Examination of the prices paid to farmers for livestock and the prices paid by Australian consumers for red meat

A report to the Minister for Agriculture, Fisheries and Forestry

February 2007
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ACCC contact
Summary

On 28 November 2006 the Hon. Peter McGauran, MP, Minister for Agriculture, Fisheries and Forestry, wrote to the Australian Competition and Consumer Commission (ACCC) requesting that the ACCC ‘examine the prices paid to farmers for livestock and the prices that Australian consumers are paying for red meat’. The minister was concerned that farmers were receiving minimal returns for livestock while consumers were paying record high retail prices for red meat.

The request was made following a large increase in the number of sheep and cattle sold in saleyards which in turn led to a sharp decline in the prices of livestock. For example, the eastern young cattle indicator (EYCI) decreased by 30 per cent between its peak in August 2006 and its first low point in late October 2006 (after a short lived recovery, it slumped to an even lower level in early December).

It was also claimed that there was no discernable flow through to consumers in decreased retail meat prices: the beef/veal and lamb/mutton meat sub-groups of the Australian Bureau of Statistics’ consumer price index were at, or near, record levels (in nominal terms) in the 2006 September quarter.

The beef/veal and lamb/mutton sub-groups of the consumer price index did, however, decrease in the December quarter (by 1.87 and 0.69 per cent respectively).

Key findings

The ACCC urges caution when interpreting movements in the margin between saleyard and retail meat prices, particularly over short periods of time. This is primarily because short-term movements in margins do not necessarily mean that market conditions are moving in ways that are ‘out of the ordinary’ or caused by weaknesses in competition.

There are a range of indicators of both saleyard and retail prices for red meat. Although the different price indicators vary in the amount, the margin between saleyard prices and retail prices for red meat has widened over the past few months. Movements in this margin, however, are not unusual and may be caused by several factors, such as changing costs throughout the supply chain and increased value added at the retail end.

In examining the recent widening of this margin, the ACCC has focused on two key issues:

- The relationship between saleyard and retail meat prices and whether or not recent movements appear inconsistent with the nature of industry supply arrangements, the costs of other inputs and historic experience.
- Whether any particular seller, or groups of sellers, is able to unduly suppress the price of livestock and/or set domestic red meat prices without regard to competitors.

In other words, in addition to examining the link between livestock prices and retail meat prices, the ACCC has considered whether there are other factors that influence retail meat prices that may work to counteract lower livestock prices and also whether there is likely to be sufficient competition at either end of the retail red meat supply chain so that no single buyer or seller, or groups of buyers or sellers, is able to exert undue influence on the price of livestock or red meat. If buyers and sellers do not have significant price setting power in either of these sectors, it is unlikely that the apparently widening margin between saleyard prices and retail red meat prices is caused by inadequate competition.
On the basis of the evidence available to it, the ACCC considers there are three factors that appear to mitigate concerns that large buyers/sellers are exerting market power:

- The supply of red meat to consumers involves a long and complex supply chain. This means that there will not necessarily be a direct and immediate relationship between the price of the raw product (livestock) and the final good (packaged meat).
- There is a range of supply arrangements in place throughout the supply chain that affect the relevance of saleyard indicator prices as a gauge of appropriate retail prices, especially in the short term.
- There appears to be a reasonable degree of competition at both ends of the supply chain.

Long and complex supply chain

The cost of livestock is only one component of the total cost incurred by supermarkets (and other retailers) in providing fresh meat to consumers and it represents a relatively small proportion of the final price of packaged meat.

Costs and value are added to the raw product via ‘finishing’ on grain to meet quality specifications and by activities such as slaughtering, processing, transporting, butchering and packaging. There is no reason to believe that these costs will necessarily remain unchanged while livestock prices move. One of these costs, the price of feed grain for the finishing of livestock seems to be of particular importance in the current conditions.

The price of feed grain nearly doubled during 2006 as grain shortages increased because of drought and import restrictions.

While grain finishing of beef is commonplace, the increased feed prices would not normally be such a significant factor in lamb production. However, the current drought conditions mean that an increasing number of lambs are being ‘supplementary fed’ on grain because of poor pastures.

