

WOOLWORTHS LIMITED

ACCC inquiry into the
competitiveness of retail prices
for standard groceries

Public submission by Woolworths
in response to the Horticulture Code of
Conduct Issues Paper

18 June 2008

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1 Introduction

Woolworths' business model incorporates "best in class" supplier relationships. This is shown through factors such as:

- adherence to detailed produce specifications and quality assurance procedures;
- forward strategic supply planning;
- provision of detailed supply contracts;
- prompt payment;
- stable revenue streams; and
- access to dispute resolution process.

Accordingly, the clarity in the detail of the business relationships between Woolworths and its suppliers provides industry best practice. This has been acknowledged in the adoption of the Woolworths Supply Terms and Conditions as the model for use by participants under the Produce and Grocery Industry Code of Conduct.

In Woolworths' view, for retailers who demonstrate such high levels of commercial practice, there is no reason to deviate from the original exemption from the Horticulture Code of Conduct (**Code**). Furthermore, as suggested by the Issues Paper regarding the Horticulture Code of Conduct (**Issues Paper**), amendment of the Code to include retailers might interfere with effective trading, add cost and complexity without adding value and impose a standard that will in fact be below the "better than minimum" Code standards already in effect.

Furthermore, Woolworths notes that it is already a party to the voluntary Produce and Grocery Industry Code of Conduct (**PGICC**), which was written to improve trading behaviour in the produce and grocery sector and serves as a guide to good business practice. As noted in the submission of the Produce and Grocery Industry Code Administration Committee, the PGICC plays a significant role within industry due to its overall coverage of the supply chain, and includes commercial relationships between suppliers and purchasers of goods or services in different stages of production or distribution in the retail grocery industry supply chain (excluding consumers).

For clarity, this submission replicates the relevant issues raised in the Issues Paper in italicised text immediately above Woolworths' comments in relation to the stated issue. Woolworths notes that it has not commented in respect of issues relating to enforcement of the Code, the Horticulture Code transitional arrangements or agents (given that Woolworths has no experience in the use of agents).

2 Extension of the Code

Issue: Should the Horticulture Code be extended to regulate retailers? On the one hand, the regulation of retailers and their agents may provide growers with greater clarity and transparency in their transactions with retailers. On the other hand, such an extension may capture dealings that do not warrant intervention and in doing so may impose unnecessary compliance costs. Alternatively, should the Horticulture Code be extended to cover retailer's agents (and not retailers themselves) as a distinct category of trader?

2.1 Woolworths' supply contracts

Woolworths considers that there is no additional benefit to industry parties covered by the PGICC in extending the Horticulture Code of Conduct (**the Code**) to regulate retailers. As contemplated by the Issues Paper, including retailers in the Code would impose burdensome record retention and administration and compliance costs upon retailers without addressing the reasons for the Code's introduction.

Woolworths maintains full transparency in its arrangements with all suppliers (both growers and merchants). This is made possible through the following:

- a great number of growers receive the benefit of annual Supply Schedule Arrangements (**SSAs**), which set out Woolworths' annual commitments for supply of product;
- Woolworths' terms of trade are clear and well communicated to all suppliers; and
- Woolworths provides all suppliers with fully detailed purchase orders (usually a week in advance of the supply date). This includes documentation of the agreed price. Woolworths never accepts goods on consignment, or without a fully extended purchase order being provided.

As Woolworths does not employ agents or consolidators, it is unable to comment further regarding the inclusion of agents or consolidators who are employed by retailers, or the inclusion of dealings of growers with merchants, agents and consolidators. However, it is likely that the transparency issue lies in the interaction between the grower and the merchant, agent or consolidator. There are no transparency issues between Woolworths and its growers, as evidenced by the lack of disputes between those parties under the PGICC, during 8 years of the operation of the PGICC.

2.2 Evidence submitted by other parties

Evidence submitted to the Grocery Inquiry suggests that most growers are satisfied with their relationships with the major supermarket chains (**MSC**) (ie Woolworths and Coles).

For example, Horticulture Australia Ltd stated in its submission to the Grocery Inquiry:¹

Whilst press releases and industry news suggest that Growers are concerned about the market power of MSC, discussions as part of this submission with numerous Growers and Consolidators that are preferred suppliers to MSC indicate they are quite satisfied with their relationships with MSC.

Horticulture Australia Ltd also noted:²

The contracts agreed to by the major retailers with their direct suppliers more than meet the minimum requirements of the [Horticulture] Code – in general, they are solid documents covering both the terms of trade arrangements and the specific agreements currently covered by the Horticulture Produce

¹ Horticulture Australia Ltd, *Public Submission to ACCC Grocery Inquiry by Horticulture Australia Ltd*, prepared by CDI Pinnacle Management Pty Ltd, 11 March 2008, p. 10.

