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Thursday, 1 May 2008

Response to ACCC inquiry into the competitiveness of retail prices for standard groceries

1. Can you please identify the location of SPAR's warehouses.

SPAR warehouses are located in Brisbane the dry goods is located at 1 Fox Road Acacia Ridge QLD 4110 and the refrigerated foods warehouse is located in the Versacold complex at 51 Alexandra Place Murarrie QLD 4172.

The dry warehouse is operated and managed by our own staff and the refrigerated foods warehouse is operated by Versacold Logistics Services.

2. Of the 250 stores through Queensland and New South Wales SPAR supplies, how many of these stores are over 1000 mt? Could you please provide the precise location of these stores.

Our large supermarkets are in the following locations:

Lowood	51 – 61 Main Street, Lowood QLD 4311
Boonah	58 High, Boonah QLD 4310
Fortitude Valley	Emporium Centre 1000 Ann Street, Fortitude Valley 4006
Maclean	4 River Street, Maclean NSW 2463
Malanda	1 -10 English Street, Malanda QLD 4885
Manilla	165 Manilla Street, Manilla NSW 2346
Mt Isa	43 Sunset Drive, Mt Isa QLD 4825
Mt Isa	Cnr East and Ann Streets, Mt ISA 4825
Mullumbimby	36 Burringbar Street, Mullumbimby NSW 2482
Springsure	71 Eclipse Street, Springsure QLD 4722
Woolgoolga	8 Queen Street, Woolgoolga NSW 2456

3. Are there commercial advantages and disadvantages of vertical integration between grocery retailing and wholesaling? What are these advantages and disadvantages?

Vertical integration has and will continue to have an effect on the independent retailer, smaller wholesalers and suppliers to the grocery industry.

The MSC's now control the flow of products through the industry. Simply by stocking or not stocking a product will have a major effect on the ability of a supplier to produce and market the product for consumers. This means that product categories will have fewer brands available to the independent trade and as such will affect competitiveness in the market; fewer suppliers competing for the category will reduce the need to fight for additional sales through enhanced marketing programs to sustain the production of the product.

There are advantages in vertical integration through supply chain optimization and realization of efficiency gains. These advantages would reach the consumer however this does not appear to be the case in the Australian market due to the low level of competition and market dominance of the MSC's.

The independent sector major supplier Metcash is involved in this practice by acquiring equity in some of its major customers. It would appear that the strategy is to restrict the freedom of choice of customers to deal with alternative sources. Evidence of this is borne out in the rollout strategies of IGA>F, the fresh division of the organization, in linking overall discounts to combined purchases from both grocery and fresh divisions.

4. Does vertical integration of the major supermarket chains (MSCs) impede SPAR from achieving a competitive scale in grocery wholesaling?

The answer to this is yes, the MSC's have created the ability to amortise costs, develop supply chain efficiencies and employ strategies to change the dynamics of purchasing from suppliers. Their market dominance gives them leverage over suppliers' which allows them to achieve better wholesale pricing. The MSC's have highlighted this point in their many press releases regarding supply chain optimization initiatives. It is far more difficult for smaller wholesalers to achieve similar buying prices.

This also applies to grocery wholesaling where the major player (Metcash) controls more than 90% of the market. This organisation is a monopoly and uses its power and market force to restrict the growth of SPAR in Australia.

5. What are the impediments to entry into grocery wholesaling? Is large-scale entry likely? Does SPAR plan to expand its operations in the near future?

The impediments to entry include: high capital cost in stock and equipment., e.g. to setup a distribution centre and stock it would require a major capital outlay. This type of investment would be high risk without supporting volumes of warehouse purchases from the customer base. An entrant to the market would need a guaranteed turnover of stock in the order of several hundred million dollars per annum.

We continue to get inquiries from retailers in states on the eastern seaboard for us to supply goods, as they are unhappy with the service, pricing and demands from their current supplier. As a small company we cannot expand without securing enough volume in business to ensure that a new interstate business would be viable.

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

It is difficult to give a definitive answer to this question. The reason for this is that the grocery industry and in particular the suppliers to the industry have over time been manipulated by the MSC's to their advantage.

Trading terms with suppliers are not transparent, and largely remain confidential between the parties. The small supplier is not able to determine the difference in buying terms and is therefore unable to quantify the variance in the terms.