Whether the increased cost of feed is sufficient to completely mitigate the effect of lower livestock prices or not depends on the relative magnitude of each and may be different for beef and lamb. The ACCC has not sought to definitively answer this question. It does, however, consider that grain feeding cattle and sheep is having an effect on retail beef and lamb prices that, to some degree, counteracts lower livestock prices.

The effect of direct supply agreements

Extensive use of direct supply agreements by large retailers means that a large number of transactions occur outside the traditional saleyard and such agreements usually include risk management provisions to hedge against the effect of price shocks. Accordingly, large and sudden movements in saleyard indicator prices will not have a direct and immediate effect on the retail prices charged by these retailers.

The two larger supermarkets both buy most of their meat supply through direct supply agreements, rather than from saleyards. Both submitted that virtually all beef and an increasing proportion of lamb are supplied through direct supply agreements.

Both Coles and Woolworths provided details of their actual buy and sell prices to the ACCC. Throughout 2006, the average buying price for beef for both supermarkets was above and more stable than the EYCI. The sharp decline in the EYCI in the December quarter was not reflected in the supermarkets’ average buying prices.

There appears to be two key reasons for this. First, the direct supply agreements provide a degree of risk management, with prices negotiated some degree in advance. Second, as direct supply agreements and other forms of vertical integration remove an increasing number of livestock from ‘traditional’ saleyard markets, these markets have potential to become more volatile.

Similar results applied to lamb; however, the supermarkets’ average buying prices were not as stable as for beef. This appears to be due to greater seasonality in lamb production and less reliance on direct supply agreements.
Competition at both ends of the supply chain

The ACCC considers that saleyard prices for cattle and sheep are determined by a number of supply and demand factors. In both sectors international demand is a key influence on saleyard prices and may place a constraint on domestic stock, particularly high-quality stock. The quality of livestock sold through saleyards is also a key determinant of saleyard prices: the higher the quality of stock, the higher the price it can command in both export and domestic markets.

In both the lamb and beef sectors, sales to international markets account for a large share of total meat production and even the largest retailers buy only a small proportion of total production. Under these conditions it seems unlikely that any one party would be able to suppress prices and/or impose onerous terms and conditions without producers altering their specifications to target alternative markets.

Domestic sales are divided between the food service, food processing and retail sectors. Within the retail sector, sales appear to be divided fairly evenly between the large supermarket chains and butchers. In these conditions, it seems unlikely that an attempt by any one party to charge unreasonably high prices could be sustained without losing market share.
1. Introduction

1.1 Ministerial request

On 28 November 2006 the Hon. Peter McGauran MP, Minister for Agriculture, Fisheries and Forestry, wrote to the Australian Competition and Consumer Commission (ACCC) requesting that the ACCC ‘examine the prices paid to farmers for livestock and the prices that Australian consumers are paying for red meat’. The minister was concerned that farmers were receiving minimal returns for livestock while consumers were paying record high retail prices for red meat.

The ACCC has interpreted the term ‘red meat’ to encompass beef and veal production and lamb and sheep meat production.

The request was made following a large increase in the number of sheep and cattle sold in saleyards which in turn led to a sharp decline in the prices paid for livestock. For example, the eastern young cattle indicator (EYCI) decreased by 30 per cent between its peak in August 2006 and its first low point in late October 2006 (after a short lived recovery, it slumped to an even lower level in early December).

At the same time, there was no discernable flow through to consumers in the form of decreased retail meat prices: the beef/veal and lamb/mutton meat sub-groups of the Australian Bureau of Statistics’ consumer price index were at, or near, record levels (in nominal terms) in the 2006 September quarter.

1.2 Nature of inquiry

The minister’s request to the ACCC did not constitute a formal price inquiry under Part VIIA of the Trade Practices Act 1974, nor was it an allegation that there had been a contravention of the Trade Practices Act. As the request was not a price inquiry under Part VIIA, or an allegation about a contravention of the Trade Practices Act, the ACCC had no formal information gathering powers and instead relied on the cooperation of interested parties and industry bodies. A number of parties made submissions and provided data to assist the ACCC in its inquiry and many more assisted by discussing the issues raised in submissions with ACCC staff.

