Queensland Dairyfarmers' Organisation Limited ABN: 90 090 629 066

Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600
Email: economics.sen@aph.gov.au

4th March 2011

Dear Committee Secretary,

Re: Inquiry into the impacts of supermarket price decisions on the dairy industry

The Queensland Dairyfarmers' Organisation Ltd (QDO) welcomes the opportunity to submit the following comments to the Senate Standing Committee on Economics to assist with its inquiry into the impacts of supermarket price decisions on the dairy industry.

The QDO is the peak industry organisation representing the interests of dairy farmers in Queensland. The QDO is a member of the Australian Dairy Farmers (ADF) and the Queensland Farmers' Federation (QFF).

The QDO is currently seeking further advice on the recommendations we wish to make to this Inquiry and as such the QDO will be seeking to provide a supplementary submission to present these recommendations. However, put simply, the use of milk as a close to or below cost 'advertising agent' by major retailers needs to stop as it has led to a situation of market failure and is undermining the sustainability of the domestic dairy industry.

The QDO would welcome the opportunity to discuss any of these issues and or information presented in our submission with the members of the Senate Inquiry.

Yours Sincerely,

Brian Tessmann
President
Queensland Dairyfarmers' Organisation Ltd

Queensland Dairyfarmers' Organisation

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Submission to the

Senate Standing Committee on Economics

Inquiry into the impacts of supermarket price decisions on the dairy industry

4th March 2011

Introduction & Key Issues

With the initiation of the current milk price war, dairy farmers and their families in Queensland and across the nation are questioning their future in the industry, having endured a decade with severe droughts, floods, cyclones, increasing operational costs and low farm gate returns for much of the period.

In Australia half of the annual milk sales in the domestic milk industry occur through major supermarket chains and the other half of sales occur through the 'route' trade of which the major supermarkets also now have a growing market share.

Major supermarkets, which hold some 80% of the grocery market, are using supermarket 'store brand' milk as a close to or below cost discount price 'marketing agent' in a manner which is devaluing milk nationally and undermining the sustainability of the Australian domestic dairy industry value chain.

If the situation continues it will cause major irreversible damage to the Australian domestic dairy industry affecting investment and employment from the dairy farming sector right through the industry value chain and undermine the production and supply of fresh milk in a number of regions across Australia, particularly in states such as Queensland. The loss of fresh milk production in regions could result in milk having to be freighted further at higher costs and or loss of fresh milk choices for consumers.

On the 26th January, Wesfarmers owned company Coles launched a national advertising campaign using Coles store brand milk at a discounted price of up to 33 percent reducing the price to $1 per litre, following which Coles also discounted other dairy products including cream and butter. Immediately following the Coles announcement Woolworths dropped their price of Woolworths brand milk to match the price and other stores followed suit with some such as Aldi, cutting the price even further to $1.99 for 2 litres and $2.89 for 3 litres.

The discounting of milk by Coles and as followed by other retailers will inevitably force down farm gate prices for milk, which has been supported by public statements from Woolworths and other retailers stating that the reduction in price is unsustainable.

The discount of milk is part of Coles "Down And Staying Down" campaign and Coles has promoted the milk discount as a win for consumers. Coles also present in their advertising that the price is not a 'special', 'it's Down and Staying Down!'.

The strategy is aimed at using milk as a marketing agent as an every day inelastic staple to attract more consumers to Coles stores to grow customer market share and at the same time grow the market share of the Coles supermarket brand milk, at the demise of processor proprietary brands. This in effect is sacrificing the value of milk to serve an advertising function.

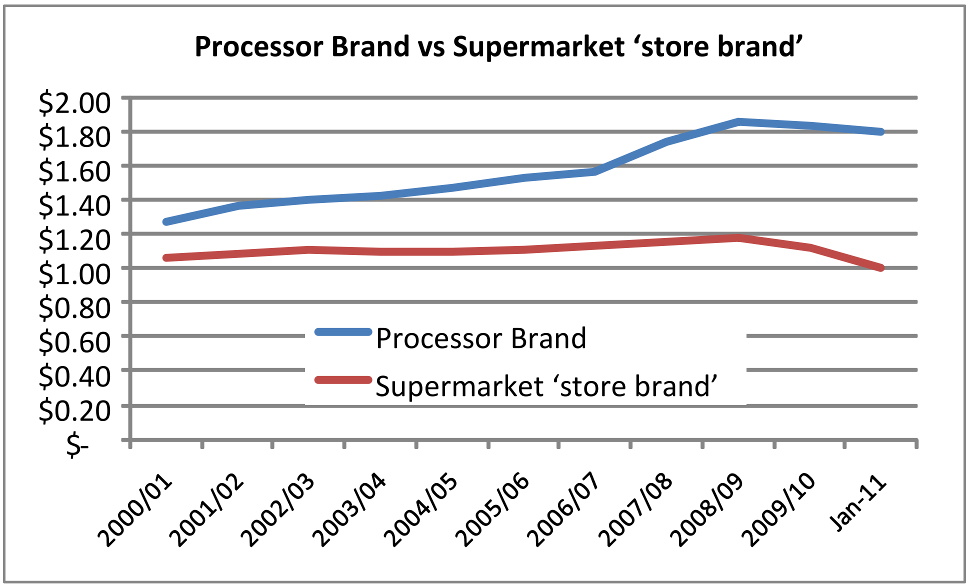
Coles has sought to defend its actions publically, however a number of statements they have made are misleading or completely wrong. Coles have stated that "Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased." Coles has also given this assurance to senior Government Ministers. In stark contrast to the Coles' claims, as stated above, during 2010 farm gate prices for a large proportion of Queensland and New South Wales dairy farmers was reduced in some cases by some 18 percent.

Reduced returns to the dairy industry value chain from major supermarket chains ‘store brand’ strategies is already undermining the profitability, sustainability and viability of the dairy farming sector. A large number of dairy industry organisations and retailers, including Woolworths have stated publically that this practice is unsustainable.

Over the last ten years it has become well known in the dairy industry that cut price predatory type marketing tactics by major supermarket chains drives the price of fresh milk down in the market place. As other retailers have the choice of losing market share or having to drop their price as well to compete, this has resulted in lower returns to the dairy industry value chain and prices to farmers.

The Coles “Down And Staying Down” campaign has involved a significant amount of advertising expenditure over and above other retailers and Coles has gained a significant increase in market share at the expense of other retailers and proprietary brand products. Wesfarmers and Coles executives have publically reported sales growth of their Coles brand milk of between 15 and 20 percent in the first few weeks of the discount campaign.

This price drop increases the price difference between supermarket ‘store brand’ milk and processor branded milk. Generic supermarket ‘store brand’ milk, due to its lower price and margins, gives a lower return to processors and farmers than processor branded milk.



Source Dairy Australia

With Coles gaining increases in market share with its ‘Coles store brand’, there has been a loss of market share and thus sales of processor proprietary brand milk. With this, farm gate prices for farmers supplying milk into these proprietary brand milk products will start to drop this month with the lower sales volumes. This evidence completely discredits the public claim by Coles that farm gate prices would not be affected.

Supermarket ‘store brand’ products generally provide lower margins to both the retailers and manufacturer, but offer greater control of the supply chain, and reinforcing loyalty to the retailer rather than processor brand.

Increasingly, the use of supermarket ‘store brand’ products has seen supermarkets reducing the shelf space available to branded products, narrowing the range of branded suppliers within each category and driving consumers toward supermarket ‘store brand’ products.

This in turn increases competition amongst manufacturers for the supermarket ‘store brand’ contracts, in order to access this important channel to producers, often driving down wholesale prices.

As the major supermarkets have increased the market share of the grocery market they have been able to use their market position to their advantage in a number of different ways. The major example being the implementation of tendering processes for the packing and supply of ‘store brand’ milk supplies. These tenders have ranged in size, but due to their increasing size in overall milk sales volume, have pressured processors to secure these important volumes of product sales turnover to ensure plant efficiencies in key capital city plants. This pressure has seen the negotiation over lower prices for milk to a point where there is no profits – thus processors are now paying unsustainable prices to farmers for the same milk.

While consumers on the whole have benefited from the shift towards a cheaper milk product in this scenario, with a range of choices currently existing between processor proprietary ‘branded’ and supermarket ‘store brand’ products, the increasing market share enjoyed by the supermarket brands creates a risk that at a future point in time supermarkets will start to limit choice as it will not be economical for processors to support proprietary branded products and the innovation in speciality milk products that service a range of preferences for a smaller volume of sales.

This effect over time may limit product choices for consumers and prices could well increase to consumers over time, with no ability from suppliers to influence price other than offering competing products through other outlets. With the major supermarkets taking a larger share of the fuel convenience retail market, the alternate channels to the consumer that are not affected by these influences has also declined.

In recent times with the impact of the economic downturn, major supermarkets have benefited from consumers seeking to economise by moving to lower cost products within product categories such as moving from purchasing processor proprietary ‘branded’ milk to purchasing supermarket ‘store brand’ milk. This transition places processors under further pressure as average returns per litre from processors declines and thus places pressure on processors to reduce prices paid to dairy farmers.

In recent years, the pressure on processors has been a significant factor in further rationalisation and concentration of the processing sector, which has the consequence of presenting fewer options for dairy farmers to negotiate with, for supply of their highly perishable fresh milk product.

For processors seeking to retain margins, this has meant that they have had to increase wholesale prices to other retail channels. This however has had the impact of placing other retail channels under further price competition with major supermarkets. The long term affect of such an environment could be to the detriment of competition and consumers choice.

For processors it is difficult to differentiate regular white milk in the market place. Processors have moved more to the modified milk products with different fat and taste profiles, added nutrients and levels of functionality for consumers.

Processors have been able to capture the benefits of this innovation with more sustainable margins for their branded product, which in turn has supported category development. However, the latest round of retailer price cuts have targeted at this modified milk market segment, and initially reports have presented that processor modified milk brands have lost a significant amount of market share to the heavily discounted supermarket ‘store brand’ modified milk.