As example of the difference and disadvantage for the smaller wholesalers, one only has to refer to the published creditor days/KPI's for the MSC's. SPAR as a small supplier is at a disadvantage to MSC's based on the published payment days achieved by large suppliers. If the large suppliers are not paying their supply creditors on time, then they are getting away with it or else they are being provided greater terms.

There are very few companies that have a set of terms that reward wholesalers or retailers for reducing costs through the supply chain or that in-fact specify the allowances available for achieving supply chain efficiencies and using latest technology.

We believe that the latest negotiating tool being used by the MSC's is to advise the suppliers that they require a minimum gross profit on the sale of a product before they will consider ranging. This means that the emphasis is away from being efficient and working to achieve a common goal and moving to abuse of market power by demanding a level of profit to the

organisation that meets with corporate objectives, prior to stocking the line or when reviewing the performance of the line.

7. Do suppliers incur lower unit costs in supplying larger wholesalers or retailers? What are the sources of these costs savings (bulk sales, purchase guarantees, etc.)? Are these reflected at the retail level?

We believe that the cost to move a pallet of finished product to a truck supplying an MSC or a small wholesaler like SPAR is the same.

If both organisations order full truck loads and both pay at the same time then the costs to service the organisations would be the same.

The number of times a buyer fills a truck should have less significance in the overall structure of the trading terms.

We believe as we have stated in the answer above that these are not the only reasons that more favourable trading terms might be applied to larger organisations. The risk to a supplier of not being stocked by the wholesaler (MSC) is far too great. This situation is one where the MSC has leverage over the supplier and therefore is able to dictate more favourable trading terms.

There is little evidence that the advantage created by the large wholesaler and the MCS's is passed on to their customers in the main, it is retained to boost the profits and to fund expansion.

8. Do suppliers offer the same terms and conditions to all grocery wholesalers or retailers? For example, if SPAR offered to purchase the same volume as a large wholesaler, would SPAR receive the same volume discount?

In the absence of transparent trading terms with all suppliers we can only assume that we would be at a disadvantage to the MSC's. The difficulty lies in understanding the make-up of the terms with each supplier, they are too complex to use one component as an example for analysis.

9. Is there evidence that large grocery wholesalers have market power as acquirers of products and what are its effects at the retail level?

There is no hard evidence of this; it can only be assumed that this is happening and that savings do not get passed on to consumers. One only has to look at the market power of Walmart and draw the

comparisons with the Australian market and MSC's. If the MSC's purchases from a particular supplier represent a large percentage of the suppliers business, then it stands that the MSC would have strong leverage over that supplier.

Questions selected from the Issues paper for specific response to the inquiry.

3. *What have been the major changes to the structure of grocery retailing in Australia over the past 5 to 10 years?*

Consolidation has been the major factor of change in the industry for many years and is continuing at supplier level. There are now fewer retailers and wholesalers, which in turn means less competition and also makes it more difficult for smaller retailers to grow and make an impact in the market.

MSC's have flooded the major towns and cities with aggressive developments, sometimes creating their own opposition to stave off the smaller retailers.

These large retailers are now looking to the regional areas to strategically place stores to capture market share from smaller communities, (example Woolworths Plainlands and Fernvale QLD), where previously smaller independents existed or currently exist.

If this grab for market share is allowed to continue the country is at risk of having a duopoly in the grocery industry and only niche operators have the ability to survive.

The growth of the MSC's into petrol and liquor and their potential to move into categories like news agency and pharmacy have had and will have detrimental impacts on specialty retailers, these have had a major impact on the traditional structure of the industry and many other industries.

8. *How does the structure of grocery retailing differ between metropolitan, regional and country areas?*

Today, there are many regional areas that only have an independent retailer in the location or close by. Those retailers are under pressure due to the rising costs of fuel and services and can not dilute these costs through a large network of operations. They must make sufficient profit in their business to be able to re-invest into the business and to continue to support the community. This means in most cases that costs cannot be absorbed and must be passed on in pricing.

The MSC's look to the major centres to operate or go to areas where they can draw from several smaller communities, often these developments take time to become profitable, but through offering subsidised pricing they can win over a major share of the business to the detriment of the independent retailers. This type of development is reported as good for the communities, but in the longer term it further enhances the share of the MSC's.