² Horticulture Australia Ltd, *Public Submission to ACCC Grocery Inquiry by Horticulture Australia Ltd*, prepared by CDI Pinnacle Management Pty Ltd, 11 March 2008, pp. 6-7.

Agreement. ... In general, industry has no reason to suppose that these contracts are not operating as intended.

In addition, there is a strong view among many growers that direct supply relationships with the MSC offer the best long term stable returns. This is consistent with research findings that integrated supply chains with retailers reduce price volatility and increase returns to growers. For example, the Australian Bureau of Agricultural and Resource Economics has concluded that direct supply contracts can provide greater price stability and a guaranteed market for produce, increased flow of information to farmers on consumer requirements and the development of innovative and superior product lines based on that information.³

2.3 Importance of the voluntary Produce and Grocery Industry Code of Conduct

As indicated previously, Woolworths is a party to the voluntary Produce and Grocery Industry Code of Conduct (**PGICC**). The PGICC is a successful code with a broad membership that promotes good business practices for the entire produce and grocery industry. Woolworths notes that, even if the Horticulture Code of Conduct were to be extended to include retailers, this would still leave large parts of the produce and grocery industry not covered by a mandatory code and might potentially remove the incentive for growers, wholesalers and retailers to remain committed to the PGICC.

As foreshadowed by the submission by the Produce and Grocery Industry Code Administration Committee, such an outcome would be detrimental to the broader produce and grocery industry as it could result in the disbanding of the longstanding PGICC that has proven to be effective in its contribution to an improvement in business practices across the entire produce and grocery industry. Woolworths considers that, based on its experience of its existing business practices and its commitment to the PGICC, there is no practical benefit to extend the Horticulture Code to regulate retailers.

3 The definition of delivery, and a requirement that merchants establish price on delivery

Issue: Is the requirement that the parties agree on a price for produce either before or immediately upon delivery appropriate to achieve this goal of providing growers with clarity and certainty regarding the price they will receive? Should the Horticulture Code be amended to enable merchants to provide growers with a method or formula by which price will be established? Should this formula be restricted in any way to provide growers with greater transparency and clarity as to the price they will receive from the merchant?

3.1 Woolworths' suppliers already benefit from clarity and certainty about prices

Woolworths operates at the level of "best practice" within the industry. One element of this is that Woolworths negotiates with each and every supplier weekly to establish the forecast price of goods for the following week. This price holds firm for Sunday and Monday deliveries, then may be amended by mutual consent once Monday "Market levels" are established.

³ Jacenko, A. and D. Gunasekera (2005) 'Australia's retail food sector: Some preliminary observations', Australian Bureau of Agricultural and Resource Economics, The Pacific Food System Outlook 2005-06, 11-13 May.

Woolworths' contracts have several key standard features. In the case of fresh produce, they are based on a relatively simple set of obligations, with an emphasis on close and regular communication between suppliers and buyers. Key features include the following:

- (a) A clear and simple Supply Schedule Arrangement which sets out in detail volumes to be supplied based on forecasted trade (usually for the calendar year ahead). Suppliers are not bound to supply Woolworths with the full quantity specified in the contract if this is not possible.
- (b) Pricing based on a weekly monitor of market pricing (wholesale and retail) and agreed weekly after discussion between the supplier and the Woolworths buyer.
- (c) A stipulation that all product be supplied within specifications at all times, with agreement on the part of the supplier to the requirements of the Woolworths Quality Assurance (WQA) Standard.
- (d) Provision for joint promotional activity designed to stimulate demand for product during appropriate periods of the season or to help launch a new product.
- (e) A requirement for regular communication (usually on a weekly basis) with a Woolworths Business Manager designated as the point of contact in the event that the supplier feels the spirit of the agreement is not being met.

3.2 Suggestions to improve the Code

Woolworths suggests that, for those participants already regulated by the Horticulture Code, the following amendments to the Code might assist in improving clarity and certainty for growers and non-wholesaler suppliers. These amendments are based on Woolworths' own experience of operating at the level of "best practice" within the industry:

- Amending the definition of "delivery" to mean: "when the goods have been accepted at time of delivery in good condition ie in accordance with the agreed specification"; and
- Mandating that a firm price be negotiated and agreed to prior to delivery (prior to dispatch from the farm) and appropriately documented.

4 Service agreements

Issue: Should the Horticulture Code permit merchants to provide growers with additional services as part of their horticulture produce agreement? If so, when should ownership transfer from the grower to the merchant take place? In these circumstances, should the Horticulture Code impose further obligations upon merchants, in addition to requiring them to take due care and skill, prior to the transfer of ownership?