Some of the submissions were made on a confidential basis and in those cases the ACCC undertook to maintain the confidentiality of the information and data provided. Accordingly, this report does not contain all the information the ACCC relied on to reach its views.

The ACCC has generally relied on the submissions and statements of interested parties, but has also tested the assertions and positions put forward in these submissions and statements with other industry participants before forming its views about particular matters. The ACCC has not, however, tested information claimed as confidential against the views of other industry participants. In these cases the ACCC has sought to obtain similar information from multiple sources and has used this mechanism to test information provided in confidence.

In undertaking this examination of prices, the ACCC considered that its object was to develop an understanding of the factors that drive the setting of retail red meat prices and determine whether or not there were any impediments, such as a lack of competition, to genuine cost savings flowing through the supply chain to consumers.

The ACCC has not sought to examine the costs and prices at all levels of the supply chain or to identify all drivers of costs in the industry and it considers such an industry survey to be beyond the scope of the minister’s request.
1.3 Outline of report

Section two provides a brief overview of beef and lamb meat production in Australia, providing some details of the scale of production and the relevance of exports for the domestic meat market.

Section three provides a brief description of the supply chain, with a particular focus on the involvement of the major supermarkets in the supply chain, and a description of retail meat market shares in Australia.

Section four examines the recent and longer term movements in livestock and retail meat prices.

Section five discusses three factors that may mitigate concerns that retail prices have remained too high despite lower livestock prices.

Section six presents the ACCC’s conclusions.
2. Red meat production in Australia

Beef and lamb are major agricultural commodities in Australia and represent a significant segment of the Australian economy. In 2005–06 the gross value of Australia’s lamb and cattle production was approximately $9.5 billion, or nearly 1 per cent of Australia’s total gross domestic product.¹

Australia is one of the largest producers of red meat, contributing 4 per cent of the world’s beef supply and 7 per cent of the world’s lamb supply. It is the world’s second largest exporter of both beef and lamb.²

Red meat is the most significant component of Australia’s total meat production, accounting for approximately 70 per cent of total production.³

Red meat is also Australia’s most popular meat, commanding 55 per cent of total retail fresh meat purchases (beef and lamb accounted for almost all of this). In 2005 Australian consumers spent more than $7.9 billion on red meat.⁴

2.1 Beef production in Australia

Australia produces over 2 million tonnes of beef and veal annually. In 2005–06 the value of domestic production amounted to over $7.4 billion, 65 per cent of which was sold to export markets.⁵ In 2006–07 it is estimated that beef and veal alone will account for approximately 16 per cent of Australia’s total farm exports.⁶

The beef cattle industry is also the most geographically dispersed agricultural industry in Australia with production spread across each state and a diversity of climatic environments as shown in figure 1.⁷ In 2005–06 producers in Queensland represented over half of Australian beef and veal production, with NSW and Victorian properties each producing around one-fifth of total production. Figure 1 provides a state-by-state breakdown of Australia’s beef and veal production.

Figure 1: Australian beef and veal production, 2005–06

![Pie chart showing beef and veal production by state: Qld 50.9%, NSW 20.4%, Vic 16.4%, Tas 2.7%, WA 5.5%, SA 4.0%, NT 0.1%]

Source: ABARE

¹ Meat and Livestock Australia (MLA), Australian beef industry—fast facts 2006 and Australian sheep meat industry—fast facts 2006.
² ibid.
³ Australian Bureau of Statistics (ABS), Agricultural commodities, 7121.0 2004-05, p. 25 data.
⁷ MLA, Australian beef industry—fast facts 2006.
The Australian Bureau of Agricultural and Resource Economics (ABARE) reports marked differences in the structure and financial performance of farms within the beef industry. Unlike other Australian broadacre industries, such as grain production, there are a large number of small-scale producers. Around 30 per cent of specialist beef producers (for whom beef is the dominant agricultural activity) are classified as small beef specialists because they have fewer than 300 beef cattle. Those producers, however, account for just 13 per cent of the value of beef production.\(^8\)

The feedlot industry has emerged as a vital factor in cattle production in Australia. At June 2006 there were approximately 1 million cattle on feed and it is estimated that 34 per cent of national cattle slaughter is sourced from feedlots. The feedlot industry continues to be sustained by strong domestic and international demand for premium quality grain-fed beef. In recent times, the growth of the feedlot industry has largely been driven by increased demand by Japan and Korea for grain-fed beef—Australia’s status as ‘disease free’ providing an important competitive advantage.