- 13 *How important are economies of scale in grocery wholesaling? What are the sources of these economies of scale? Are economies of scale primarily the result of lower transport costs, lower storage costs, better stock management or the ability to negotiate better deals with suppliers?*

The grocery industry is a high volume low margin model, hence the more centralised the business the better the economies of scale are to that business. The savings go further than those mentioned, some of the other functions that lower costs with scale are;

- Marketing and advertising
- Administration costs
- Technology
- Warehousing and distribution

Overall almost every cost the industry has can be negotiated by the operator with the highest turnover, however it does not appear to go back to the consumer in lower prices but rather is passed to the shareholder through profit optimisation.

- 15 *Are there any structural differences in grocery wholesaling in metropolitan, regional and country areas? If so, please explain.*

Grocery wholesalers operate from the capital cities in all states, deliveries are mostly intrastate with little cross the border movement. The majority of the major retailers buy from these central warehouses to get the best price available.

This is not dissimilar to the way the MSC's operate.

- 23 *Would unit pricing (a requirement that the price per kilogram or per 100 grams etc is displayed on the supermarket shelf or product) improve the ability for customers to compare prices? Should unit pricing be made compulsory? Would unit pricing lower the cost of shopping for customers?*

Unit pricing would provide minimal improvement for customers to make a price comparison with similar products. This is because, where a consumer calculates unit pricing, it will be improbable that a consumer could calculate unit pricing over several products and be able to then undertake further consideration of unit pricing in another store. As an example, studies have found that most consumers can only remember about 6 prices from an entire supermarket range.

Unit pricing would have little effect on lowering the cost of goods to the consumers, and in fact would cost a lot to implement as changes would need to be made to the supplier data files, store data files and store labeling/systems. These costs would ultimately be passed onto consumers.

- 34 *Has the move by Coles and Woolworths into petrol retailing and the adoption of petrol shopper docket schemes altered competition between the MSCs and competition in grocery retailing more broadly? If so how?*

Yes, the acquisition of petrol outlets and implementation of petrol shopper dockets has increased market power of the MSC's. Suppliers like SPAR are not able to effectively compete with the incentivised system of petrol shopper dockets. SPAR does not own petrol outlets and is only able to provide a fragmented petrol shopper docket system by partnering with other small suppliers in such systems. The acquisition of petrol outlets has assisted the MSC's to further increase revenues and market share.

- 36 *To what degree do grocery prices differ between metropolitan, regional and country areas? How does this differ by product group? What are the major reasons for differences in grocery prices between metropolitan, regional and country areas (transport costs, land costs, market structure and competition, etc.)?*

Transport costs are the major contributor to the pricing in the regional and country areas. Independent retailers must recover the cost of freight to the country in every location, as opposed to the MSC's who can amortise the costs over the whole of their business. The larger the MSC base business in capital cities the easier for that business to spread the cost. Independent retailers counter this activity by applying lower margins to remain competitive in the market they operate in.

- 40 *Are major shopping centre landlords willing to offer sufficient space to a new supermarket chain? Are there any restrictions (contractual or otherwise) that may limit the ability of landlords to offer such space?*

The SPAR experience is that the major shopping centre Landlords give preference to the MSC's in nearly every situation. In most cases the prime supermarket positions have been offered prior to the smaller competitor such as SPAR finding out about the development or where SPAR seeks a site, the Company is told that the site will go to the MSC.

- 41 *To what degree are smaller supermarket chains discouraged from expanding by higher costs relative to the MSCs. What are the sources of higher costs (e.g. higher costs of wholesale groceries, inability to take advantage of economies of scale or density, etc.)?*

It is difficult to determine the gap between the pricing models the MSC's use and the independent warehouses but there will always be an advantage for an integrated business when compared to, two different businesses, i.e., the supply warehouse owned by a different party to the retail outlet (SPAR model).

The MSC's do not have to operate their distribution facilities as profit centres, because of their size the MSC's have buying power in everything they do from site selection to fitting out the stores with the latest equipment to stocking with the latest range of products and services.

- 43 *Does the vertically-integration of the MSCs impede other players from achieving a competitive scale in grocery wholesaling?*

There is no doubt that this is the case, it is a very efficient way to operate and the profits are pouring into the balance sheets of these large companies.

- 45 *What are the impediments to entry into grocery wholesaling? Is large-scale entry likely?*

The impediments to entry include the capital required to setup a major distribution centre, e.g., cost of goods, equipment, labour and services. The operation of distribution centres are a major operation dynamic in nature and highly time critical. Apart from the Capital outlay in setting up a distribution business, there is also the aspect of providing a reliable distribution network across sizeable geographic areas. These factors are major barriers to entry into grocery wholesaling.