If these discount tactics significantly change the market share to be dominated by supermarket 'store brands' it will significantly limit the ability or willingness of processors to invest in new product development, given their inability to capture the benefits in higher margin branded products.

The outcome for the category could be similar to the United Kingdom milk market, where the dominance and periodic price cutting of the supermarket chain 'store brand' product has stifled innovation and new product development.

In the months ahead, the supermarkets will need to renegotiate contracts with processing companies for the milk in the bottles of their 'store brands'. The pressure will then again be on the entire milk value chain for lower and lower prices, even though there is nothing left to trim from the value chain. There is already little to no margin in major supermarket brand milk.

National Foods, which is now the largest milk processor in Australia supplying the domestic market including a number of supply contracts to Coles, has publically stated this week that they "currently make a profit margin of less than 2 per cent on white milk processed for the Australian market" and that "No business would find these returns acceptable, especially given the need to collect milk daily from more than 1000 farmers, maintain a national network of milk factories and also 700 distributors."

Processors are understandably cautious about pushing back on large retailer pressure in relation to 'store brand' tenders as the major supermarket chains provide the largest retail avenue to consumers in Australia for processor branded product sales.

Major supermarket chains, with their own 'store brand' are no longer just retailers, they are manufacturers and brand owners as well with significant brand market share.

The industry is surviving on the value generated by processor branded milk products – and unfortunately the cut-throat pricing is eroding market share from these brands, whilst at the same time placing downward pressure on the value of all milk categories in the market.

The major supermarkets have the ability to sell milk at a lower price than other smaller retailers can buy it at from normal channels and as such smaller retailers cannot compete. Already the vending sector is losing business as small retailers such as coffee shops etc are buying their milk supplies from major supermarkets. A number of vendors have reported drops in deliveries of over 20 percent since the Coles discounting started.

In addition, the major supermarkets with huge market share of all groceries are in a position where they have to cover the costs of these marketing tactics by putting the margin up on other products which consumers do not see. Where as, the smaller retailers and vendors have no such choice and as such suffer losses and eventually face erosion of the viability of their businesses.

It has been reported that the cost to Coles from the milk price cut alone, if as they claim they do not pass on the price cut, would be approximately $60 million per annum and that Coles is spending a record amount of marketing being reported at around $6 million. The cost to Coles and Woolworths is significant and they will not be able to absorb this for any length of time – it will be passed on to consumers through higher prices on other products and recouped from processors and dairy farmers.

A representative from Coles gave evidence to a Senate Inquiry last year that would indicate a similar lack of profit with such cheap milk.

Coles told the inquiry that margins were about 24 percent on previous prices of about $1.20 per litre. With new prices at $1/litre, the previous 24 percent margin would now seem non-existent. It is therefore believed there is a prima facie case for the ACCC to immediately investigate the potential of 'loss leader' predatory marketing.

Over the last decade it is clearly evident that the consumer has been a major beneficiary from the deregulation of the domestic milk price and the growth of major supermarket chain 'store brand' procurement and marketing strategies. However, the benefits consumers have derived and major supermarket chain have procured have come at the cost of the dairy industry production and processing sectors.

In another context the price difference between supermarket 'store brand' prices and proprietary brands is the equivalent of what the major supermarket chains are willing to spend, through foregoing the return on advertising their own supermarket 'store brand', to grow their own market share in the product category, as a mechanism to attract consumers and locate them in the store.

From data presented by the Queensland Dairy Accounting Scheme (QDAS), dairy farm production costs increased by more than 48 percent over the last ten years from 35 cents per litre in 1999/00 to 52 cents per litre in 2009/10. Where as the price received per litre at farm gate was recorded as 39 cents per litre in 1999/00 and for the year ahead of 2010/11 the price will be approximately 53 cents per litre, an increase of just 36 percent. For a lot of farmers who suffered significant price cuts last year this will be less, with negative returns for many. For the Queensland average dairy farm a one cent per litre drop in price will reduce the bottom line of the farm by $9,000.

This situation presents that the viability and sustainability of the production sector has been slowly eroded over the last decade. This is due to the returns to the dairy industry value chain and through the farm gate declining as the major supermarket 'store brand' procurement and marketing strategies have grown the amount of market share major supermarkets have with their own brands.

Reduced returns to the dairy industry value chain from major supermarket chains 'store brand' strategies is already undermining the profitability, sustainability and viability of the dairy farming sector which produces milk on an 'every day of the year' basis for the domestic fresh drinking milk market.

Recent market analysis presents that the average retail price and supermarket 'store brand' price of milk is lower in Queensland than in NSW and Victoria. An analyst presented that they attributed this to competitive forces between major retailers for market share in the growing market of South East Queensland. The major contrast to this situation is that to produce milk in northern Australia, ie northern NSW and Queensland every day of the year is more costly than in temperate environments, however in these regions the retail prices are the lowest.

The QDO has lodged a formal complaint with the ACCC and called for an ACCC investigation into the practices of Coles in relation to potential breaches of the Competition and Consumer Act 2010 including predatory pricing, anti-competitive practices and false advertising.

Unless their practices are stopped the dairy industry will suffer further losses which will lead to farms exiting the industry and causing the loss of employment through the whole dairy industry value chain, especially in states which produce the majority of their milk for the domestic market such as Queensland.

Facts and Figures - Australian Dairy Industry & Domestic Milk Market

2009/10 (p)	Australian fresh milk sales = 2,269 million litres Per capita consumption = 102.4 litres per head
2009/10 (p)	Total milk sold through major supermarket chains accounted for 1,161 million litres or 51% of total domestic milk sales
2009/10	The two major processors supplying the domestic market with drinking milk is National Foods and Parmalat
1999 to 2010	major supermarkets have doubled their 'store brand' market share
1999/2000	major supermarket chain 'supermarket brand' sales accounted for some 25% of total supermarket sales, compared to
2009/10 (p)	major supermarket chain 'supermarket brand' sales doubling to account for some 50% of total supermarket sales or approximately 585 million litres.
2008/09	major supermarket chain 'supermarket brand' volume growth was 6.5%
2009/10 (p)	major supermarket sales grew by 3.8%
2010/11 (f)	major supermarket discounting of milk from the 26th January 2011 has already seen sales growth of 'supermarket brand' milk of between 15 and 20 percent,
2000/2001	difference in price between proprietary 'branded' milk products and major supermarket chain 'supermarket brand' label products in 1999/2000 was $0.18 per litre and for whole milk the difference in price was $0.07 per litre,
2009/10 (p)	the difference in price between proprietary 'branded' milk products and major supermarket chain 'store brand' products in 2009/10 (p) was $0.71 per litre and for whole milk the difference in price was $0.71 per litre,
2010/11 (f)	if the major supermarkets continue to discount milk to $1 per litre then the price difference will increase to over $0.87, assuming no other price changes occur in milk processor proprietary 'branded' products,
1999/2000	'supermarket brand' label price for regular whole milk was $1.26 per litre, and supermarket market share of whole milk sales through supermarkets was 31 percent and processor brands 69 percent,
2009/2010(p)	'supermarket brand' label price for regular whole milk had dropped to $1.12 per litre or 11% and supermarket market share of whole milk sales through supermarkets increased to 71 percent and processor brands declined to 29 percent,
2010/2011(f)	the current discounting has seen prices drop to between $0.96 and $1.00 per litre,
1999/2000	proprietary 'branded' price whole milk was $1.33 per litre,
2009/2010(p)	proprietary 'branded' price whole milk was $1.83 per litre up 38%,
1999 to 2010	inflation increased by approximately 36%,

The following Table 1 provides Dairy Australia's figures for 2009/10 (p) and 1999/2000 for branded and supermarket 'store brand' milk sales volumes and average prices sold through supermarkets.

Over the last ten years supermarkets have more than doubled their supermarket milk brand market share through using a range of discount and marketing tactics.

When this value difference of milk sales is equated across the market share of major supermarket chain ‘supermarket brand’ sales for 2009/10 (p) compared to the value of proprietary brand sales through supermarkets the difference is $414 million and some $90 million per year in the Queensland market. In 1999/2000 the value difference amounted to some $44.5 million.

As a result processor brands have lost market share and the margin to the industry has been reduced to a point where the loss in value to the dairy industry is over $414 million per annum, compared to $44 million ten years ago.

If this amount of money, $414 million, was retained at the farm gate it would translate to an increase in farm gate price for dairy farmers of 18 cents per litre for milk supplied for the domestic fresh drinking milk market.

This is the amount the large retailers have taken out of the value chain with their supermarket brand procurement, branding and marketing policies, which previously flowed back through the industry value chain.

To get a further insight into the impact of the current discounting of milk Table 1 also provides a forecast impact analysis.

The first forecast is based on 2009/10 milk volumes, with the assumption that the discounting runs for a year and results in an average price for supermarket brand whole and lite milk of a $1 per litre with no change in market share of supermarket “store brands”.

The result is that the 2009/2010 value of all milk sold through supermarkets was $1.92 billion but with the supermarket discounted ‘store brand’ milk the value of milk sold through supermarkets for the year would be devalued by $96 million to $1.82 billion.

In addition the accumulated value difference would increase from 71 cents to per litre to 87 between the two categories of milk, being supermarket ‘store brand’ and processor proprietary brands, with the current supermarket price cuts. This increasing price difference between the categories provides the supermarkets with a larger price marketing advantage over processor proprietary brands.

The second forecast includes in an increase in market share of 15 percent of whole and lite milk supermarket “store brands” at the expense of a loss of market share of 15 percent by processor whole and lite milk proprietary brands.

The result is that the movement of market share from processor proprietary brands to supermarket “store brands” combined with the discount of whole and lite milk supermarket “store brands” to $1 per litre further devalued milk sales from $1.92 billion to $1.75 billion being a reduction of $158 million.

