Australian Competition & Consumer Commission

Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries

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EXECUTIVE OFFICE

Australian Competition & Consumer Commission

GPO Box 3131
Canberra ACT 2601

23 Marcus Clarke Street
Canberra ACT 2601

tel: (02) 6243 1111
fax: (02) 6243 1199

www.accc.gov.au

31 July 2008

The Hon Chris Bowen MP, Assistant Treasurer
Minister for Competition Policy and Consumer Affairs
Parliament House
CANBERRA ACT 2600

Dear Minister

Inquiry into the competitiveness of retail prices for standard groceries

On 22 January 2008 you directed the Australian Competition and Consumer Commission (ACCC) to hold a public inquiry into the competitiveness of retail prices for standard groceries, pursuant to section 95H(1) of Part VIIA of the *Trade Practices Act 1974* (the Act).

The inquiry was conducted by Commissioners John Martin, Stephen King and myself. The inquiry was to be completed and a report submitted to you by 31 July 2008.

Please find enclosed a copy of the ACCC's report.

Yours sincerely

Graeme Samuel

Graeme Samuel
Chairman

Contents

Glossary

Bundled trading terms	Where one comprehensive rebate is negotiated between supplier and retailer instead of a number of separate rebates.
Category average margin	A target margin used by the MSCs to measure the performance of products across a category. The margins made by the retailer across all particular products in a category defined by the retailer are averaged margins obtained by various products in the category are then compared to this figure.
Dry groceries	Dry category consisting of non-perishable food products and certain non-food products. Typically shelved, these are most grocery items excluding fresh, perishable products such as baked items, dairy, deli, meat, frozen foods and fresh produce. Examples of dry grocery products would include biscuits, toilet paper, pasta, rice, dishwashing detergent and canned products.
Gross margin	Sales revenue less COGS (usually expressed as a percentage of sales).
List price	The basic wholesale price set by the supplier that applies to all customers, before any customer -specific trading terms are accounted for.
Packaged groceries	Includes dry, frozen and chilled groceries.
Percentage point	The unit used for the arithmetic difference of two percentages. For example, if a company's EBIT margin in one year was 2 per cent, and in the next year was 3 per cent, the EBIT margin has increased by one percentage point.
Private label	Also known as home brands, own brands, store brands or generic products. These are products that are manufactured or provided by one company (which may also produce its own proprietary branded products in competition with the private label) for sale under a retailer's brand.
Settlement period/terms	The period following invoicing or delivery in which a retailer is required to pay or settle their account with the supplier.
Trading terms	The agreements which set out the conditions, such as discounts, rebates and fees, upon which products will be purchased from a supplier by a retailer or wholesaler.
Ullage	A rebate negotiated by a retailer to compensate them for products which are damaged during transport and rendered unsaleable.
Vertical integration	The undertaking by a single firm of successive stages in the process of production and supply of a particular good.
Wholesale list price	A list of prices compiled by suppliers for the products that they sell to retailers. The wholesale list price is common to all retailers selling the product and is the starting point for price negotiations.

List of shortened forms

ABA	Australian Beef Association
ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
ACC	Australian Country Choice
ACCC	Australian Competition and Consumer Commission
ACCC red meat report	ACCC, *Examination of the prices paid to farmers for livestock and the prices paid by Australian consumers for red meat*, February 2007
Act (the)	*Trade Practices Act 1974* (Cwlth)
AFGC	Australian Food and Grocery Council
AHBIC	Australian Honey Bee Industry Council
AIW	Australian Independent Wholesalers
ALFA	Australian Lot Feeders Association
ALIC	Agriculture & Livestock Industries Council
ANRA	Australian National Retailers Association
APAL	Apple and Pear Australia Limited
ASP	average selling price
ASX	Australian Stock Exchange
BITRE	Bureau of Infrastructure, Transport and Regional Economics
CALC	Consumer Action Law Centre
CFS	Colonial First State
CODB	cost of doing business
COGS	cost of goods sold
CPI	consumer price index
DAFF	Department of Agriculture, Fisheries and Forestry
EBIT	earnings before interest and tax
EBIT margin	EBIT divided by sales
EBITA	earnings before interest, tax and amortisation
EBITDAR	earnings before interest, tax, depreciation, amortisation and rent
EDLP	everyday low prices
EU	European Union

