growing loss of dairy producers and a looming potential shortage of fresh milk in a number of dairy regions, such as Western Australia.

Q 10 What have been the major changes to the structure of grocery retailing in Australia over the past 5 to 10 years? and

Q 11 What factors have driven these changes?

As I mentioned in my first submission, "5 to 10 years" will not give an adequate explanation to the recent major structural changes in Australia's retail industry as the major policy changes which weakened the *Trade Practices Act* by removing the price discrimination provisions and which began the process of pressing the states to further deregulate the retail sector, especially in relation to trading hours, were implemented in the mid 1990s – 13 years ago and to get a reasonable picture of what the impacts of changes have been which began in the mid 1990s, you need to take your data back at

least another 5 years, so you should be inquiring about structural changes over the last 15 to 20 years.

The removal of S49 of the *Trade Practices Act*¹, coinciding with the introduction of a range of other changes which strengthened the market power of the major retail chains at the expense of both their competitors and their suppliers, clearly provided the major supermarket chains with the incentive to use those powers to increase their market share. But where it might normally be expected that introducing policy which increased the market power of corporations would require stronger regulatory checks and balances to prevent market power abuse of both competitors and suppliers, in Australia, the opposite happened, those powers were weakened.

National Competition Policy not only saw the removal of important aspects of the *Trade Practices Act* but set in place a process by which each of the states and territories were put under considerable pressure to reduce or remove regulatory arrangements in a much wider range of areas including trading hours and liquor retailing as well as statutory marketing arrangements for a range of primary products including dairy, meat, eggs, grains and seafood.

My research into the impacts of National Competition Policy on the Australian dairy industry² illustrates that this type of deregulatory action provided opportunities for corporate supermarket chains to take greater control of those sectors, and, in the case of dairy, has left Australia with considerably less ownership and control the dairy processing and manufacturing sector and may, in the future leave many consumers without fresh milk if too many producers walk away from the industry.

Other issues such as the changes to retail trading hours regulations occurred at different times in different states. For instance, Saturday afternoon trading was introduced in NSW in the mid 1980s, and the main beneficiary from that appeared to be discounter Franklins as Australia's recession saw more consumers seeking out discount groceries, Franklins' market share rising from 17.5% in 1982 to a maximum of around 29% in 1989 and that was mainly at the expense of smaller, independent grocers.³

After the recession, the combination of regulatory changes which allowed Sunday trading by application in the early 1990s in NSW, in addition to the sideways expansion of the product ranges of the Coles and Woolworths Supermarket chains into fresh produce and ready-to-eat meals then began to sharply increase their packaged grocery market shares this time largely at the expense of Franklins whose steadily reducing market shares and profitability saw its owners exit the market by 2002.

At a national level, structural changes impacting on or by market shares included major reductions in stock keeping units (SKUs), for instance, at the point in the mid 1980s when Woolworths national market share had increased by 9%, it began to implement a policy of brand reductions, that is, removing slower moving brands in order to find the space to include certain high demand items which would normally be

¹ See Margetts 2007 p 20

² Margetts (2007a), Margetts (2007b)

³ Market share data quoted from Retail World Magazine, 1978- 2004.

supplied by smaller, independent retailers. The smaller, independent specialist retailers which were likely to have been affected by this sideways expansion of range (whilst consumer brand choice in packaged groceries was diminishing) include newsagents, bakeries, butchers, delicatessens, health food shops, florists and chemists.

The above examples are part of the reasons I have suggested that this inquiry should include a widespread survey absolutely protected by confidentiality of both small business competitors and suppliers of the major sector so that the impacts of major policy changes at both the Government and corporate level can be better assessed.