### 2.1.1 Australian beef exports

As mentioned above, approximately 65 per cent of Australia’s beef production is exported. Japan, the United States of America (USA) and Korea are the major export markets for Australian beef, collectively accounting for almost 90 per cent of total Australian beef exports in 2005–06.\(^9\)

Beef and veal exports rose by 5 per cent during 2006 to a record 953 932 tonnes shipped weight (swt)—1 per cent above the previous record of 946 629 tonnes exported during 2001.\(^10\)

In 2005–06 nearly 600 000 live head of cattle (valued at $404.4 million) were exported. Indonesia and the Middle East were the largest markets, accounting for 62 and 15 per cent of live exports respectively.\(^11\)

### 2.2 Sheep and lamb production in Australia

In 2005–06 the value of Australia’s sheep meat production was estimated to be $2.1 billion. This amounted to approximately 380 000 tonnes of lamb and 244 000 tonnes of mutton. As with beef, the export sector is vital with approximately 45 per cent of lamb and 76 per cent of mutton destined for international markets.\(^12\)

In 2005–06 around 38 700 broadacre farms had more than 200 sheep. Approximately 75 per cent of these produced lambs for slaughter. These farms accounted for nearly 90 per cent of all lambs slaughtered in Australia.\(^13\)

Victoria and NSW jointly produced 62.4 per cent of Australia’s total lamb production and 61.3 per cent of Australia’s mutton production, with Western Australia and South Australia being the other two major sheep meat producing states.\(^14\)

Strong international demand and historically high domestic lamb prices, coupled with falling wool prices, have in recent years shifted the focus in the Australian sheep industry to the production of sheep and lambs for slaughter. While in 1990–91 farms with more than 200 sheep earned just 6.3 per cent of their gross revenues from sheep and lamb sales, this figure is estimated to have increased to 20 per cent in 2005–06.\(^15\)

From 1998 to 2005 domestic consumption of lamb fell by 17 per cent.\(^16\) Despite this decrease, Australians remain among the world’s highest per capita lamb consumers, eating an average of 10.2 kg of lamb per person annually.\(^17\)

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10 ibid.
12 MLA, *Australian sheep meat industry—fast facts 2006*.
14 MLA, *Australian sheep meat industry—fast facts 2006*.
17 MLA, *Australian sheep meat industry—fast facts 2006*. 
2.2.1 Australian lamb exports

Australia is the world’s largest exporter of mutton and the second largest exporter of lamb. 18 Approximately 45 per cent of Australia’s lamb production and 75 per cent of mutton production is exported.

Over the past two decades, exports have become increasingly more important for Australian producers. Since 1998 lamb exports have increased by 29 per cent and have increased from 16 per cent of total production to 45 per cent. 19

In 2005–06 the value of Australian lamb and mutton exports amounted to $783 million and $442 million respectively. In volume terms, lamb exports for the 2006 calendar year reached a record 146 706 tonnes swt—an increase of 3.6 per cent compared with 2005. Mutton exports for 2006 totalled 162 881 tonnes swt—an increase of 15.3 per cent compared with 2005 levels and the highest level for the past four years. 20

The USA and North Asia are the biggest consumers of Australia’s lamb exports, jointly accounting for almost 50 per cent of the market. These regions are also large importers of Australian mutton; however the Middle East is the largest consumer of Australian mutton, accounting for nearly 24 per cent of the export market. 21

Australia is the world’s largest exporter of live sheep. In 2005–06, almost 4.3 million live sheep were exported with a total value of almost $300 million. Over 99 per cent of these sheep were destined for the Middle East, with Kuwait and Saudi Arabia accounting for over 50 per cent of live sheep exports. 22

2.3 The relevance of exports for Australia’s domestic meat market

The above discussion highlights that the domestic red meat market represents only a portion of Australia’s total red meat production. In the case of beef production, domestic consumption accounts for around 35 per cent of total production. For lamb, the corresponding percentage is higher at around 55 per cent.