FAL	Foodland Associated Limited
FGV	Fruit Growers Victoria
FPI	food price index
FTC	Federal Trade Commission
GST	goods and services tax
GWF	George Weston Foods
HAL	Horticulture Australia Ltd
HES	Household Expenditure Survey
HHI	Herfindahl-Hirschman index
HSCW	hot standard carcase weight
IGA>D	IGA Distribution
KVI	key value items or known value items
MGA	Master Grocers Association
MLA	Meat and Livestock Association
MSC	major supermarket chain
NARGA	National Association of Retail Grocers of Australia
NFF	National Farmers Federation
OECD	Organisation for Economic Cooperation and Development
PGICAC	Produce and Grocery Industry Code Administration Committee
PGIO	Produce and Grocery Industry Ombudsman
PPI	producer price index
PPP	purchasing power parity
PTUA	Public Transport Users Association
QCA	Queensland Consumers Association
RBA	Reserve Bank of Australia
RGICC	Retail Grocery Industry Code of Conduct
ROFE	return on funds employed
SCCA	Shopping Centre Council of Australia
SIW	Statewide Independent Wholesalers
SKUs	stock keeping units
SSRA	Southern Sydney Retailers Association
VFF	Victorian Farmers Federation
WAIGA	WA Independent Grocers Association

Overview

Most Australians are regular visitors to supermarkets for their grocery needs. As the average Australian household spends around 12 to 14 per cent of its after tax income on standard groceries, increasing prices for these goods have been strongly felt.[1] The high level of media interest and consumer apprehension about grocery prices reflects this sentiment.

Farmers, processors, manufacturers and individuals in the transport, storage and retail sectors all contribute to the grocery supply chain. A significant concern raised during the inquiry is whether the gap between farm gate and check-out prices for groceries has been widening in recent times, such that farmers and suppliers are getting less, while retailers are getting more.

Concerns about the long-term future of small family-run independent supermarket operators and smaller retailers such as butchers, bakeries and greengrocers have also been raised. Their ability to compete with the major supermarket chains (MSCs)—Coles and Woolworths—has come under public scrutiny.

This report focuses on competition in the Australian grocery sector. Specifically, the report asks whether a lack of competition is an explanation for the concerns identified above. The report analyses the extent to which competition (or a lack of it) has contributed to increased grocery prices. The supply chain and bargaining power of Coles, Woolworths and Metcash (the major wholesaler to the independent sector) are given detailed attention. The competitive position of independent retailers also comes under close scrutiny, with an analysis of the factors that may make it difficult for independent grocery retailers to compete aggressively with Coles and Woolworths on price.

Supermarkets sell a diverse range of products. This report concentrates on basic staple products essential to households. These products do not include items such as liquor, cigarettes and stationery, although they are found in most Australian supermarkets.

The inquiry process and key findings

The inquiry held hearings around Australia, received over 250 public submissions and obtained vast quantities of data, information and documents from Coles and Woolworths, other retailers, Metcash and many suppliers. The ACCC would like to thank all those organisations that provided information to the inquiry.

In scrutinising the information before the inquiry, it has become clear that some industry participants, representative groups and commentators have made unsupported claims to the inquiry and in the media. These claims were based on generalisations and there was a failure to provide facts to support the claims.

In addition, certain claims have been based on inappropriate information sources. For example, while the rate of food price inflation in Australia has increased significantly in recent years, it appears that Australian Bureau of Statistics (ABS) figures have been misinterpreted in the media, which has had

1 The 12 to 14 per cent figure is based on the Household Expenditure Survey (ABS cat. no. 6530.0) and Census of Population and Housing (ABS cat. no. 2003.0) data.

the effect of exaggerating the size of the problem. More specifically, retail price data for some food products such as milk, bread and eggs have been compared over time despite clear warnings by the ABS that these price statistics are not fit for such purposes.

The ACCC has focused on making evidence-based findings and recommendations. On the basis of careful analysis of all the material available to the inquiry, the ACCC has made the following key findings:

- Grocery retailing is workably competitive, but there are a number of factors that currently limit the level of price competition, including:
  - high barriers to entry and expansion, particularly in relation to difficulties in finding new sites for development.
  - the limited incentives for Coles and Woolworths to compete aggressively on price.
  - limited price competition that Coles and Woolworths face from the independent sector. Independent supermarkets tend to focus on convenience and service. A key factor inhibiting price competition from the independent retailers is the wholesale prices of packaged groceries supplied by Metcash.
- Price competition is strongest on promotions of key value items (which are products known by the supermarkets to be used by consumers to assess value). This is to be expected, given that the pricing of these products is most likely to encourage consumers to change where they buy groceries.
- ALDI has been a vigorous price competitor since its entry into Australia and has the incentive and ability to engage in sustained price competition. This has had a dynamic impact on the grocery sector and brought about competitive responses from Coles and Woolworths on many products.
- Any possible weakening in the level of competition in retailing is unlikely to have been a substantial contributor to food price inflation in Australian. The gross margins of Coles, Woolworths and Metcash have increased over the last five years. However, ACCC analysis indicates that these increases in gross margins could have only made a small contribution to overall food price inflation.[2] In other words, the vast majority of grocery price increases in Australia are attributable to other factors, such as supply and demand changes in international and domestic markets, increases in the costs of production and domestic weather conditions.
- The ACCC has not identified anything that is fundamentally wrong with the grocery supply chain. Evidence provided to the inquiry does not support the proposition that retail prices have risen while farm-gate prices have stagnated or declined. While there may be some instances where this has occurred, generally movements in farm-gate pricing are set by supply and demand in competitive markets. Changes in the wholesale prices that Coles, Woolworths and Metcash pay suppliers are reflected in movements in shelf prices over time.
- Coles, Woolworths and Metcash have significant buyer power in relation to many packaged grocery products because many suppliers effectively have little option other than to deal with these buyers. Competition between retailers is, however, sufficient to ensure that Coles and Woolworths cannot simply retain all of the benefits of the lower wholesale prices they extract—at least some of the benefits flow to consumers in the form of lower retail prices.