In broad summary, the structure of the Australian grocery industry has changed considerably since the mid 1970s, when Australia's independent grocery sector held over 60% of Australia's packaged market share to the present, where it is estimated that the independent grocery sector holds only around 20% of the packaged grocery market share.⁴ Not surprisingly, the major supermarket chains in recent years have generally prevented data on market share from being published. There was considerable concern expressed during the 1999 Parliamentary Grocery Inquiry into creeping acquisitions and that has no doubt been a major factor behind the growth in market share of Coles and Woolworths, giving them almost unmatched market domination on a global comparison.

The impact of such market domination has not just been on price, but potentially on consumer choice as well as serious impacts on Australia's grocery manufacturing and supply sector. This, of course, has important implications for Australia's balance of trade as more and more of our processed food and other packaged groceries are imported, especially as brand reduction strategies have been generally accompanied by a push for private and generic labels, more and more of which are sourced from overseas.

It should also be noted that from the mid 1990s to 2002, Woolworths had ownership and control of Australian Independent Wholesalers, which supplied part of the independent grocery sector.

Once Franklins' market share was severely diminished and Aldi announced their intention to commence operations in Australia, the two major corporate supermarket chains would have been very aware that, as a competitor, Aldi would offer much lower prices but would not be a range rival due to its much smaller number of SKUs (500 to 600), and so the 2 major chains began the process of introducing more smaller format stores such as Woolworths Metros and Coles Express. Retail World Magazine accurately predicted at that time that the two major chains' strategies were likely to include emphasising value-added components of their ready-to-eat products, bigger (sideways) ranges, extended trading hours as well as more departments and services such as banking and petrol.⁵ Ironically, this kind of range expansion involved further reducing brand numbers in the traditional grocery lines and spreading further sideways into high turnover products that would normally be offered by pharmacies, health food shops etc

⁴ Data sources – Retail World Magazine 1978 - 2002

⁵ Retail World AGIMG 2000 p 6

This has an impact not only on supermarket shoppers, but on the way surviving specialty retailers such as butchers, bakeries, pharmacies and health food shops etc now had to organise their own businesses especially their ranges and trading hours. This is one good reason why, as part of this inquiry, the ACCC should include a detailed consumer survey into the impacts of brand reduction strategies on real choice and competition.

Q 13 How important are economies of scale in grocery wholesaling?

The sharing of wholesale suppliers amongst independent grocers has certainly appeared to reduce grocery costs to retailers. Choice Magazine's recent surveys would indicate that IGA's prices over a selected basket of goods is now only around 10% higher on average than Coles and Woolworths average prices.

One important issue which should be considered, however, is the potential for large supermarket chains to require their suppliers to increase their volume supply to them to the point where suppliers need to invest in substantial new infrastructure, then, like Japan or China's commodity trading strategies on an international scale, make those suppliers more vulnerable in subsequent years by threatening to reduce or cancel their supply contract if those suppliers don't agree to reduce their prices or provide their products in precisely the manner to suit supermarket profit maximising, high turnover strategies.

Q 14 What are the most appropriate ways of measuring the shares of grocery wholesalers? Should industry or market shares be measured across all grocery items or for particular product categories (.....) How have these shares changed over the past 5 to 10 years?

Most people will be aware that grocery price surveys, where possible, tend to try to compare particular brands, sizes or items, as far as possible (with the exception of staples such as milk, bread etc where the lowest priced items of a particular volume may be appropriate). But it is more difficult to make direct comparisons of fresh food (meat, vegetables and other fresh foods etc), when there is so much variation in size, quality and source. However, it would be useful if the market shares of packaged groceries could once again be made public and, in separate calculations, the market shares of particular types of fresh produce, if that was possible, along with store numbers of those retailers in particular sectors. It would also be a very useful measure of the health and vitality of Australia's retail sector if the Australian Bureau of Statistics produced and published more frequent surveys of store numbers in their categories. Once again, the request for market share information over the last 5 to 10 years is unlikely to tell the full story – it should be over the last 15 to 20 years and, as most people will know, market share figures of individual chains have been discontinued since around 2002.