Within the domestic market, beef and lamb are inputs into a number of other sectors, such as food processing, food service and the retail grocery sector for sale as fresh meat. Within the latter category, retail outlets include independent butchers, independent supermarkets and the large supermarket chains such as Coles and Woolworths.

Meat and Livestock Australia estimates that the retail sector accounts for around 24 per cent of Australia’s beef production and around 49 per cent of Australia’s total lamb production.

Based on these estimates and Roy Morgan Research estimates of retail meat market shares, the ACCC has estimated 23 the proportion of total beef and lamb production that is purchased by fresh meat retailers. These estimates are shown in figures 2 and 3 respectively.

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18 ibid.
19 ibid, p. 4.
21 MLA, Australian sheep meat industry—fact facts 2006.
22 ibid.
23 By applying the retail market share to the proportion total production purchased by retailers.
The ACCC estimates that in 2005–06, Woolworths and Coles bought 6.4 per cent and 5.6 per cent respectively of total beef production and 13.2 per cent and 11.5 per cent respectively of total lamb production. Together, Woolworths and Coles purchased only 12 per cent of total beef production and 24.7 per cent of total lamb production.

A number of market participants submitted that there is sufficient competition between the domestic market and export markets to allow producers (as well as processors and feedlots) to switch to export markets if they are unhappy with the prices offered by supermarkets.
Coles stated that the domination of exports in the meat sector has previously led to tight supply and quality problems for Australian retailers and that these limitations were the catalyst for Coles developing its vertically integrated meat supply chain in 1998. A similar view was also expressed by wholesaler Metcash who stated that the strong export market leaves an ever diminishing supply of quality product available for domestic sale. Woolworths also submitted that it faces significant competition from the export sector for the purchase of livestock.

Research prepared for the Department of Agriculture, Fisheries and Forestry (DAFF)\textsuperscript{24} also found that buyers of cattle for the domestic market compete at various points of sale against export buyers while the Australian Lot Feeders Association (ALFA) submitted that there is an extraordinarily high level of competition for Australian beef around the world and this puts strain on supply to domestic markets. Similarly, according to ABARE, Australian beef cattle saleyard prices are being driven largely by off-shore developments.\textsuperscript{25}


3. Red meat processing and retailing in Australia

There is a considerable amount of processing, transport and packaging required to transform the live animal into the various cuts of red meat that consumers buy from retailers. This section provides a brief description of the supply chain, with a particular focus on the involvement of the major supermarkets in the supply chain, and a description of retail meat market shares in Australia.

3.1 Long and complex supply chain

The fresh red meat supply chain is long and complex. Woolworths described its meat supply chain as follows:

- Purchase of live animal
- Finishing to specification
- Transportation to abattoir
- Slaughter and boning
- Transportation to processing plant
  (for preparation of case-ready meat)
  or distribution centre (for in-store butcheries)
- Ageing and storage
- Transportation to stores
- In-store butchery preparation
- Refrigeration and display
- Sale to customer

The supply chain is similar for all Australian meat retailers; however, the extent of retailers’ vertical integration through the supply chain varies. Nonetheless, the cost of purchasing live animals is only one component of the supply chain.

Information provided by Coles reveals that the price it pays for a whole cow (inclusive of producer and feedlot costs) typically accounts for 53 percent of the end retail price. Processing activities and costs (kill fee, boning, packaging and chilling) account for 14 percent of the end retail price while retail activities and costs (slicing and trimming, packaging, labour, shrinkage, promotion and advertising, store costs and retail margin) account for about 30 percent of the end retail price. These shares of value added are similar to findings reported by Whitehall Associates.27

Similar information provided for lamb revealed that the price (inclusive of producer and feedlot costs) of the live animal typically accounts for about 50 percent of the end retail price. Processing activities and costs (kill fee, boning, chilling and freezing) account for 13 percent of the end retail price while retail activities and costs (slicing and trimming, packaging, labour, shrinkage, promotion and advertising, store costs and retail margin) account for 31 percent of the end retail price.