2 Increased gross margins may not reflect increased prices for consumers, and may reflect other factors such as lower wholesale prices or increased efficiencies in retailing.

The grocery retail sector today

The following provides a brief description of the players in the industry:

- Coles and Woolworths, two large vertically integrated retailers (meaning that they operate at the wholesale level and retail level) operating throughout Australia
- ALDI, a vertically integrated retailer operating in Victoria, New South Wales, the Australian Capital Territory and Queensland, which is growing quickly and has a targeted product range
- Franklins, a vertically integrated retailer, with 80 stores in New South Wales
- independent supermarket operators, which generally operate relatively small stores, although there are a number of large-format independent supermarkets. Nearly all independents are supplied with packaged groceries by Metcash. Fresh produce is generally sourced by these stores directly from suppliers or via wholesale markets
- small specialty stores, such as bakeries, butchers, greengrocers, fishmongers, Asian grocers and delicatessens, which sell standard groceries but only a small part of the overall grocery range.

Coles and Woolworths are seen as dominating the grocery sector. Nevertheless, there is a need for some caution when looking at figures used to describe market concentration because a variety of statistics are used. Also, it is clear from the analysis by the ACCC that there are local markets as well as wider regional and national markets.

Statistics analysed by the ACCC suggest that Coles and Woolworths account for approximately 70 per cent of packaged grocery sales in Australia and approximately 50 per cent of fresh product sales, such as meat, fruit and vegetables.

Coles and Woolworths have maintained a fairly consistent share of supermarkets above 1000 m^2 over the last 10 years, with each having just over 30 per cent of stores nationally. Coles and Woolworths are much more significant in relation to larger stores, accounting for around 87 per cent of all supermarkets above 2000 m^2.

There is little evidence to suggest that Coles and Woolworths have simply 'bought out' the competition. Millions of Australian consumers shop at Coles and Woolworths in preference or addition to a number of alternatives—the local independent, the specialty bread shop, the Saturday market and/or the corner shop. High concentration levels alone do not dictate the nature of competition. There are other markets internationally that are more concentrated but appear to be more competitive.

What has caused increased food prices in Australia?

High rates of food price inflation are a key motivation for this inquiry. The ACCC has examined food price inflation in Australia and in comparison with OECD countries. There is little doubt that food prices have increased significantly in recent times in Australia. The evidence shows that a range of domestic and international factors have significantly contributed to food price inflation.

For example, the implications of the drought and supply disruptions caused by natural disasters in Australia have been considerable. The duration of the drought and the extent of the decline in stored water levels have reduced agricultural production and affected the prices of a broad range of food products. Adverse weather conditions have affected food prices and caused considerable price volatility, particularly for fruit and vegetables. Further, where the supply of fruit or other food products

could not be readily supplemented by food imports as a result of quarantine restrictions, prices were more susceptible to sharp price increases when local supply disruptions occurred.

Also, as a result of the world commodities boom, the cost of doing business for many food producers has increased substantially and subsequently put upward pressure on food prices in Australia. For example, raw materials and other inputs into farm production, such as petrol and fertiliser, have risen at an increasing rate since the early 1990s. In this regard, the ACCC notes its contemporaneous examination of fertiliser prices, which finds that the increasing domestic fertiliser prices reflect international prices.

Further, increased international food commodity prices affect the domestic food market. Suppliers consider the returns that can be achieved from exporting their products into the world market against returns that can be achieved from the domestic market.

It is difficult to be precise about the extent to which these domestic and international factors explain the food price inflation experienced by Australian consumers. However, the potential contribution of any weakening of price competition in grocery retailing/wholesaling to food price inflation is limited. In the ACCC's assessment, at most, roughly one-twentieth of the increases in food prices over the last five years could be directly attributable to the increase in the gross margins achieved by the major grocery players.

Competition in grocery retailing

Most grocery retailers and suppliers compete to deliver value on price and quality. Price competition is the strongest on key value items.[3] This is not surprising as the prices of these items are most likely to influence where consumers shop. Price competition is also intense for the types of products stocked by ALDI, indicating the dynamic effect that ALDI has had on the grocery sector in Australia.