Q 16 How profitable are grocery wholesalers? What margin over supply costs do grocery wholesalers achieve? Do these margins differ by size of the wholesaler? If so, how? What rate of return on capital do grocery wholesalers achieve? Has this changed over the past 5 to 10 years?

This is the kind of question which should be included in a widespread survey of Grocery suppliers, covered by **absolute confidentiality** to protect individual businesses from possible retribution. And once again, the request for information spanning 5 to 10 years is inappropriately short.

B Consumer behaviour and choice

Q 22 What options or choices of retailer do consumers have to purchase grocery products? How far will customers travel for their groceries? How does this differ by grocery product (...)? How does this differ depending on the type of shopping trip?

This question may be more complex than it seems because it depends on what kinds of grocery products are referred to. Of every large trolley full of groceries, there is likely to be a number of missing preferred brand or missing lower volume consumption items. The response to these kinds of trends will depend on the individual as to whether they purchase something vaguely similar, go elsewhere or do without. It is the kind of question which I believe should be included in a widespread consumer survey on the impacts of brand reductions.

Q 24 How important to consumers is the convenience of purchasing from a retailer offering a broad range of grocery products (meat, fruit and vegetables, packaged products etc)?

Once again, this should be included in a widespread **consumer survey**, along with questions as to whether the convenience of purchasing more fresh products at supermarkets is achieved at the expense of greengrocers or by limiting the available range to only those items of high demand.

It is a little unclear in this context what kinds of “packaged goods” they are referring to but packaged products in supermarkets these days can mean almost anything, but in relation to fresh foods this can mean salads, marinated meats or even ready to cook meals, all of which potentially increase the profitability of the major supermarkets whilst, at times, putting suppliers under ever increasing pressure. These kinds of issues are covered quite well in Joanna Blythman’s book “Shopped – The shocking power of British Supermarkets”

Q 25 How important is price for consumers when they decide where to buy groceries? Does this differ depending on the grocery product?

This is the kind of issue which has been covered quite frequently by ACNielsen and published in their Grocery Reports. As I have pointed out above, for a period in the late 80s when Australia was experiencing a period of recession, many consumers tended to favour discount supermarkets like Franklins but this trend did not appear to continue in the same manner after the recession. These days, consumers surveys appear to point to the fact that consumers are looking for the shopping experience, for known brands, for quality, for GM free, for specific ingredients or local production, not just for price and the case of organic products, for instance, they are generally prepared to pay more.

Q 26 How important are factors such as distance of travel, freshness of perishable items, product range etc. Does this differ depending on the grocery product? If so, how and why?

One of the important issues which sparked lively community debate in the lead up to the 2005 Referendum on trading hours in WA was the desire of consumers to support local producers. There is also an issue with fresh produce that if it is picked too early (in order to give it more shelf life or travel long distances) the impact on flavour obvious.

Q 29 How do retailers compare their prices with those of other retailers? How often are such comparisons made? Over which products are such comparisons made? Against which retailers do they compare prices? Are price comparisons done on a national basis, or both?

This is very important question and if you ask many specialist small independent retailers in close proximity to one of the major supermarkets you will probably find that the price checks are done frequently by the major supermarkets. It is, however, not just price check that are important. The other questions are whether having a health food shop or chemist in close proximity to a major supermarket, means that the supermarket makes a greater effort to keep a better range of those kinds of items.

It is the kind of question which could justify the ACCC conducting **confidential** surveys of small specialist retailers to find out what their experience has been in this regard. It is also useful to ask whether, having undertaken regular price checks, supermarkets have been prepared to reduce their prices of specific items in order to destroy specialist small business competitors.

C. Competition in grocery retailing

Q 31 Does the nature of competition in grocery retailing differ across product groups? Does the nature of competition differ across the types of shopping trips? What elements of the customer offer are important in each product group?