26 Information provided by a market participant showed that, in December 2006, feedlot activities and costs accounted for 30 per cent of the value of cattle ready to be processed.

Because the cost of livestock represents a small proportion of the total cost of the finished product, any given decrease in the price of livestock results in a much smaller percentage decrease in retail meat prices (the retail price is significantly higher than the livestock price). For example, if saleyard costs represent 20 per cent of retail prices, and saleyard prices fall by 10 per cent, retail prices would be expected to fall by only about 2 per cent, if the price of all other inputs remained the same.

3.1.1 Direct supply agreements

Both major supermarkets, Coles and Woolworths, have vertically integrated supply and service agreements throughout the supply chain with farmers, feedlots and processors. The supermarkets argued that these arrangements involve setting prices based on the prevailing costs of production including a profit margin.

The supermarkets also claim that prices are negotiated with producers in advance and set for various periods. Subsequent changes in market prices (either up or down) do not alter the agreed price. For example, Woolworths stated that it negotiates a guaranteed minimum lamb price with producers three months in advance. If the market price falls below the agreed price, Woolworths pays the negotiated price but if the market price rises, it shares the gain with the producer.

These types of agreements provide a degree of certainty to both producers and supermarkets. The use of a guaranteed minimum, rather than a maximum price suggests that the negotiating power between buyer and seller is not unduly skewed in favour of the buyer. The use of contracts to determine input prices in advance also suggests that there is unlikely to be a direct and immediate relationship between the contracted price and prices in the spot markets (e.g. saleyard prices).

Coles claimed that no supplier has left its supply chain since it was developed in 1998; while Woolworths claimed that none of their suppliers have complained about the prices they receive from Woolworths. This argument was supported by ALFA who surveyed a select number of feedlots to understand their supply arrangements with Coles and Woolworths. ALFA noted that:

In each response from the feedlots, one simple comment was reiterated: the Australia cattle and beef markets are so highly competitive and complex that the potential for any single business within the market to dictate prices is considered negligible.28

3.1.2 The importance of grain finishing

The vast majority of beef and an increasing amount of lamb sold to Australian consumers are finished on grain. That is, the livestock are fed a particular mix of feed for a specified period to reach a certain quality. Woolworths, Coles and some independent butchers all identified the importance of grain feeding to meet the quality expected by Australian consumers.

While grain finishing of beef is commonplace, the increased feed prices would not normally be such a significant factor in lamb production. However, the current drought conditions mean that an increasing number of lambs are being ‘supplementary fed’ on grain because of poor pastures.

3.1.3 Feedlots and processors

It was noted by one market participant that the pricing structure within the feedlot industry is very transparent and if the feedlots aren’t satisfied with the price offered to them by the supermarkets, feedlots will refuse to supply the supermarkets and target other markets instead. Furthermore, one market participant noted that the red meat supply chain works as a ‘two-way street’ and that it is in the best interests of suppliers and buyers to ‘look after each other’. Indeed, one processor reported that it had been paying farmers to continue to feed lambs to ensure that the quality requirements of its customers were met.

Several market participants expressed the view that abattoirs and processors typically operate with small margins and that margins are very volatile and fluctuate with supply and demand.

28 Submission from the Australian Lot Feeders Association.
The Victorian Farmers Federation (VFF) stated that processors preferred a smooth, reliable supply of livestock, avoiding large peaks and troughs to ensure they can retain their workforce.

A number of parties stated that processors have been stretched to capacity in recent months as drought conditions have brought unprecedented levels of sell-offs by producers. The VFF argued that price is the most effective way for processors to signal to producers the effects of these constraints on their ability to process stock.