Viewed overall, supermarket retailing is workably competitive, but there are a number of factors that currently limit the effectiveness of price competition. These include high barriers to entry for large-format supermarkets, a lack of incentives for Coles and Woolworths to compete strongly on price and the limited price competition from the independent sector.

It is the ACCC's view that the appropriate policy response is to attempt to lower barriers to entry and expansion, in both retailing and wholesaling to independent supermarkets and potential new entrants. The most significant underlying factor explaining the nature of competition in the grocery sector is the high barriers to entry.

The lack of incentives for Coles and Woolworths to compete strongly across the board on prices reflects the high levels of concentration in the industry and frequent monitoring of competitors' prices. Evidence indicates that if one player attempts to lead prices down, the other will follow, making it extremely difficult for either to win significant numbers of customers from the other through an aggressive pricing strategy. There is little incentive (and perhaps limited capability on the part of Coles) to upset the existing balance. Australian consumers would significantly benefit if Coles and Woolworths faced more competitive threats that encouraged more aggressive pricing strategies.

In contrast, ALDI has been a significant influence on Australian grocery retailing. ALDI has forced Coles and Woolworths to react by reducing prices—specifically in states and localities where ALDI is present. Even if a customer does not shop at ALDI, they obtain significant benefits from having an ALDI in their local area or state, as the Coles and Woolworths stores price more keenly. ALDI creates a strong

3 As noted earlier, key value items are products known by the supermarkets to be used by consumers to assess value.

competitive dynamic on the products it stocks and puts pressure on Coles and Woolworths to offer many of their private label products at prices not seen before ALDI's entry.

The entry of ALDI provides an example of how barriers to entry can be overcome, particularly for new styles of retailing. Although there are still very significant barriers to entry for large-format, one-stop-shop supermarkets that would compete across the range with Coles and Woolworths, ALDI has demonstrated that a new player does not have to be a full-service supermarket to generate a significant competitive reaction from Coles and Woolworths. Entry of further grocery retailers with differentiated business models poses a potential competitive threat to Coles and Woolworths.

Metcash and the independent retailers

Coles, Woolworths, ALDI and Franklins have their own wholesale operations. Nearly all other supermarkets in Australia are supplied with their packaged groceries by Metcash. Most of these stores are smaller stores, which largely compete on the basis of convenience, service and local community ties rather than on the basis of price. Almost half the stores are below 500 m^2 in size and only about a quarter are above 1000 m^2. While small independent retailers provide a competition alternative, they do not contribute significantly to price competition.

There are a reasonable number of independent supermarkets that have the size and location that should give them the ability to compete strongly with Coles and Woolworths on price. Indeed, some independent supermarkets do compete on price. However, the ACCC considers that the prices Metcash sets for its wholesale packaged groceries are a significant factor holding many independent retailers back from more aggressive price competition.

Metcash is the only significant wholesaler to independent supermarkets in Australia. Metcash sets its wholesale prices for packaged groceries in such a way that independent retailers can only compete with Coles and Woolworths on price by earning low net margins on the goods supplied by Metcash. Evidence suggests that those independent retailers that attempt to compete on price make their profits on fresh products and individual items sourced directly from suppliers.

Although Metcash is the only significant wholesaler to independent retailers, there are two significant threats that constrain Metcash's pricing behaviour. First, independent stores can either individually or collectively establish their own wholesaling operations for packaged groceries, as Franklins has done. Secondly, there is the threat of the independent supermarkets losing sales to Coles and Woolworths. Both these factors are constraints on Metcash's pricing to independent supermarkets. However, they are limited constraints.

Establishing a rival wholesale operation would involve overcoming many barriers and taking significant financial risk. Further, the agreements that Metcash has with independent retailers and suppliers, which restrict choice in dealing with players other than Metcash, may be protecting Metcash's position and preventing the establishment of rival wholesalers.

If Metcash raised its wholesale prices by a significant amount, many of the larger independent supermarkets that attempt to compete on price would struggle to survive and would lose sales. While sales to smaller independents that tend to compete on convenience rather than price would probably be less affected, overall the loss of sales would hurt Metcash. This constrains Metcash's wholesale pricing to independents to some extent. However, Metcash has an incentive to set its wholesale prices to independent retailers under the pricing 'umbrellas' set by Coles and Woolworths. This limits the ability of independent retailers to compete aggressively on price.

It is often thought that the reason for the higher wholesale prices for the independent sector is the lack of scale. From the evidence available to the ACCC, this may not be the case. The ACCC's analysis indicates that although Metcash buys certain products from suppliers on inferior terms, on some products it buys on equivalent or occasionally better terms than Coles or Woolworths. It is likely, however, that Coles and Woolworths are able to achieve greater efficiencies than Metcash by spreading operating costs over greater volumes.