This data clearly presents that the large discounting of milk by Coles is devaluing the value of milk sold through supermarkets nationally and is causing a significant loss in returns to the dairy industry value chain which is not sustainable.

Table 1 Comparison of National Milk Sales through Supermarkets

	1999/2000			2009/10 (p)			2010/11 (f) Price Cut & 15% Market Share Change		
	Branded Milk Sales			**Branded Milk Sales**			**Branded Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	325,000,000	$ 1.33	$ 432,250,000	148,000,000	$ 1.83	$ 270,840,000	94,150,000	$ 1.83	$ 172,294,500
Reduced Fat	168,000,000	$ 1.47	$ 246,960,000	185,000,000	$ 2.03	$ 375,550,000	158,450,000	$ 2.03	$ 321,653,500
Low Fat	88,000,000	$ 1.53	$ 134,640,000	59,000,000	$ 2.07	$ 122,130,000	59,000,000	$ 2.07	$ 122,130,000
Flavoured	36,000,000	$ 2.36	$ 84,960,000	74,000,000	$ 3.72	$ 275,280,000	74,000,000	$ 3.72	$ 275,280,000
UHT	70,000,000	$ 1.33	$ 93,100,000	110,000,000	$ 1.63	$ 179,300,000	110,000,000	$ 1.63	$ 179,300,000
Other	17,000,000	$ 1.57	$ 26,690,000						
	704,000,000	$ 1.45	$ 1,018,600,000	576,000,000	$ 2.12	$ 1,223,100,000	495,600,000	$ 2.16	$ 1,070,658,000
	Private Label Milk Sales			**Private Label Milk Sales**			**Private Label Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 1.26	$ 185,220,000	359,000,000	$ 1.12	$ 402,080,000	412,850,000	$ 1.00	$ 412,850,000
Reduced Fat	22,000,000	$ 1.37	$ 30,140,000	177,000,000	$ 1.30	$ 230,100,000	203,550,000	$ 1.00	$ 203,550,000
No Fat	3,000,000	$ 1.47	$ 4,410,000	4,000,000	$ 1.63	$ 6,520,000	4,000,000	$ 1.63	$ 6,520,000
Flavoured	-	$ 2.74	$ -	5,000,000	$ 2.01	$ 10,050,000	5,000,000	$ 2.01	$ 10,050,000
UHT	74,000,000	$ 0.90	$ 66,600,000	40,000,000	$ 1.15	$ 46,000,000	40,000,000	$ 1.15	$ 46,000,000
Other	-	$ -	$ -						
	246,000,000	$ 1.16	$ 286,370,000	585,000,000	$ 1.19	$ 694,750,000	665,400,000	$ 1.02	$ 678,970,000
	950,000,000	$ 1.37	$ 1,304,970,000	1,161,000,000	$ 1.65	$ 1,917,850,000	1,161,000,000	$ 1.51	$ 1,749,628,000
	Difference in Branded & Private Label Milk Sales			**Difference in Branded & Private Label Milk Sales**			**Difference in Branded & Private Label Milk Sales**		
	Litres	**Price/Litre**		**Litres**	**Price/Litre**		**Litres**	**Price/Litre**	
Regular Whole	147,000,000	$ 0.07	$ 10,290,000	359,000,000	$ 0.71	$ 254,890,000	412,850,000	$ 0.83	$ 342,665,500
Reduced Fat	22,000,000	$ 0.10	$ 2,200,000	177,000,000	$ 0.73	$ 129,210,000	203,550,000	$ 1.03	$ 209,656,500
No Fat	3,000,000	$ 0.06	$ 180,000	4,000,000	$ 0.44	$ 1,760,000	4,000,000	$ 0.44	$ 1,760,000
Flavoured	-	-$ 0.38	$ -	5,000,000	$ 1.71	$ 8,550,000	5,000,000	$ 1.71	$ 8,550,000
UHT	74,000,000	$ 0.43	$ 31,820,000	40,000,000	$ 0.48	$ 19,200,000	40,000,000	$ 0.48	$ 19,200,000
Other	-	$ 1.57	$ -						
	246,000,000	$ 0.18	$ 44,490,000	585,000,000	$ 0.71	$ 413,610,000	665,400,000	$ 0.87	$ 581,832,000

Further to the above, this impact is also increasing across the whole Australian milk market as the major supermarkets are now actively pursuing market share from the ‘route’ trade including from independent fuel stations, corner stores, other small retailers, and distributors and vendors.

While the price cuts to supermarket ‘store brands’ announced by Coles and Woolworths are currently being absorbed by the retailers, if they are maintained they can be expected to flow on to other branded products and market channels.

This is an extreme concern to the dairy industry as the margin from processor proprietary brands sustain the dairy industry value chain at this time compared to the extremely slim margins available from supermarket ‘store brand’ milk sales.

The current aggressive move by the major supermarket Coles is aimed at changing consumer behaviour and increasing market share and other retailers are seeking to protect their market shares.

The table below outlines a possible scenario for the whole national drinking milk category, as consumers shift to supermarket ‘store brands’. This is a static analysis for indicative purposes only, note the assumptions that have been made, which are detailed below. The total changes quoted in the table assume that all these impacts occur, and there is no subsequent response from consumers in terms of their buying behaviour.

Table 2	**Retail value of drinking milk category ($mill)**		
	Supermarket	**Route***	**Total**
2009/10	$1,916	$2,350	$4,266
Initial price cut to $1 per litre for all supermarket whole and reduced fat ‘store brand’ products (absorbed by retailers)	$1,820	$2,350	$4,171
15% shift to supermarket price cut whole and reduced fat ‘store brand’ product with no overall consumption increase*	$1,750	$2,350	$4,100
15% shift from route trade to supermarket ‘store brand’ label product at price cut whole and reduced fat supermarket ‘store brand’	$1,903	$2,025	$3,928
15% decrease in branded price to compete with lower supermarket ‘store brand’ label products	$1,703	$1,721	$3,424
Change from 2009/10 benchmark*	-$213	-$629	-$842

**Assumptions:* *route retail price is equivalent to branded supermarket retail price, cuts to branded prices are made in both supermarket and route outlets, no overall consumption increase reflecting limited price elasticity of milk consumption, price cut maintained for 12 months*

Source: Extrapolated from Dairy Australia Data 2011

As illustrated in this scenario, while the initial cuts estimated at $96 million may be absorbed by the supermarkets, the flow on effects could be significantly higher, dependent on the degree of consumer shifts, and the adjustments made to branded prices.

As is expected if discounting battles continue between major supermarkets the reduction in supermarket 'store brand' will have flow on impacts including;

- devaluing all supermarket 'store brand' milk sales as major supermarket compete with other to protect market share and continue to use 'store brand' milk as an advertising agent,
- devalue processor proprietary brands of milk as processors either resort to discounting and or increase advertising to try and mitigate market share losses across both supermarket and route trade market channels,
- reductions in the retail price of processor proprietary branded product and supermarket 'store brand' products will necessarily flow through to wholesale prices and processor profitability, as will any shift to lower margin resulting from these price discounts.

In order to demonstrate the potential impact, if it was assumed that the devaluation of milk was shared equally amongst the three main sectors of the dairy industry value chain, being retailers, processors and dairy farmers then the following would occur;

- overall milk value chain loss is estimated at $842 million,
- each value chain sector would have to absorb a loss of approximately $281 million,
- average dairy farmer would see a reduction of 12.4 cents per litre or for a average farm with a production of 1 million litres a loss of $124,000, which for the majority of dairy farmers at this size would render them unviable.

Background to the Dairy Industry

Australian Dairy Industry

There are around 7500 dairy farms in Australia and 1.6 million dairy cows producing 9 billion litres of milk annually (*Australian Dairy Industry In Focus 2010*).

This makes the dairy industry Australia's third largest rural industry with a farm gate value of $3.4 billion. It is estimated that approximately 40,000 people are directly employed on dairy farms and manufacturing plants. Related transport and distribution activities, and research and development projects, represent further employment associated with the industry.

The dairy industry is one of the largest value added rural industries with most milk produced in regional areas and generating more then $9 billion in ex-factory sales each year.

In 2009/10 approximately 55 percent of national milk production is consumed domestically and states such as Queensland the domestic market consumes some 95 percent of production. Approximately 45% of annual milk production is exported to a large number of different countries in a range of different dairy products. Domestic drinking milk consumption makes up around 25% of all Australian milk production.

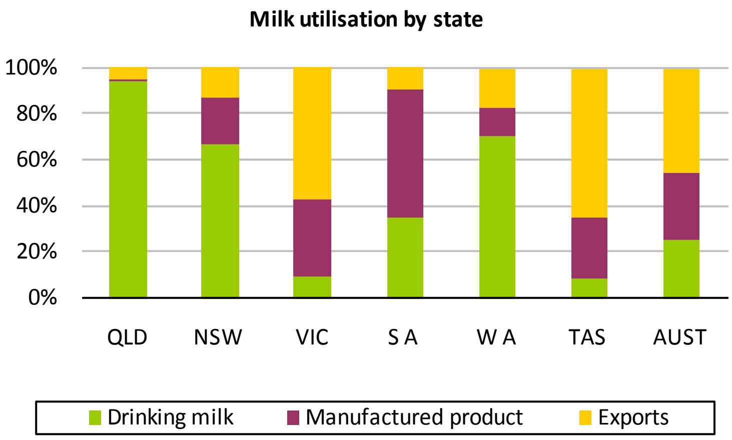
So therefore on average of every 100 litres of milk produced in Australia, 25 litres is consumed as drinking milk, 30 litres is consumed domestically in form of manufactured dairy products and 45 litres is exported in the form of dairy manufactured products.

Due to the effects of several years of drought, national milk production has reduced below the peak reached in 2001/02, with minimal growth in output over the past few years. With this, the Australian market has steadily grown in importance and influence in recent years as overall milk output has fallen. Supply to the domestic market has grown slowly whilst the volume and share of exports has declined.