My research into the impacts of dairy deregulation in Australia has indicated that the prices of ordinary, full fat milk has been used at times as a loss leader in order to lure more consumers into supermarkets but other dairy items have increased in price at a rate far exceeding farmgate prices, which would indicate that price strategies are not just based on cost but on gaining market share and profitability.

Q 33 To what extent do Coles and Woolworths compete against each other? To what degree does the option of shopping at other supermarkets chains (e.g IGA), specialist grocery retailers, convenience stores etc constrain the conduct of MSCs? How does this constrain the conduct of the MSCs? And to what degree does this differ by product group or type of shopping trip?

Research by Baker and Marshall in 1998⁶ has used spatial analysis to describe the separation of Coles and Woolworths in many parts of Australia where they tend to

⁶ Baker R G V & Marshall D C *The Hilmer Paradox*, Urban Policy and Research Vol 16 No 4 1998

dominate the retail sector. This apparently does not happen to the same extent in states which have a stronger independent sector, such as Western Australia.

In order to obtain information on the impact of the presence of specialist independent retailers, it is recommended that a widespread confidential survey of such retailers be undertaken by the ACCC and undertake comparisons of the range and prices of those kinds of specialist items that are stocked in MSCs which do or do not have specialist retailers in close proximity. In relation to convenience stores, it was reported in Retail World Magazine that Coles and Woolworths embarked on a major program of establishing central city convenience stores as a result of the expected arrival of Aldi, so it would appear to have been aimed at reducing the potential market share of Aldi for people living or working in the cities. Therefore it can be assumed that both Coles and Woolworths are now not too worried about the impact convenience stores in states such as NSW as a growing number of them now belong to the MSCs themselves.

Q 35 & Q 36 Checking pricing policies across locations requires a considerable effort and it is better that such studies are not undertaken by those associated with either the MSCs or independent retail groups. This is therefore the kind of research which SHOULD be undertaken by the ACCC in this regard.

Q 37 Is the Australian grocery industry of sufficient size to sustain a third supermarket chain of similar size to Coles and Woolworths?

Clearly, over the last 20 years, this has been the case in the Eastern States (in relation to Franklins) and in Western Australia, IGA independents still hold a substantial share of the market, so the answer is yes, and it is not so much a matter of the size of the market so much as the regulatory environment which makes it feasible for more than two supermarket chains to survive.

Q 39 Is access to suitable sites a significant impediment to the entry or expansion of supermarket chains? Do local planning laws impede the access to suitable sites?

The wording of this question appears to be calling for comments on further deregulation but it should probably be asking how and why MSCs dominate and whether their market power results in unfair market conditions for access to sites by potential competitors.

Q 40 and 41 The issue of leasing conditions and their associated costs has come up on many occasions, and is clearly one which requires further serious research. It may require legislative action to reverse or at best avoid further market power abuse if what is happening in many parts of Australia is that small independent retailers are having to pay unfairly high rentals for space in shopping centres etc because MSCs demand and get unfairly low rates.

D. Competition in grocery wholesaling

Qs 42-45 The issues of commercial advantages and disadvantages, contestability etc are the kinds of issues which are only likely to be addressed reasonably by confidential surveys of a range of those likely to be affected.

E. Buying power in grocery supply markets

Q 46 *Are large grocery wholesalers or retailers able to acquire products from suppliers at lower prices or on better terms than smaller wholesalers or retailers. Does this differ by product type?*

Clearly this has been the case, especially since the removal in 1995 of S 49 of the *Trade Practices Act* (which provided some protection against price discrimination). The patterns of market power abuse by large wholesalers or retailers are not unique to Australia.⁷

Q 47 *Do grocery wholesalers or retailers with buying power pass on the lower prices they can achieve from suppliers to retailers and consumers?*

Aspects of this question have been addressed in a recently published paper from the UK.⁸ Their econometric analysis provided in relation to milk margins and market power tend to reinforce the findings of my own research on the Australian dairy industry, which shows that, since deregulation, the retail price of milk has become detached from the prices offered to producers, and on average, consumers have not been the “big winners” as predicted prior to deregulation.⁹

Another important angle on this is that whilst profit margins for retailers do not necessarily reflect the costs to retailers, when MSCs decide to target certain items for super specials or “rollback” type prices, it has been reported in *Retail World Magazine* that it is generally at the expense of manufacturers or suppliers, i.e. low price offers cost suppliers but higher margins (in such things as fresh produce) tend to benefit the MSCs.