The ACCC considers that Metcash earns higher margins than it would if it faced direct competition in wholesaling. Unless Metcash faces greater competitive constraints in wholesaling, the potential for larger independent stores to compete with Coles and Woolworths on price may be limited. However, the implications of another large-scale wholesaler entering the industry are unclear. As the only national wholesaler to the independent sector, Metcash can take advantage of significant economies of scale. If there were two large-scale wholesalers, it is possible that neither would achieve the same economies of scale that Metcash has achieved.

Is access to sites a problem?

Access to suitable sites is a critical barrier to entry or expansion. Many new site options are associated with shopping centre developments. The ACCC has accordingly investigated the relationship between Coles and Woolworths, and shopping centre developers very closely.

Because of the reputation that Coles and Woolworths have in driving sales, both retailers are considered almost 'must have' tenants for any successful, large-scale shopping centre. While the preference of centre owners to have Coles and/or Woolworths as tenants reflects the importance of Coles and Woolworths to the success of the centres, it does create a significant barrier to entry for other supermarket operators.

The inquiry heard evidence that Coles and Woolworths engage in deliberate strategies designed to ensure they maintain exclusive access to prime sites. In particular, both supermarket chains include terms in their leases which effectively prevent centre managers leasing space in centres to competing supermarkets. These restrictive provisions usually take the form of an outright prohibition on the centre owner introducing a second, or third, supermarket into the centre for a specified period (commonly around 10 years) or make provision for a sufficient financial penalty, in the form of reduced rent payable, that renders it commercially unviable for the centre owner to introduce a competing supermarket.

A number of supermarket operators provided the inquiry with specific and credible evidence of leases between the major supermarket chains and shopping centres which, they contended, have prevented or delayed their entry into a centre. The ACCC also used its information-gathering powers to obtain leases from Coles, Woolworths and shopping centre owners which confirmed that such restrictive provisions are often included in leases.

The ACCC accepts that there are circumstances where centre developments are occurring, particularly in areas of projected future population growth, where a guarantee of a period of exclusivity is necessary to encourage a supermarket operator to enter. Accordingly, these restrictive provisions play a role in attracting an anchor tenant to a complex that may not otherwise be built without that anchor tenant.

However, in the vast majority of leases in larger metropolitan centres, there appears to be little justification for these clauses other than to prevent competitive entry. In these cases it would appear that such clauses are sought to maximise the profitability of the incumbent supermarket by restricting its exposure to potential competitors.

Restrictive provisions in leases are prohibited under Part IV of the *Trade Practices Act 1974* (the Act) in circumstances where they have the purpose or effect of substantially lessening competition. However, before this inquiry, very few concerns had been raised with the ACCC regarding these lease arrangements and the arrangements have not to date been a focus of the ACCC's enforcement activities.

Given the significant concerns expressed during the inquiry and the information received, the ACCC will be undertaking reviews of specific cases and may take further action. The ACCC encourages independent retailers who have evidence of existing arrangements affecting their ability to establish supermarkets on new sites to contact the ACCC. The ACCC's assessment of the competitive effect of any particular arrangement will depend on the specific nature of the restriction and the characteristics of the market in which the restriction applies.

Concerns were also raised that planning and zoning laws act as a barrier to the establishment of new supermarkets. Independent supermarkets were particularly concerned with impediments to new developments given the difficulties they have in obtaining access to existing sites.

The ACCC also received specific and credible evidence of incumbent supermarkets using planning objection processes to deter new entry in circumstances where the incumbent supermarket had no legitimate planning concerns. When questioned about this practice, Woolworths said such appeals are lodged to protect Woolworths' opportunities for new stores and to protect existing business.[4] Woolworths further stated that this is a practice adopted regularly by other supermarkets.

The ACCC recognises that zoning and planning policies are designed to preserve public amenity. However, zoning and planning regimes, including existing centres' policies, also act as an artificial barrier to new supermarkets being established with the likely unintended consequence of potentially impacting on competition between supermarkets. In particular, existing centres' policies, combined with the strong preference of existing centre owners to lease space to the major supermarket chains rather than independent supermarkets or new entrants, are likely to lead to a greater concentration of supermarket sites in the hands of Coles and Woolworths. Broadly speaking, little regard is had to competition issues in considering zoning or planning proposals.

Further, the complexities of planning applications, and in particular the public consultation and objections processes, provide the opportunity for Coles and Woolworths to 'game' the planning system to delay or prevent potential competitors entering local areas.

Submissions put to the inquiry support planning authorities taking competition issues into account when approving new developments. Given the high barriers to entry in grocery supermarket retailing, including the difficulty in obtaining suitable supermarket sites, the ACCC considers that new ways of incorporating competition analysis into planning decisions should be considered.