The Australian market has offered good value and volume growth, although the recent economic downturn has also weakened consumer markets as households have economised on food spending, limiting the gains in average unit selling prices across the dairy category.

The Australian dairy industry is unregulated with no trade support mechanisms. The industry has to compete in the world market in a trade environment which is often deemed to be the most distorted of any agricultural commodity, with many countries using export subsidies, tariffs and a range of other protectionist mechanisms which distort the international supply and demand functions, price and resource flows.

Many protectionist trade policies have heightened the impact of the Global Financial Crisis on international prices and trade of dairy commodities.



Source: Dairy Australia

Across the different production regions of Australia the price for dairy products and drinking milk is influenced by different market forces.

In the south eastern milk production regions such as Victoria where the majority of milk production is manufactured into products for export, farm gate prices are largely influenced by the international price for dairy commodities and the exchange rate.

The majority of wholesale dairy product prices in the domestic retail, foodservice and industrial product markets are more influenced by prevailing international prices than the domestic market. This reflects the share of exports in processed dairy products, longer shelf life of processed dairy products, as well as the virtually free access to the domestic market for dairy imports, however this international price influence changes with transport distance between competitors.

In milk production regions such as Queensland, New South Wales and Western Australia where the majority of milk produced is consumed by the domestic market as drinking milk, farm gate prices are more influenced by contract negotiations between processors and retailers, regional milk production levels, location of regional milk production pools and processing plants, the distance milk can be viably transported both in terms of cost, maintenance of quality and the location of markets.

In milk production regions such as Queensland, New South Wales and Western Australia the majority of milk produced is now consumed by the domestic market as drinking milk, as over the last ten years since deregulation these states have produced less milk leading to the rationalisation and closure of dairy product and UHT processing plants.

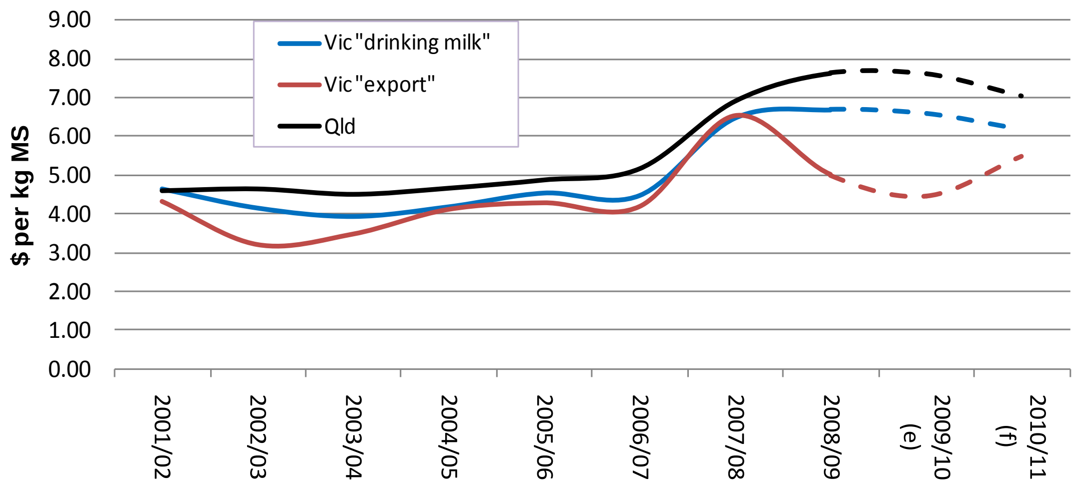
These differences in product and market mix mean that there are differences between the regions in production systems, costs of production and farmgate price drivers.

Farmgate price drivers in the regions that primarily service the drinking milk market mostly reflect the balance between local demand for drinking milk and security of supply.

The lack of relationship between international dairy price movements and domestic price movements in recent years is demonstrated by the following graph from Dairy Australia.

This is in contrast to recent public claims by Coles executives that, "The farm gate price dairy farmers receive is set by the world price because most Australian milk products are exported. (Coles statement 15th February 2011), which as demonstrated by the following graph is incorrect.

Average farmgate milk price comparison



In the absence of any manufacturing infrastructure, milk production in the region has had to be closely matched with daily fresh demand in recent years. This is a challenge for both farmers and processors, as either over or under supply represents significant issues for the regional market, producing a flat supply curve is costly for farmers, while coping with seasonal peaks and troughs imposes costs on the processing sector.

Given these dynamics it would be hard to argue that farmgate prices in Queensland, parts of New South Wales and Western Australia aren't significantly influenced by retail prices for drinking milk.

The Northern Dairy Industry

The northern dairy region incorporating Queensland and northern NSW currently supports approximately 800 dairy farms producing around 820 million litres of milk annually, (QDO estimate from Dairy Australia 2009/2010 Data).

Within the region there are seven major processing plants operated by two companies and one co-operative, being National Foods, Parmalat and Norco (producer owned co-operative) and more than 50 minor processing factories (refer to Figure 1 for location of dairy farming regions and processing factories).

The northern dairy industry employs approximately 4500 people, incorporating some 2700 on farm and the remainder in processing and distribution.

On an annual basis, the northern dairy industry is valued ex-factory at approximately $1 billion.

Figure 1: Map indicating the location of northern dairy industry farms and processing plants.

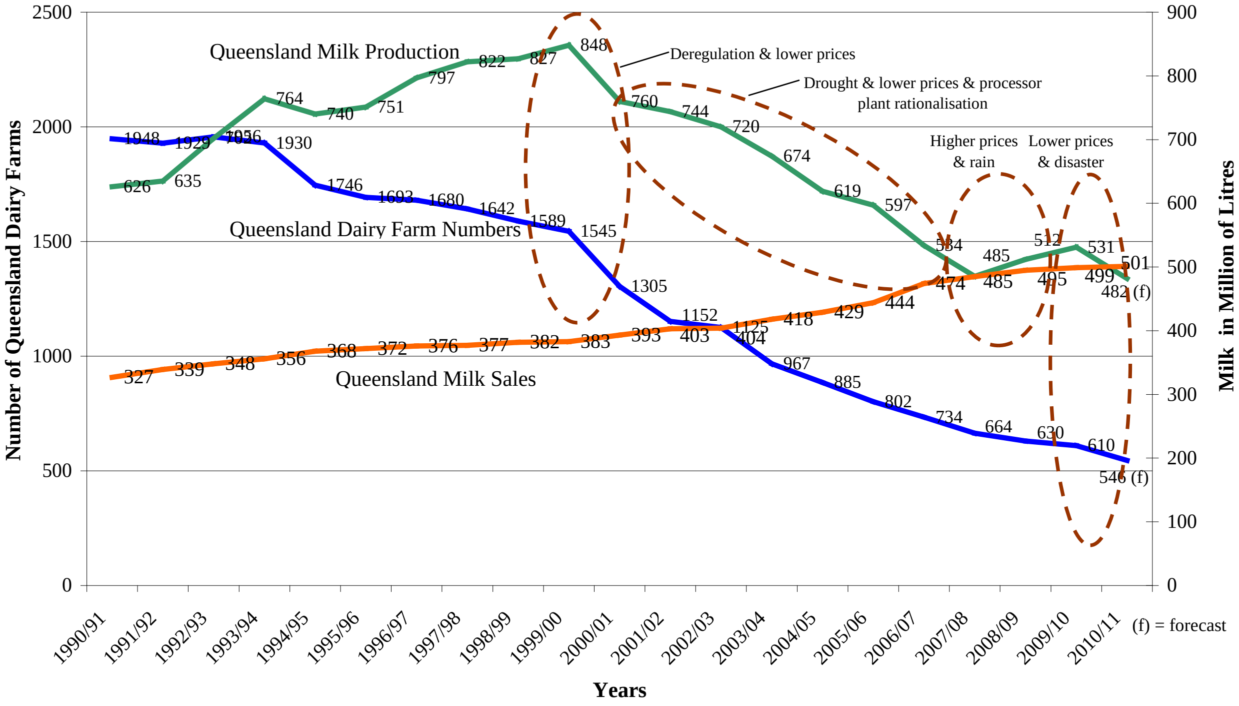
Population growth in the coastal regions of Queensland and northern NSW has in recent years been driving ongoing expansion in fresh milk and dairy product markets in retail and food service sectors. At the same time, increases in per capita consumption of fresh milk products and effective brand marketing of flavoured and functional milk products have also contributed to this increase.

Fresh milk sales growth for Queensland has over several years been the fastest of the Australian states, with sales volumes in the year to June 2008 up 5.5% over the prior year, compared to a national volume increase of just 2.0% (Dairy Australia, 2008). However in the past year, the economic downturn has influenced an easing in the demand growth in milk sales in the Queensland market as consumers tightened their spending on discretionary purchases. Sales growth in Queensland for the year to June 2010 slowed to less then 1 percent compared to 1.8 percent nationally and to the end of January 2011 sales have dropped to a negative 0.5 percent.

Queensland dairy industry

Deregulation, natural disasters, increasing operational costs and poor farm gate returns have seen the dairy farm population of Queensland fall by more then 60 percent over the last decade from 1,545 in 2000/01 to around 582 currently. Even with these many challenges dairy farmers have continued to improve their productivity.

Comparison of Queensland Dairy Farm Numbers, Milk Production & Sales from 1990/91 to 2010/11



Over the last decade milk production has fallen from 848 million litres in 1999/2000 to 531 million litres in 2009/10.

- The dairying regions of southern Queensland, including the Wide Bay Burnett, Darling Downs and South East Queensland regions combined have some 465 dairying enterprises. The majority of these farms supply one of three main processors including Parmalat, National Foods and Norco.
- Far North Queensland dairying region of the Atherton Tablelands is made up of 66 dairy farms supplying one processing plant at Malanda owned by National Foods. The region also has a few small niche market processing plants producing cheese and organic dairy products.
- The Central Queensland has approximately 51 dairy farms that supply the Parmalat owned processing plant at Rockhampton.