Q 48-53

This are the kinds of very important issues which should instigate a very detailed study by the ACCC using their Prices Surveillance powers to check both prices and margins, especially for fresh produce.

In addition, for the purpose of this inquiry, it is my belief that it is essential that the ACCC conduct a widespread confidential survey of grocery suppliers, manufacturers and small business competitors to get an accurate picture of whether the current market power abuse provisions of the *Trade Practices Act* are working, and if not, devise strategies including regulatory or legislative or surveillance strategies to fix the problem.

The section of Q 53 relating to brand de-listing, and substitution of private labels and generic brands is, as I have mentioned a vital issue in this inquiry and it should be a

⁷ Joanna Blythman’s “*Shopped*” and Raj Patel’s “*Stuffed and Starved*” provide copious examples of this trend in other countries.

⁸ Smith, Howard & Thanassoulis, John 2008 “*The Milk Supply Chain Project*, Oxford University, UK

⁹ Margetts, D (2007a), “National Competition Policy and the Australian Dairy Industry”, *Journal of Australian Political Economy*, Number 60, University of Sydney pp 98 -129

Margetts, (2007b) *Competition Policy – What’s that got to do with the Price of Milk?* Australian Global Studies Research Centre, UWA, Nedlands, WA

very important part of a confidential survey of Australia's grocery suppliers and manufacturers but its implication do not stop there.

It is important to gain a perspective of the impacts of such market policy directions on consumers, on real choice and real competition. **It is therefore essential for the ACCC to conduct a widespread consumer survey on these issues.**

F. Competitive position of small and independent grocery retailers.

Qs 54 - 59 It would be appropriate to put these questions into a widespread confidential survey of small and independent retailers.

Q 60 Have there been acquisitions of independent stores by the MSCs in the past three years that have not been brought to the ACCC's attention and are not listed in Attachment A?

It is not satisfactory that the list of acquisitions that the ACCC has provided only goes back 3 years, especially since the whole issue of creeping acquisitions was a major focus of the 1999 Parliamentary Joint Select Committee Inquiry on the Retail Sector.

Qs 61 & 62. These kinds of questions on impacts and terms of trade on independent traders and suppliers should constitute part of the confidential surveys (of independent retailers and grocery manufacturers/suppliers) that I have strongly recommended should be a major source of information for this inquiry.

Qs 63 – 65. Regarding evidence of anti-competitive behaviour, the ACCC clearly admit that predatory pricing allegations have been some of their major areas of complaint in the retail sector. My research in the dairy industry pointed out how fresh full cream milk was used by MSCs in the period following dairy farmgate deregulation as a loss leader, as a means of improving their market shares (i.e. taking away the market shares of their competitors). One of the recommendations from my dairy research was that the ACCC should use their prices surveillance powers to go back and fill in the data gaps from when they ceased surveillance of prices, profits and margins in the dairy industry just 6 months after deregulation.

Once again, to get a reasonable picture of what is actually happening in Australia, the ACCC should include these kinds of questions in confidential surveys of the grocery sector and grocery manufacturers/suppliers.

G. Factors influencing the pricing of inputs along the supply chain for standard grocery items

Questions for suppliers-

Q 66. What are the major influences on the prices you receive for your produce? How are your prices determined? What proportion of the retail price of the product do you receive?