Recommendation

The ACCC recommends that all appropriate levels of government consider ways in which zoning and planning laws, and decisions in respect of individual planning applications where additional retail space for the purpose of operating a supermarket is contemplated, should have specific regard to the likely impact of the proposal on competition between supermarkets in the area. Particular regard should be had to whether the proposal will facilitate the entry of a supermarket operator not currently trading in the area.

4 ACCC, public hearing transcript, Melbourne, 19 May 2008, p. 64.

From farm gate to check-out

There is no single ‘story’ that can be told about the grocery supply chain in Australia.

Fresh products

The relationship between the farm gate and the check-out is quite direct for fresh products, such as meat, fresh fruit and vegetables. Coles and Woolworths often purchase directly from farmers, bypassing wholesalers, and then organise any necessary further processing themselves. The ACCC has not found any evidence to suggest that the major supermarket chains are acting in an anti-competitive way in their dealings with suppliers of fresh products. In particular, there is no across-the-board evidence to suggest that retail prices for fresh products are going up by a greater percentage than farm-gate prices. The gross margins of Coles, Woolworths and Metcash in fresh products have as a whole not increased significantly in recent years. There are some examples of relatively minor increases, as well as examples of falls. It is certainly the case that the large price increases in many fresh items over recent years cannot simply be attributed to the retailers.

The bargaining power of Coles and Woolworths in dealings with providers of fresh products will be strong in some cases. However, for a good proportion of fresh products, farmers have the option of selling to export markets or wholesale markets (which in turn supply independent supermarkets, butchers and greengrocers). This lowers the bargaining power of Coles and Woolworths. As stated earlier, Coles and Woolworths supermarkets account for approximately 50 per cent of fresh produce sold in Australia, which is a significantly lower percentage than for packaged groceries.

The ACCC accepts that many Australian farmers are suffering and low prices for their product may be a significant contributing factor. However, the extent to which the market power of retailers contributes to this problem is limited.

Packaged groceries

For packaged groceries, generalisations are often made about farmers receiving a small percentage of the final price charged to consumers. In the case of many packaged products, farmers receive very little, but this typically reflects the other costs that occur in the supply chain, including capital-intensive processing, packaging, advertising, delivery and retailing. The price the farmer receives for many agricultural commodities, particularly products such as sugar and wheat, is set by international supply and demand conditions. At the manufacturer/wholesaler level, it has not been possible in the context of this inquiry to investigate in detail every supply chain in the grocery sector to determine if individual wholesalers or manufacturers have market power. However, the ACCC has investigated very closely whether the major players have excessive bargaining or buyer power, which enables them to damage Australian supply industries. Coles, Woolworths and Metcash have significant buyer power in packaged groceries. This reflects the limited options available to many manufacturers—they often have no option but to sell through Coles, Woolworths and Metcash. On the other hand, Coles, Woolworths and Metcash often have many alternative options, including importing, providing more shelf space to different products or selling private label products.

The buyer power of Coles, Woolworths and Metcash may adversely affect individual competitors. However, the role of the ACCC is to consider competition, not individual competitors. There is no significant evidence to suggest that innovation or competition at the supplier level has been damaged. Further, consumers can benefit from buyer power in the form of lower prices.

In addition, retailers are constrained by the choices that consumers make. Consumers do not readily accept all private label products, which therefore limits options and lowers the major supermarket chains' bargaining power in those areas. For those producers that have strong brands with strong consumer loyalty, there are unlikely to be any concerns about the bargaining power of Coles, Woolworths and Metcash, as these producers hold 'must have' products for retail stores.

Mergers and acquisitions

The inquiry has received a number of submissions alleging that Coles and Woolworths are growing through a strategy of creeping acquisitions of independent supermarkets. The phrase 'creeping acquisitions' generally refers to a series of acquisitions of smaller competitors over time which individually do not raise competition concerns, but which when taken together may have a significant competitive impact. Creeping acquisition might also refer to a player with existing market power making a small acquisition, even though the small acquisition does not substantially lessen competition in itself. Section 50 of the Act, which deals with mergers and acquisitions, is unlikely to be able to deal with creeping acquisitions.

The ACCC does not consider that acquisitions by Coles and Woolworths of smaller competitors over time are a significant current concern in the grocery retail sector. Most of the new growth by Coles and Woolworths in recent years has not come from acquisitions of independent supermarkets. Of all *new* store openings by Coles and Woolworths in the last two years, only 10 per cent have involved acquiring or leasing a site which was previously operating as an independent supermarket. However, that figure has been significantly higher for certain periods in the past.