Of the current 582 Queensland dairy farms approximately;

- 269 supply National Foods,
- 264 supply Parmalat,
- 33 supply Norco,
- 15 supply small micro processors.

In Queensland there exist a number of collective bargaining groups or co-operatives that represent dairy farmers including:

- Premium, which is a registered Collective Bargaining Group that represents dairy farmers which supply Parmalat.
- Port Curtis Dairies which supplies the Parmalat Rockhampton plant,
- Progressive Dairies, which is a registered Collective Bargaining Group, under the Australian Dairy Farmers ACCC authorisation, that represents a small group of dairy farmers that supply National Foods,
- Dairy Farmers Milk Co-operative, which is owned by dairy farmers which supply National Foods,
- Norco Co-operative, which is owned by dairy farmers which supply the market with their own Norco branded milk and a range of other dairy products.

Producers in Queensland are paid to supply milk all year round to meet the fresh daily drinking milk market demand and that to produce milk year round in northern subtropical production environments is a higher cost production system. As such prices paid to dairy farmers in Queensland have generally been higher than to producers in southern dairying regions due to the fact that the Queensland dairy farmers are supplying a fundamentally different market than their southern counterparts.

The only alterative would be for processors to transport milk long distances to service Queensland markets which would be at a high cost and the quality and shelf life of the end product would decline. In addition, the southern dairy industry seasonally produces milk and would at times of the year not meet the volume or quality requirements of the northern industry for fresh daily product every day of the year.

During 2010 there has been significant downward pressure on farm gate prices for Queensland dairy farmers with contracts that have come due for renegotiation.

The majority of the farm contracts which came due involve dairy farmers which supply National Foods, with a smaller number with short term supply contracts with Parmalat and Norco.

Farm, gate prices have been dropped by approximately 15 to 18 percent for the majority of farmers, which includes farmers that supply milk for Coles supermarket branded milk, and approximately 10 percent for a smaller number of farmers for milk which is sold as fresh drinking milk.

In addition a major processor has introduced a two Tier pricing system with the first Tier reflecting fresh bottled milk sales and the second Tier milk used for manufacturing with a lower price. The price offered for Tier is around 47 cents per litre for some 70 percent of the farmers' production, based on last year's contracted production volume. For Tier Two the price on offer is around 30 cents per litre on the remaining milk production. These reductions are not sustainable for dairy farmers operating in the Queensland environment and will result in many farms experiencing negative returns this year.

In has been publically reported by Coles that they had awarded an increase in price to milk processor National Foods in January 2011, however there has been no increased price to farmers at this stage. It is understood however negotiations are still in process with the largest dairy farmer supplier group Dairy Farmers Milk Co-operative (DFMC).

Over the last decade the Queensland dairy industry has experienced a number of major impacts following deregulation, including;

- the longest drought in recorded history for many regions,
- severe floods and cyclones,
- poor farm gate returns for much of the period,
- a continual erosion of returns from the market place due to the growth in market share of major supermarket milk brands at the expense of processor proprietary brands,
- rising costs of production,
- an increase in government regulation and redtape,

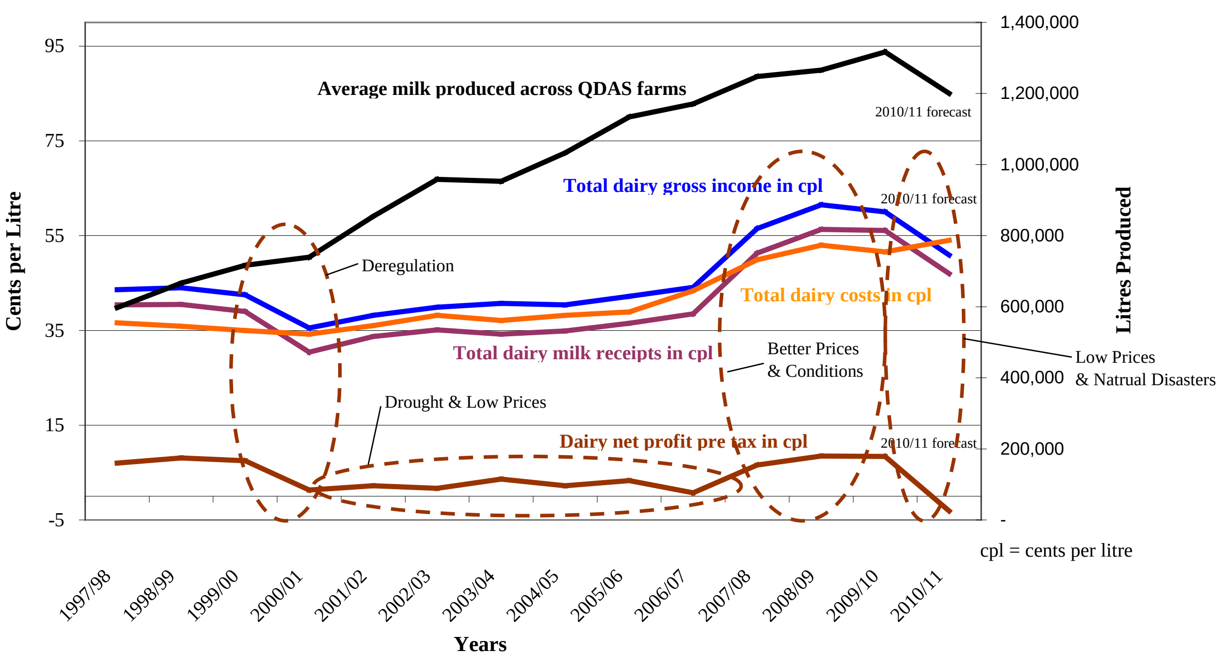
2008 saw a return to confidence in the industry with increases in milk price and expanding consumer demand. This confidence was reflected in the 2008 National Dairy Farmer Survey results with 80% of respondents in the northern dairy region responding to a national dairy farmer survey expressing a positive attitude. Along with this improved confidence attributed to higher milk prices, 54% of surveyed farms in the region indicated investment intentions across a variety of asset types including improving farm systems, machinery, dairy and feed infrastructure (Freshlogic, 2008).

This sentiment however has declined significantly in the last year with farm gate prices being dropped and even further with the impact of severe flooding and cyclones and even further with the initiation of a domestic market milk price war by Coles.

With the harsh operational conditions, poor farm gate returns and poor outlook with the devaluation of milk at retail level, the QDO has forecast that more then 60 Queensland dairy farms could exit the industry this year.

The following graph provides a presentation of data from the Queensland Dairy Accounting Scheme (QDAS) for income, costs and returns from 1997/08 to 2009/10 with the addition of a forecast for the 2010/2011 financial year.

Queensland Dairy Accounting Scheme Data 1097/98 to 2010/11



QDAS is an industry program developed and delivered by Queensland Primary Industries and Fisheries (QPI&F) to improve the understanding of business principles by providing farm management accounting information and analysis to northern dairy farmers and advisors. It is important to note that QDAS does not present a picture of the average performance of Queensland farms and in fact presents a picture of above average. The number of farms involved in QDAS has declined with the drop in farm numbers over the last decade. In 1997/98 there were 346 farms involved in QDAS whereas in 2009/10 there were 54 dairy farms involved.

This graph presents key financial performance data of dairy farmers which have participated in QDAS over the last 13 years. The 2010/11 figures presented are estimates produced from a forecasting model based on current changes to and information on impacts on key dairy farm variables gained from a survey of dairy farms.

Prior to deregulation regulated milk prices provided a stable return to the farm enterprise and even in times of natural disasters such as the severe droughts of the 1980's and 1990's the QDO was able to negotiate a price increase to cover the costs of the impacts and to ensure a stable supply of fresh milk to the domestic market.

Following deregulation prices to dairy farmers in Queensland dropped significantly from a regulated price of 54.9 cents per litre and an average farm price (weighted average of combination of regulated drinking milk price and manufacturing milk price) of 36.82 cents per litre in 1999/2000 to a single farm gate price of approximately 31 cents per litre 2000/2001.

The significant drop in price, even with the provision of the deregulation support packages saw the exodus of many dairy farmers from the industry. Following deregulation the Queensland dairy industry was again plagued by severe drought for over a decade and this impact combined with low farm gate prices and higher operational costs saw farm numbers and milk production continue to decline through to 2007/2008.

At this level of production from the region it barely met annual supply requirements of the market and at various times of the year fell well below market requirements.

With this situation, combined with repeated calls from dairy farm organisations processors increased farm gate prices and offered longer term contracts. With a return to more normal seasons milk production increased to be in surplus of market needs, however with the impact of sever flooding and cyclones and lower farm gate prices it is forecast that production will decline by more then 12 percent this year and again create a shortfall of milk to market needs.

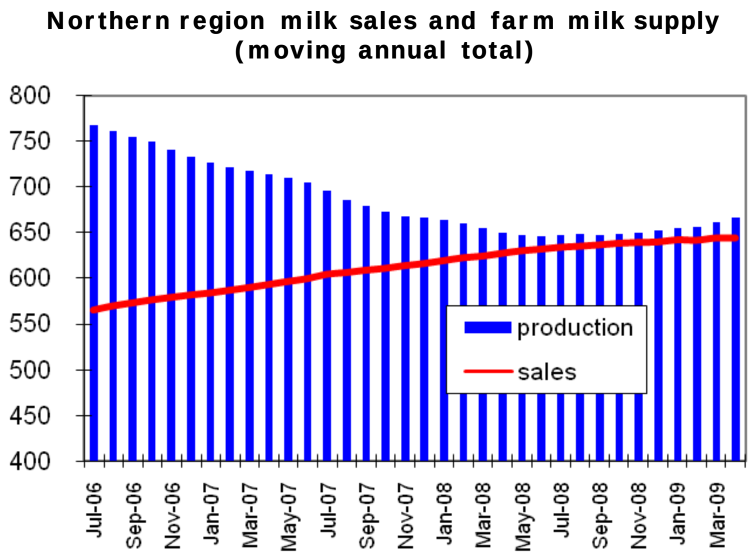
For many farmers the passing through of any margin losses by processors would eliminate their profits altogether. It is estimated by Dairy Australia that in the most exposed region of Queensland and northern New South Wales a 10 percent shift toward supermarket 'store brand' label alone would halve farmers' 2009/10 profits should the processor be forced to pass the impact on to farmers. Average farm incomes for the region are already set to be drastically reduced in 2010/11 for many farmers due to lower average farmgate price, as well as the impact of natural disasters.