4.1 Woolworths' Quality Assurance program

The Woolworths Quality Assurance program, a rigorous quality standard system that applies to all fresh food and private label suppliers, is seen increasingly as a "best practice" industry standard. The system examines product specifications, manufacturing processes, cleaning procedures, product labelling and other related food safety matters. Woolworths works cooperatively with its suppliers to develop and review quality specifications, a process which requires substantial ongoing investments by Woolworths in cost efficient systems, packaging and delivery arrangements.

The submission by Horticulture Australia Ltd to the Grocery Inquiry suggests that, where increased costs are unavoidable, major retailers such as Woolworths:⁴

realise that the demands that they place on their suppliers may result in additional costs which if their suppliers are to survive need to be rewarded.

Woolworths has not transferred costs to suppliers. On the contrary, increasing volumes of purchases have allowed cost savings on logistics, while the introduction of electronic ordering and payments systems have reduced administration costs throughout the supply chain. Growers have also generally welcomed the introduction of better packaging requirements (such as replacing cardboard containers with reusable plastic crates) as they ensure lower costs and better product handling in the long-run (reducing the level of wastage on products such as avocados).

4.2 Woolworths' classification of "delivery of goods"

Woolworths accepts ownership of goods upon inspection and receipt. Product rejection rates are low (only 1 per cent) with a focus on continual improvement. Where product is rejected, growers receive a report within three hours of delivery, including digital photos and an explanation of why the produce is being returned.

It is Woolworths' practice to classify delivery of goods to be at the time that product is delivered and accepted in good condition (ie in accordance with the agreed specification). It is also Woolworths' practice to treat other products, such as those requiring ripening, in the same way, and to manage the cost and process of ripening as a separate function that does not delay transfer of ownership.

In the case of products requiring ripening, ripening cannot be conducted at the growers' location. The purchaser of the unripened goods should accept responsibility for all aspects of the goods (including ripening) at the point of receipt and ownership should transfer accordingly.

5 Packing houses and cooperatives

Issue: Should transactions between growers and grower-owned cooperatives/packing houses be excluded from regulation by the Horticulture Code where the cooperative / packing house 'markets' the grower's produce (i.e. act as an agent)? Should dealings between the cooperative/packing house and traders be regulated by the Horticulture Code?

Woolworths considers that, where a cooperative / packing house acts as an agent for the grower through "marketing" the grower's produce, transactions between the cooperative / packing house and the grower should be treated in the same manner as transactions between merchants, agents, consolidators and cooperatives / packing houses.

Also, insofar as the cooperative / packing house replaces the grower by "marketing" the grower's produce, Woolworths considers that the cooperative / packing house should be treated in the same manner in relation to traders as the grower is treated in dealing directly with traders.

⁴ Horticulture Australia Ltd, *Public Submission to ACCC Grocery Inquiry by Horticulture Australia Ltd*, prepared by CDI Pinnacle Management Pty Ltd, 11 March 2008, p. 23.

6 Pooling of produce and price averaging

Issue: Should the Horticulture Code be amended to provide greater flexibility within the industry for pooling and price averaging to enable growers to continue to manage their risk in circumstances where there are significant fluctuations in produce prices over time and across various markets throughout Australia. On the other hand, if the Horticulture Code were to permit pooling and price averaging, producers of high quality produce may not be treated fairly and as a result there may be less incentive to produce high quality produce. What protections should the Horticulture Code provide to growers who choose to join a pool and receive an average price?

Price averaging does not encourage best practice within the Horticulture Industry. The Issues Paper itself sets out the adverse effects of price averaging and the inappropriate result of rewarding poor practice and penalising best practice.

Furthermore, averaging provides agents with an unfair advantage over merchants in day-to-day dealings in the market place by removing any requirement to act in the grower's best interest. Price averaging thus appears to allow the exploitation of growers.

7 Summary

Woolworths does not see how any of the issues raised in the Issues Paper can be solved simply by extending the Code to include retailers, particularly since most of the issues seem to be located within the pre-retail structure of the grocery industry.

Furthermore, Woolworths' voluntary participation in the Produce and Grocery Industry Code of Conduct indicates that Woolworths is already subject to a level of industry transparency and accountability regarding its produce and grocery operations. To the extent that the inclusion of Woolworths in the Horticulture Code of Conduct duplicates the regulatory burden on Woolworths, this would seem to be unnecessarily onerous and costly.

The Government must carefully consider the potential implications of mandatory participation of retailers in the Horticulture Code, in particular that any inclusion would complicate and distort fair market operation. If retailers are included, particular attention should be paid to the ability of national retailers to offer efficient, quality service to their customers, and that no price increases to customers are caused by added layers of bureaucracy.