Firstly, this is another area where reference to the very recently published paper by Oxford University Economists, Smith and Thanassoulis would be a good point of reference.¹⁰

Secondly, the outcomes of my research on the dairy industry give some idea of how the retailer and producer margins appeared to shift dramatically in a post-deregulatory environment, especially for producers of fresh milk. The dairy paper indicates that there is great deal more research work required on these issues in similar or related areas.

Q 67. Have the prices you receive for your produce changed over the past 1 to 3 years? What have been the major reasons for any changes in the prices you receive? Have your costs of production changed over the past 1 to 3 years? Have the prices you receive for your produce changed by more than the cost of production. Please provide details.

Similar to the earlier questions regarding suppliers' problems, which only requested data going back 5 to 10 years, this data time request is **inappropriately short**. For instance, Australian drought conditions have gone back for more than 3 years. How could the ACCC separate out those kinds of factors with only 3 years of data? It again leaves the impression that the ACCC do not want to know what the real issues have been for suppliers. And it is rare for producers to provide details of their costs of production without the guarantee of absolute confidentiality, so the most appropriate way to gather this kind of important information is through a widespread confidential survey of suppliers.

Qs 68 & 69 are very important but those with the answers could be extremely vulnerable to retribution if they publicly provided that kind of information. This kind of information should be sought but protected by absolute guarantees of confidentiality, perhaps once again by surveys.

Qs 70 & 71 are also very important but they are the kinds of questions which should be checked by the ACCC using their prices surveillance powers to conduct a detailed study.

Q 72 should be asked on a confidential basis and the answers can be assessed against answers give by confidential surveys of suppliers.

H. Impediments to efficient pricing of inputs along the supply chain

Qs 73 – 80 The issues paper states that the ACCC will examine pricing and supply agreements along supply chains to determine if there are impediments to the efficient pricing of inputs. Whilst this is likely to be a very useful process, if the behaviour of Australian MSCs resembles that of corporate supermarkets in countries like the UK,¹¹ it should also be followed up by confidential surveys of those who are required to enter into such agreements to see if the contracts are “one-way” or “two-way”, that is,

¹⁰ Smith, Howard & Thanassoulis, John, 2008, *The Milk Supply Chain Project*, Oxford University, UK

¹¹ Blythman, Joanna (2004) “*Shopped – The shocking power of British supermarkets*” Harper Perennial, Hammersmith, UK.

is there evidence of frequent changes to agreed conditions of contract by MSGs which make suppliers much more vulnerable.

I. Horticultural Code of Conduct

Qs 81 – 83

Whilst there has already been a response from the Horticultural Code Committee, they clearly will not have had sufficient time to provide detailed responses on these questions, so a confidential survey of growers, suppliers and grocers on these issues would be appropriate.

Summary and Conclusions

Many problems arising from Australia's grocery sector relate to the fact that major policy changes beginning in the mid 1990s which have tended to provide greater market shares for the corporate retail sector occurring at the same time as checks and balances under the *Trade Practices Act* were weakened. This inquiry is asking some of the right questions but has not provided the community sufficient time to respond.

If the ACCC are really interested in finding answers to the kinds of questions they are asking, they should conduct widespread (and confidential) surveys of those sectors most likely to have been affected by such policy or structural changes.

Asking for information and data of only 5 to 10 years is insufficient to provide the full picture of the major structural changes in Australia's grocery sector, especially as the major changes in microeconomic reform, especially the introduction of National Competition Policy, occurred in the mid 1990s. If the ACCC do conduct a series of useful confidential surveys, their questions should invite information and data going back 15 to 20 years.

In addition, the ACCC should use their prices surveillance powers to check costs, margins and profits, especially in those areas where it appears, that the MSGs have gained the greatest market power advantages such as fresh produce.

The kinds of information which should be sought by this inquiry should not be limited to price because the massive brand reduction strategies initiated when MSGs have gained more market share would clearly have had an impact on Australia's grocery supply and manufacturing industries. This is likely to impact on future prices, choices and competition in the Australian grocery sector as well as our balance of trade.