Regional Demand and Supply

Milk production in the northern region (Southern Qld and Northern NSW) steadily declined for about 8 years. This was due to prolonged drought, relatively low milk prices, irrigation water shortages, farm size constraints, rising input costs, and the incapacity of farm operators to cope with an increasing complex operating environment.

The conditions combined with an ongoing low milk price outlook exposed producers to volatility and weakening confidence in returns from the regional supply chain.

During the 2007/2008 financial year regional milk supply fell to levels barely sufficient to meet local fresh milk demand, affecting processors' ability to manage their supply chains and confidently meet customer requirements.



At this time alternate milk supply options were also under stronger competitive threat due to the lack of growth in southern milk supplies and the strong export demand for dairy products at historically high export prices.

Over the last decade due to a lack of economic milk throughput, processors have rationalised and closed a number of processing plants that processed milk excess to fresh daily demands into a range of products including Ultra High Temperature (UHT) milk, cheese, butter and milk powders.

Dairy processing plants which have been closed have included Toowoomba, Warwick and currently Booval. In addition a number of current plants have had their operations rationalised and dairy processing lines closed and moved to southern regions. As a result, the region no longer possesses production facilities that can cope with converting milk, that is in excess of fresh product demand, into storable dairy products, requiring careful logistical management and milk balancing to avoid incurring excessive costs.

The absence of any material volumes of milk being converted into commodity dairy products enabled processors to offer milk prices that better reflected returns from the fresh milk market. In effect, regional milk prices had been suppressed for many years because of the existence of a "surplus" of milk above economic processing volumes, as regional manufacturing plants were small in capacity and therefore less able to compete with the cost and reliability of the supply of product from larger southern facilities in the marketplace.

After some delay in farmgate prices reflecting the fragility supply/demand situation, milk prices in the northern region rose significantly in 2007/08 and have been reflected in milk supply contracts of up to 5 years in length being offered by Parmalat, the largest processor of milk in the region, which compelled other companies to match these levels. This has resulted in a "decoupling" of milk prices in the Northern region from the influence of southern milk values.

In 2008/09, a combination of the higher milk prices, existence of long-term milk supply contracts and the best seasonal conditions seen for many years and reduced bought-in feed costs has resulted in stronger milk supply and a strong improvement in producer confidence in 2009/10.

The recent strong recovery in milk production coupled with a slowing in demand growth created an over-supply of milk to regional milk processing plants in 2009/2010 (based on regional market demand). With the absence of regional manufacturing plants to process such surplus, processors have incurred higher costs in moving milk to plants in NSW. As a result of the surplus milk issue processors have or are moving toward a two price structure system where by one price reflects milk which is sold as drinking milk and the other reflects milk being sold for other purposes.

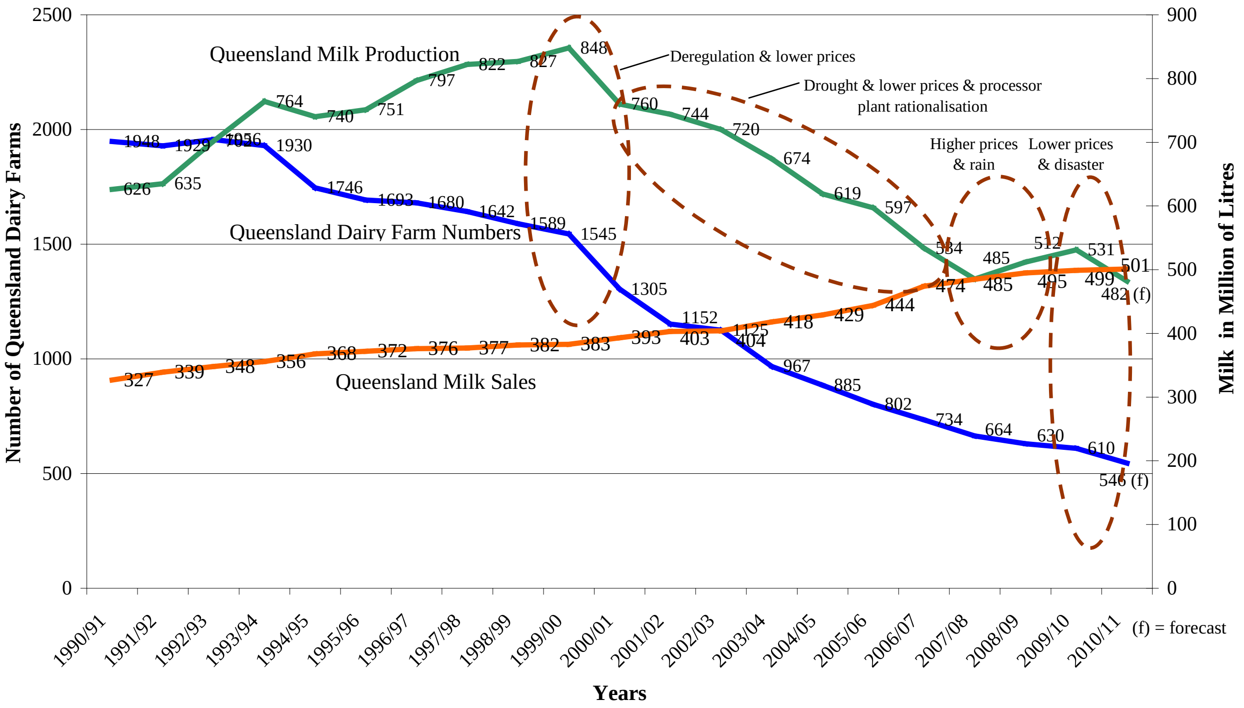
While the permanence of price signals is important to future producer and investor confidence, over-supply of milk in the region may weaken milk prices if suitable returns for surplus milk volumes cannot be sustained.

In the last three months however lower prices combined with natural disasters is forecast to see a fall in production which has already and will continue to test the ability of the industry to meet market demand.

Regional Demand Forecasts

Ongoing milk sales growth continues to provide the industry with the opportunity for further production growth in order to meet market demands. The following graph presents the annual figures for drinking milk sales for Queensland over the last two decades compared to Queensland milk production.

Comparison of Queensland Dairy Farm Numbers, Milk Production & Sales from 1990/91 to 2010/11



The graph demonstrates that Queensland milk production now closely aligns with the market demand for fresh drinking milk.

Milk is moved within the northern region, which includes Northern NSW, as required as surpluses and shortages occur. In worse case scenarios milk is sent and or brought in from regions further south.

The population of South East Queensland (Brisbane and Moreton Statistical Divisions) is projected to increase by 2 million people to 4.4 million people by 2034, up from 2.4 million people recorded in 2001. With this forecast growth in population over the next two and a half decades there is expected to be an equal to greater increase in the regional domestic market demand for dairy products.

It is estimated that for every one million people in the domestic market there is a demand of more than 105 million litres per annum of drinking milk. In addition to this there is also a demand for manufactured products which we have factored on the same ratio above. As such with the forecast population growth over the next two and a half decades it is estimated that there will be an increase in demand for milk and dairy products in excess of 210 million litres of milk.

Wholesale milk prices

While the QDO is not privy to the wholesale price of milk between processors, vendors and retailers, we are aware that it varies considerably between the vendoring sector with small retail shops and that between processors and major retailers.

In relation to farm gate prices at the current time in Queensland, it varies between processor and farmer and also with different forms and lengths of contract.

During 2010 farm gate prices were reduced significantly for dairy farmers who had supply contracts that came due during 2010. Reductions in prices for milk used for drinking equated to some 18 percent for many producers.

Table 3: Landed cost comparison – projected 2010-11 season

	Cents per litre at "reference litre" milk components			
	Sth Qld	Nth NSW	Mid NSW	Nth Vic
Farmgate	47-58 ~ 30**	47-52	45-50	42-44
Freight	3-4	5-6	10	17-20
Landed cost	50-62	52-58	55-60	59-64

* This assumes milk prices on a year-round basis, given likely pricing by fresh milk processors in that region.

** price for milk used for manufacturing offered by some processors

Whether such a price reduction is anti-competitive

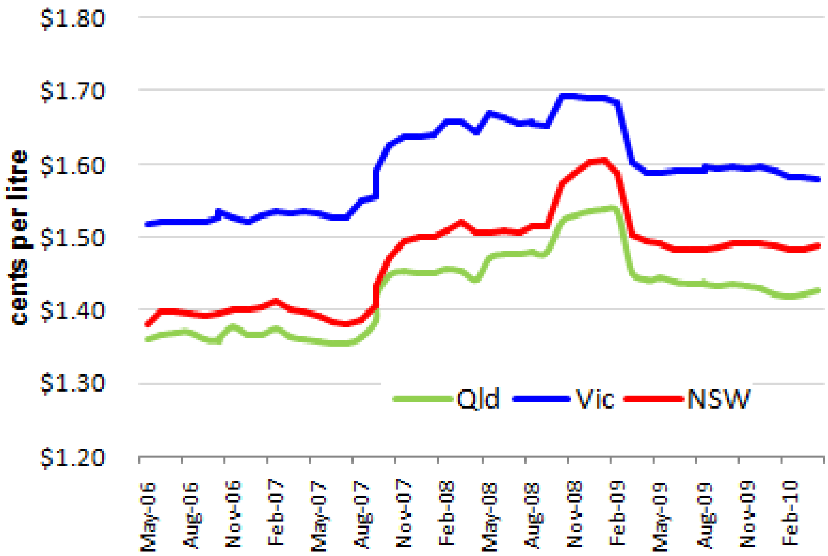
All of Coles' major competitors have stated, both publically and privately, that these price cuts are unsustainable. Further to this we believe there is a strong prima facie case under section 46, including 46 (1AA) of the Trade Practices Act 1974 (now the Competition and Consumer Act 2010) that Coles' actions constitute predatory pricing.