Although such acquisitions do not appear to be a significant current concern in the supermarket retail sector, the ACCC maintains its support for the introduction of a general creeping acquisition law. The ACCC considers that the supermarket industry, because of the particular structural features of the market, is one where creeping acquisitions are a potential area of concern.

In addition to the issue of creeping acquisitions there has also been interest concerning how the ACCC generally approaches the application and enforcement of s. 50 to supermarket acquisitions.

The ACCC can only oppose a single acquisitions, (or accept a remedy to resolve the ACCC's competition concerns) where it considers that the acquisition, on its own, has the likely effect of substantially lessening competition. The ACCC recently opposed Woolworths' proposed acquisition of the Karabar supermarket in Queanbeyan, New South Wales. This acquisition was opposed based on an analysis of the local retail market, and not on a 'creeping acquisition' approach. It does not reflect any significant change in the ACCC's approach to acquisitions.

The inquiry has, however, revealed a misconception about the ACCC's role and the scope of s. 50. It appears that some industry participants believe that the ACCC can only analyse transactions where there is an acquisition of an existing supermarket business. This is incorrect. The ACCC considers that leases of sites, acquisitions of leases currently held by other parties, and acquisitions of sites that are currently empty or used for other purposes, can all be considered acquisitions of assets under s. 50 or be assessed under other provisions in Part IV of the Act. These transactions may only raise competition concerns in limited circumstances, as new site developments are generally pro-competitive.

Horticulture Code of Conduct

The recent introduction of the Horticulture Code of Conduct was designed to impose a significant cultural and structural change on the horticulture industry. It is difficult to assess the effectiveness of the Horticulture Code, given that it has only been in place for a short period and given the changes it requires the industry to implement.

The introduction of the Franchising Code of Conduct, for example, was controversial at the time. Years later, with the assistance of the peak body, a cultural change has taken place within the franchise sector. The Horticulture Code is similarly likely to take some time to become fully effective.

The ACCC has made a number of recommendations in relation to improving the effectiveness of the Horticulture Code. These recommendations focus on making the Horticulture Code more workable, given existing industry practice, and ensuring that it applies fairly across industry participants. The ACCC recommends that industry feedback through the Horticulture Code Committee be obtained before implementing the suggested changes to ensure that any unintended consequences are appropriately accommodated in the amendments.

Specifically, the ACCC recommends that the Horticulture Code Committee and government consider the following recommendations.

Recommendations

- Amend the Act to introduce civil pecuniary penalties and infringement notices in relation to Part IVB provisions, such as the Horticulture Code and introduce random record audits as an enforcement mechanism available under the code.
- Amend the Horticulture Code to regulate first point of sale transactions of horticulture produce between a grower and a retailer, exporter or processor.
- Amend the Horticulture Code to regulate first point of sale transactions between a grower and a trader in horticulture produce, including in relation to agreements made before 15 December 2006.
- Amend the Horticulture Code to require a merchant to provide a grower, before delivery, with either a price or a formula for calculating price. Any agreed method used to calculate price must be by reference to the amount received by the merchant from the sale of the produce to a third-party purchaser.
- Amend the Horticulture Code to require that if a merchant does not reject the produce within 24 hours of physical delivery, the produce is deemed to be accepted.
- Amend the Horticulture Code to enable a merchant to deduct the cost of any services that are required to prepare the produce for resale as part of the price amount or as part of the method for calculating the price amount.
- Amend the Horticulture Code to only permit an agent to recover their commission for services performed under an agency agreement as a deduction from amounts paid by a third-party purchaser.
- Amend the Horticulture Code to exclude persons who may be an agent's competitor from inspecting that agent's records on a grower's behalf.
- Amend the Horticulture Code to ensure that transactions between a grower and a cooperative/packing house, in which that grower has a significant interest, are exempt from regulation under the Horticulture Code.

- Amend the Horticulture Code to permit agents and growers to engage in pooling and price averaging.
- Amend the Horticulture Code to exempt transactions entered into in a grower shed at the central markets from regulation under the code, while permitting parties to these transactions to access the code's dispute resolution procedure.
- The ACCC also recommends that the costs incurred by the parties to a dispute under the Horticulture Code dispute resolution procedure be subsidised by the Australian Government to the same extent as the voluntary Produce and Grocery Industry Code of Conduct (PGICC).
- The ACCC also recommends the implementation of further education initiatives regarding the Horticulture Code and its dispute resolution procedures, including the role of assessors in resolving disputes.

Unit pricing

As part of the inquiry, the ACCC was asked to investigate the representation of grocery prices to consumers. Unit pricing is the practice of displaying the price by unit of measure (for example, per litre or kilogram) along with the total sale price for each item. Unit pricing can assist consumers by enabling them to readily compare prices between different sizes of the same product, between different branded products and also between stores.