We note the following extract from the ACCC website: *"Section 46(1AA) applies to business conduct occurring on or after 25 September 2007. It prohibits businesses with a substantial share of a market, having regard to the number and size of its competitors in the market, from selling goods or services for a sustained period at a price below their relevant cost of supply. As with s. 46(1), a business must act with an anti-competitive purpose.*

It is the presence of a clear anti-competitive purpose that may turn price cutting by a company with substantial market power or market share into predatory pricing. Once competitors are damaged or eliminated, the likely results are that the company can raise its prices and exploit consumers."

From market research we have carried out comparing retail milk prices for southern Queensland compared to other states including New South Wales and Victoria, presents that retail milk prices for Southern Queensland are on average less than that of New South Wales and Victoria. The following graph provides an illustration on the difference between retail prices between different eastern seaboard states.

Average fresh white milk supermarket retail prices



In contrast to this, prices paid to dairy farmers by milk processors in Southern Queensland are higher than that paid to dairy farmers in New South Wales and even more so in Victoria. Dairy Australia data presents that for the 2009/2010 financial year Victorian dairy farmers were paid 33.9 cents per litre and in NSW 48.7 cents per litre and Queensland 55.8 cents per litre. The difference between farm gate prices between the three states relates to different market mixes and production costs.

In Queensland, the dairy industry supplies the majority of milk consumed by the Queensland domestic market and to meet the market requirements, this milk needs to be produced every day of the year. The Queensland environment poses higher production costs for milk compared to Victoria where the majority of milk is processed for export products and produced seasonally with lower production costs.

Within the dairy industry's domestic value chain, milk processors compete in a national fresh milk retail market, whereas major supermarket chains now operate national uniform pricing policies. These policies do not take account of differential costs to producers and suppliers.

As such in the Queensland domestic market the cost of milk to processors is higher than NSW and Victoria, yet Coles is applying a national discounted price of $1 per litre. When this is combined with evidence about margins presented by a Coles representative to the Senate Economic References Committee's inquiry into the Australian dairy industry in February 2010, we believe there is a prima facie case of breaching the Competition and Consumer Act 2010. We believe this case is in relation to selling milk as a 'loss leader' in a predatory manner to gain market share from competitors in the Queensland market place.

It is our belief that Coles' actions have the specific purpose and likely effect of damaging their competitors, such as other major retailers, corner stores, independent petrol stations and other small retailers of milk, and will lead to a substantial lessening of competition in the market place over time. This impact will also flow through to affect dairy farmers, service businesses, transport operators, processors, distributors and vendors and threaten the jobs of employees throughout the whole industry.

Furthermore, we believe this action by Coles impacts the viability of processor owned branded dairy products and thus lead to the loss of consumer choice and competition, as has been the experience in other countries where these marketing tactics have been applied.

In addition, for local markets in a number of rural communities where a major retailer is the only major retailer of grocery products for the community and is the 'defined market' such discounting practices as currently practised by Coles would be anti-competitive as it is resulting in the undermining of competition within the store by undercutting proprietary brands yet consumers are left with no other option within the 'defined market' to purchase their groceries.

Coles and Wesfarmers executives have publically stated that farm gate prices for dairy farmers have increased in the last year. However milk prices too many farmers have actually fallen by approximately 12 – 18 percent in Queensland and 10 percent in NSW and Victoria in the last 12 months, which includes the Tier One price dairy farmers are paid by National Foods that supply the milk for Coles supermarket branded milk.

In addition dairy farmers which have their farm gate price linked directly to processor branded sales will see their milk cheque drop in early March as a result of the Coles cut throat discount campaign increasing the market share of the Coles branded milk at the expense of market share of other brands, including processor brands.

Wesfarmers executive Richard Goyder has publically stated that the sales of the Coles brand milk has increased by some 15 to 20 percent since the products were discounted by some 33 percent on Australia Day 26th January 2011.

For Coles to publically promote that "*Coles is not reducing the price it pays to its milk processors either so this move will not impact them or the dairy farmers who supply them. In fact both farm gate milk prices and contract prices with processors recently increased.*" (Coles media release 26th January 2011 and various public statements), is tantamount to false advertising, in that it is seeking to promote to consumers that if they buy Coles branded milk at this dramatically discounted prices it will not have a negative impact on dairy farmers whom supply Coles.

As such we believe there is a prima facie case of false advertising that also should be investigated by the ACCC.

The UK Experience

Wesfarmers has introduced new management for Coles with the engagement of a management and marketing team from the United Kingdom where these types of 'home brand' discount price tactics has been common place to get market share from their competitors and to grow their own store brands.

In the United Kingdom independent branded products are now a rarity; they are all supermarket brands now and in some European countries fresh milk is getting harder to find and consumers are left little options but to purchase Ultra High Temperature (UHT) treated milk.

A 2008 study by Oxford University estimated the big four accounted for 70% of the milk market in the UK. In turn supermarket 'store brand' products account for around 71% of total milk sales. UK retailer brands have been highly successful due to the strength of the parent brand. Consumers identify strongly with the brand values of Sainsbury, Tesco et al, believing they confer attributes of quality and supply chain values.

In response, processors have struggled to develop viable differentiated brands in this market. The effect of this supermarket 'store brand' dominance has been to stifle innovation, as evidenced by the lack of product differentiation in the UK milk market. The Oxford Study noted the shift in dominance in the dairy industry supply chain from processors to retailers, with only a small percentage of the supply chain profits attainable for farmers and processors.

A 2010 study by DairyCo on dairy supply chain margins noted the absence of any decline in retail prices for milk at a time of falling commodity and farmgate prices, concluding that processors and farmers absorbed the full impact of the decline in the dairy market.

Comparing 2009/10 with 1999/2000 indicated the retail price of milk increased 60% compared to a general food price increase of 36%. Over the same period the average farmgate price increased 34% and the estimated wholesale price increased 31%.

Before major supermarket chain 'supermarket brand' pricing and marketing strategies, these returns flowed to the processor and then to farmers. The loss of these returns to the industry is not sustainable.

The suitability of the framework contained in the Horticulture Code of Conduct to the Australian dairy industry

The QDO believes that a dairy industry Code of Conduct could provide some distinct benefits for the industry and dairy farmers if it covered the entire value chain including dairy farmers, processors and retailers.

Benefits could include;

- providing greater transparency through the industry value chain,
- providing a better understanding amongst all industry value chain sectors of the issues and needs of each sector,
- provide much clearer information for dairy farmers to be able to make more informed business decisions,
- discouraging unconscionable and anti-competitive conduct,
- provide a dispute resolution process,

The Horticultural Code of Conduct's purpose is to "improve the clarity and transparency of transactions between growers and wholesalers of fresh fruit and vegetables."

While the dairy farmers have a range of challenges dealing with corporate milk processors under Collective Bargaining authorisations by the ACCC, the major challenge for the farming and processing sector is currently the treatment of milk as a discounted, at or below cost, advertising agent by major retailers to attract customers to their stores while at the same time growing their owned supermarket branded milk.

For a Code of Conduct to be effective for the dairy industry value chain it would need to include the retail sector, which the Horticultural Code of Conduct does not, as the Horticultural Code of Conduct was designed to address the agent and merchant issues between wholesalers and growers.

The requirement of the Horticultural Code of Conduct that all traders to prepare, publish and make publicly available a document that sets out the general terms and conditions under which they will trade with growers of horticulture produce, is of interest as a similar provision in a Dairy Industry Code of Conduct could help improve transparency and assist dairy farmers make more informed business decisions. Currently it is extremely difficult for dairy farmers to compare prices and supply conditions between different milk processors.

The provision within the Horticultural Code of Conduct for minimum requirements for what must be included in contractual agreements could also be applicable to the dairy industry in relation to contractual agreements between dairy farmers and milk processors and milk processors and retailers.

The provision of a dispute resolution mechanism as established with the Horticultural Code of Conduct could be of assistance to individual and groups of dairy farmers in resolving break downs in price and supply negotiations.

The QDO would also like to further investigate potential initiatives which have been introduced by the United Kingdom by the Competition Commission including the Grocery Supply Code of Practice.

The recommendations of the 2010 Economics References Committee report, Milking it for all it's worth – competition and pricing in the Australian dairy industry and how these have progressed

The QDO welcomed the last Senate Inquiry into competition and pricing in the Australian dairy industry and provided a submission to and appeared before the inquiry as well as providing supplementary information. The QDO also publically welcomed the report and recommendations from the Senate Inquiry "Milking it for all it's worth".

In late 2010 the QDO enquired of the Federal Government if progress had been undertaken on the recommendations, in particular in relation to recommendation three, however to date we have had no response.

In relation to the recommendations presented from the last inquiry the QDO recommends that a strategic working group is established between Government and industry to further recommendations that provide an opportunity to derive positive outcomes for the dairy industry and the Australian community and economy.

Recommendation 5: "The Committee recommends that the Productivity Commission reviews and evaluates the effectiveness of the national competition policy and publish its report by 30 April 2011."

The QDO supports this recommendation as there is circumstantial evidence that the objectives of the policy are not being met as retailers are using their significant market share to undermine competition in the market place, thereby lessening competition in the long run, which as experienced in some other countries such as the United Kingdom, has led to the loss of choice and higher prices for consumers.

Recommendation 3: "The Committee recommends that the Government requests the Australian Competition and Consumer Commission to use its information-gathering powers, and draw on its work for its recent report on grocery pricing, to provide more accurate estimates of the proportions of the retail price of milk that reflect (i) the costs and (ii) the profits, of farmers, processors and retailers and publish the results of that review by 30 September 2010.

The QDO supports this recommendation as there is a real need for greater transparency through the value chain of the dairy industry, particularly at the processor and retail sectors of the value chain.

Recommendation 2: The Committee recommends that contracts with farmers should offer a clear, consistent formula for milk pricing with unambiguous conditions.

The QDO supports this recommendation as there is a real need for greater transparency and comparability for dairy farmers with regard to contracts offered by processors.

Recommendation 12: The Committee recommends that the Government reviews the collective bargaining provisions of the Trade Practices Act with a view to strengthening that framework to create a more equitable balance of power between the negotiating parties and report by 30 April 2011.

The QDO fully supports this recommendation.

Recommendation 13: In reviewing the collective bargaining provisions the Committee requests that the Government considers the effectiveness of any existing alternative dispute resolution mechanisms and investigates:

- allowing collective bargaining groups to merge to address imbalances in bargaining power;
- the introduction of a requirement that the ACCC facilitate the timely appointment of a mediator should a party to a negotiation require such assistance; and
- the introduction of a requirement that cooling off periods be mandatory in contracts between dairy farmers and processors.

The QDO supports the recommendation and concepts of allowing Collective Bargaining Groups to merge, provision of a meditation process and a cooling off periods, however the QDO would like to further assess the specific elements of the recommendations.

Recommendation 11: The Committee recommends that the Federal Government commissions an independent report into the main impediments to the establishment of new processors owned by farmer cooperatives and how these impediments could best be overcome and requests that the report be tabled by 30 April 2011.

The QDO supports this recommendation.

Recommendation 1: The Committee recommends that the Government requests that the National Competition Tribunal reviews the effectiveness of section 46 of the Trade Practices Act in preventing price discrimination and considers reinstating anti-price discrimination provisions, particularly to protect those parties participating in industries dominated by multinational corporations.

The QDO supports the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 4: The Committee recommends that the Government requests the ACCC to undertake monitoring of the pricing practices within the dairy chain with a view to establishing whether predatory pricing or misuse of market power is occurring.

The QDO supports this recommendation.

Recommendation 6: The Committee recommends a moratorium on further takeovers and mergers in the milk processing industry until the Productivity Commission has published its report on the effectiveness of the national competition policy.

The QDO would like to gain further information on the recommendation.

Recommendation 7: The Committee recommends that the Trade Practices Act be amended to reinstate specific anti-price discrimination provisions and inhibit firms achieving market power through takeovers or abusing market power and that 'market power' be expressly defined so that it is less than market dominance and does not require a firm to have unfettered power to set prices. A specific market share, such as, for example, one third (set based on international practice), could be presumed to confer market power unless there is strong evidence to the contrary.

The QDO supports the concept of the recommendation in principal and would like to obtain further information and advice on the recommendation to ensure any amendments to the Competition and Consumer Act 2010 do not potentially result in any unintended consequences that may affect the industry.

Recommendation 8: The Committee recommends that the ACCC conducts further study into the implications of increasing shares of the grocery market being taken by the generic products of the major supermarket chains. The Committee recommends that the terms of reference of any such inquiry include not just the current and future impact on prices paid by consumers but also the needs of Australia in terms of food security and economic and environmental sustainability, as well as the economic viability of farmers and processors. The Committee requests that the findings of these reviews be reported by 30 April 2011.

The QDO supports this recommendation. As presented in the QDO submission the marketing, advertising and pricing tactics of major supermarkets with store branded milk is a major concern for the sustainability of the dairy industry particularly in regions which principally supply the Australian domestic market, such as Queensland.

Recommendation 9: The Committee recommends the Productivity Commission considers, in its review of national competition policy, the appropriateness of separating the functions and powers of the ACCC with the effect that separate agencies are responsible for the approval of mergers and the assessment of whether concentration is subsequently excessive.

The QDO supports this recommendation. The QDO believes that the functions of the ACCC need to be reviewed given the nature of a number of recent decisions. The QDO would like to obtain further information on this recommendation to be able to provide a more informed response.

Recommendation 10: The Committee recommends that the topic of competition and pricing in the dairy industry be again referred to the Senate Economics References Committee in May 2012 to assess whether progress has been made or whether tougher and more interventionist measures need to be adopted.

The QDO supports this recommendation to ensure that appropriate transparency and issues of market power market manipulation are adequately addressed to enable the dairy industry to be sustainable into the future.

Recommendation 16: The Committee recommends that the Australia and New Zealand Food Regulation Ministerial Council acts to ensure that labelling on dairy products adequately and accurately informs consumers about the provenance, manufacturer and contents of the product.

The QDO supports labelling laws which accurately inform consumers on the provenance, manufacturer and contents of products.

Recommendation 14: The Committee recommends that the Government addresses the issues of food security and the future sustainability of the dairy industry at a federal level. The Committee suggests to the Government that this review be facilitated through the Primary Industries Ministerial Council to ensure it receives the commitment and attention required. The Committee recommends that any review include the role of the ACCC and federal, state and territory agricultural departments in ensuring Australia's food security.

The QDO agrees with this recommendation and ADF is currently participating in the Primary Industries Ministerial Council review relevant to these matters including the review of research and development investment in agricultural industries. The QDO with other industry stakeholders have supported the development of a Sustainable Milk Production Model as a decision support tool which could provide a national reference tool for dairy farm sustainability.

Recommendation 15: In the light of the Tasmanian experience the Committee recommends that where industry bodies are encouraging increased production, all agencies involved in those bodies have regard to issues of long term sustainability in the context of long term trends. They should identify the source of increased demand, adopt cautious language and indicate the degree of uncertainty around any projections.

The QDO agrees with this recommendation as increases in production should be driven by market needs and opportunities. The QDO also encourages dairy farmers to seek professional independent advice when seeking to make business decisions.

The need for any legislative amendments

The QDO believes there is a need to make legislative amendments as well as a range of other measures.

The QDO is currently seeking further advice on the recommendations we wish to make and as such the QDO will be seeking to provide a supplementary submission to the Senate Inquiry to present these recommendations.

Other related matters

Collective Bargaining

Milk producers in Queensland avail themselves of a number of collective bargaining arrangements in their negotiation of milk supply arrangements with processors, including the following:

- Premium Milk Group which supplies Parmalat's South Queensland operations. Premium operates within an ACCC-approved arrangement,
- Port Curtis Dairies which supplies Parmalat milk for the Rockhampton plant,
- DFMC, which negotiates on behalf of its members with National Foods,
- Collective bargaining groups that operate under the arrangements administered through ADF Limited, which include the National Foods suppliers group and Progressive Dairies,

The ACCC ruling achieved by ADF in 2006 facilitates this option on a regional level. The authorisation also permits:

(a) groups of dairy farmers to form collective bargaining groups through which they may collectively negotiate terms of supply, including price, with a dairy processing company that each member of the group wishes to supply and,

(b) the ADF to hold general, non-specific discussions with supermarkets, on an individual and voluntary basis, regarding the impact of tender processes on dairy farmers subject to the certain conditions.

QDO supports continuity of these arrangements to support achievement of fair returns to dairy farmers in a consolidating dairy supply chain.

The QDO has supported the collective bargaining provision authorisations which were originally given to Premium in Queensland and then nationally to the Australian Dairy Farmers.

The QDO believes that this provision by the ACCC is essential for groups of dairy farmers to be able to be able to collectively discuss and negotiate outcomes with the processor they supply. This provision has provided the means for dairy farmers to be able to negotiate in a more balanced 'market power' environment.

There currently exist some good examples of effective collective bargaining groups whom have developed good working relationships with the processor they supply and have used the collective bargaining provisions to not only negotiate on issues of price, but to develop a better understanding of each others business needs, to collectively seek to improve systems to reduce costs, and to structure business arrangements to better reflect the needs of both businesses, which can cover supply arrangements, transport, seasonal incentives, risk management etc. Recently a collective bargaining group negotiated for a slightly lower price in return for longer contract conditions.

Over recent years the processing sector has continued to consolidate and with this, the market share that remaining processing entities hold, has increased. With this consolidation within the processing sector the QDO believes that the Collective Bargaining provisions for farmer groups should be reviewed to ensure that the current provisions provide a reasonable balance for farmer group collective negotiation in the current processing sector environment. Some Collective Bargaining groups are severely constrained by regional boundaries and now with the consolidation of processors and expansion of their milk collection base, these regional limitations on dairy farmer Collective Bargaining groups should be reviewed.

One of the critical requirements for Collective Bargaining groups to be successful over time is that they have sufficient professional skills development and support.

The Australian Government should consider making resources available specifically to assist farmer collective bargaining groups to increase their skills and knowledge and business acumen for the role of collective bargaining, managing a collective bargaining group and developing effective working relationships with processors.

Other Issues

Other current threats to the sustainability of the Queensland dairy industry include:

- the potential flow on impacts to dairy farmers from the planned introduction of a tax on carbon, unless there are viable options for offsets re available for dairy farmers,
- lessening of water security for dairy farmers from ongoing changes to water planning and legislative mechanisms that place lower priority on food producing industries over other priorities,
- increasing Government regulation which impose additional costs and restrictions on farm operations,
- declining investment into initiatives which assist industry to continue to achieve productivity and sustainability gains,

The QDO would like to see the Australian Government increase its investment and effort in;

- Supporting the Dairy Industry’s Flood and Cyclone Recovery Program,
- Supporting resource use efficiency programs within the industry, such as the QDO’s Dairy Water for Profit program,
- Increase the investment from the Australian Government into research, development and extension, which is critical to ensuring the Australian dairy industry continues to make advances in productivity and sustainability,
- Provide further support to the Australian Dairy Industry’s Natural Resource Management program, Dairying for Tomorrow, which is critical for the industry’s future sustainability and dealing with impacts such as climate change.