The ACCC recommends that a mandatory, nationally-consistent unit pricing regime be introduced for standard grocery items both on in-store price labels and in print advertising. The ACCC recommends that the unit pricing regime apply to significant supermarkets, including Coles, Woolworths, ALDI and large independent supermarkets. Smaller supermarkets will face higher implementation costs relative to turnover compared to larger supermarkets. The ACCC therefore considers that before unit pricing is introduced a detailed cost–benefit analysis should be undertaken to determine which supermarkets mandatory unit pricing should apply to.[5] Grocery outlets not required to comply with the unit pricing regime should be allowed to display unit prices on a voluntary basis. If they choose to do so, they should be required to comply with the mandatory requirements.

The ACCC has heard evidence that implementation costs of unit pricing will vary depending on the time allowed for implementation. The ACCC considers that a six- to 12-month implementation period will sufficiently reduce costs, while ensuring that unit pricing is implemented in a timely manner. The ACCC recommends that the relevant administrative body, or the Australian Government, consult with industry participants and examine how costs will vary depending on the implementation timeframe.

The ACCC recommends that any legislative mechanisms implemented should also be sufficiently flexible to enable the agency responsible for the unit pricing regime to issue legislative instruments. These legislative instruments should clearly delineate which supermarkets and products are included in the unit pricing regime and allow for appropriate compliance monitoring and enforcement.

The ACCC also recommends that a public education campaign be established to ensure that unit pricing is fully understood by consumers and has the greatest possible impact.

5 Further, an assessment of the extent to which unit pricing should apply to non-print advertising and internet retailers that do not have a physical retail store should be conducted.

Recommendation

The ACCC recommends that a mandatory, nationally-consistent unit pricing regime be introduced for standard grocery items both on in-store price labels and in print advertising, for significant supermarket stores.

Are other solutions required?

Many submissions were received suggesting recommendations to address the suspected drivers of price competitiveness for standard groceries. The inquiry has not found evidence to support many of these suggested recommendations. The three areas where recommendations have been made by the ACCC are:

- the Horticulture Code of Conduct
- unit pricing
- planning laws.

Each of the recommendations are explained above and in more detail in the relevant chapters of the inquiry report.

The issue of market concentration was raised in several submissions received by the inquiry. Suggested recommendations included:

- introduction of a creeping acquisitions law
- other amendments to s. 50
- placing a cap on the market share of any single retailer
- separating the wholesale and retail divisions of Coles and Woolworths.

The ACCC supports the introduction of a creeping acquisition law of general application. However, the ACCC does not consider that the evidence to the inquiry supports the need for the other suggestions mentioned above. Several of the suggestions would be likely to have adverse efficiency effects and would be likely to weaken the competitive environment and therefore have the potential to further increase grocery prices for consumers.

Some submissions have expressed support for the introduction of a system to formally monitor the cost of grocery products in Australia, including periodic surveys of prices from the farm gate through to the retail level. Interested parties contended that this would enable consumers to identify where along the supply chain price increases occur. A price index designed exclusively to measure the prices of an average basket of food and grocery items was also proposed.

The Treasurer announced on 13 May 2008 that the Australian Government had asked the ACCC to conduct a monthly survey of the prices for typical grocery baskets (for example, meat, vegetables and dairy products) across Australia, and to publish the survey results on a dedicated consumer website. The new GROCERYchoice website published by the ACCC will provide practical grocery price information to assist consumers in locating the cheapest supermarket chain in their area. GROCERYchoice is discussed further in chapter 1.

Other suggested recommendations included greater transparency throughout the grocery supply chain to ensure that wholesale sellers and buyers, and independent retailers and wholesalers, are able to make informed decisions. Interested parties also recommended the development of a grocery industry code covering price setting principles. The ACCC's recommendations on the Horticulture Code are

relevant to the issue. These recommendations were summarised above and are discussed in detail in chapter 18. Outside of the context of the Horticulture Code, the ACCC does not believe that the issues raised regarding transparency justify a recommendation. This is because:

- the concerns expressed are unlikely to be addressed through increased transparency and instead reflect broader buyer power issues
- confidentiality in transactions can lower the likelihood of tacit collusion or explicit cartelisation
- regulations that demand transparency are very difficult to enforce since they can often be avoided by parties having undisclosed side-agreements.

Certain parties also raised the issue of price discrimination, where a single supplier charges a different price for the same good to different buyers. Interested parties recommended that the former s. 49 of the Act be reintroduced to prohibit this practice where the price differential cannot be attributed to any actual additional cost. The ACCC does not consider that evidence before the inquiry supports such a legislative change and has not made any recommendations in relation to price discrimination.

Predatory pricing was also raised by interested parties as an issue that required legislative attention. A number of suggestions were made in this area. The ACCC discusses changes in predatory pricing laws in the report, but the ACCC does not consider that any specific recommendations on predatory pricing in the grocery sector are warranted.