### 3.2 Retail market shares

In 2005–06 Australians spent $6.4 billion on beef, with consumers eating an average of 35.6 kg per person. Beef is the most popular fresh meat at retail, commanding 35 per cent of the market share.29

Roy Morgan Research conducts quarterly surveys of consumers’ retail meat expenditure to estimate market shares for retail meat supply.

Figure 4 provides these estimates of market share for September 2006. The two major supermarkets accounted for 50 per cent of national meat sales in the 2006 September quarter. Butchers accounted for approximately 31 per cent of sales while independent and other supermarkets accounted for about 10 per cent of national meat sales.

**Figure 4: Retail share of weekly meat expenditure, September 2006**

![Pie chart showing retail share of weekly meat expenditure, September 2006](chart.png)

*Source: Roy Morgan Research*

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29 MLA, *Australian beef industry—fast facts 2006.*
4. Historical movements in livestock and retail prices

This section provides background to the sharp decrease in saleyard livestock prices in the 2006 December quarter and reviews the longer term relationship between livestock prices and retail meat prices.

The section concludes with a review of the findings of research by Whitehall Associates about the relationship between livestock prices and retail meat prices that broadly support the ACCC’s findings.

4.1 Appropriate indicator prices

There are several possible indicators of saleyard livestock prices. For example, MLA produces a number of spot price indicators on a weekly and daily basis, including the EYCI. Several participants have presented EYCI data to the ACCC, and it is widely accepted as a broad market indicator. MLA advised that it is not, however, the most appropriate indicator to compare with retail prices as it includes all young cattle including those that are not suitable for processing into meat. MLA therefore also provided quarterly data for the national ‘trade steer indicator’ for 1998–06.

While the ACCC agrees with MLA that the trade steer indicator is a better comparator for retail prices, the trade steer indicator and the EYCI are closely correlated and the EYCI’s widespread acceptance make it an obvious indicator price. Accordingly, both indicators have been used in this report.

MLA also provided quarterly data for the ‘trade lamb indicator’ for 1998–06 and this is used as the basic livestock price for lamb.

4.2 The 2006 December quarter

4.2.1 Livestock prices

The sharp decline in livestock prices appears to have been caused by an increase in the number of livestock offered for sale as farmers ‘de-stock’ their properties in response to extreme drought conditions. The number of head making up the EYCI reached record levels in this period.

The EYCI fell by approximately 30 per cent from a peak of 382 c/kg carcass weight (cwt) in August 2006 to 267 c/kg cwt in late October 2006 as shown in figure 5. After a short-lived recovery, the EYCI slumped again, to its lowest point since the last episode of severe drought in 2002–03 (265 c/kg cwt). A similar decrease occurred in the trade steer indicator.

However, considering only the peak and trough of a relatively volatile indicator overstates the ‘average’ amount of the decrease. The average EYCI for the first three quarters of 2006 was 357 c/kg cwt and for the last quarter was 290 c/kg cwt: a fall of 67 c/kg cwt (or 19 per cent).

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30 The EYCI is a seven-day rolling average of 24 young cattle categories from 26 saleyards across Queensland, New South Wales and Victoria. It is expressed in cents per kg cwt.
31 The EYCI is the base for MLA/SFE Cattle Futures Contract, listed on the Sydney Futures Exchange.
32 MLA, Eastern Young Cattle Indicator.
33 National weighted prices for trade lambs 18–22kg carcass weight, fat score 2–4 (lambs typically purchased to provide product for Australian butchers and supermarkets).
Figure 5: Eastern Young Cattle Indicator with number of head, January 2006 to January 2007

Source: MLA

Figure 6 plots the total number of trade lamb yardings and the weekly trade lamb indicator throughout 2006.

The trade lamb indicator peaked at 389 c/kg cwt in July, then decreased steadily, reaching a low of 260 c/kg in early November 2006 (a fall of around 33 percent). The number of lambs yarded peaked in November 2006.

Figure 6: Weekly trade lamb indicator and number of trade lamb yardings, 2006

Source: MLA
4.2.2 Retail price movements

There is limited data on retail meat prices available. However, ABARE adjusts the beef/veal and lamb/mutton sub-groups of the consumer price index (CPI) to arrive at the ‘average retail prices’ for beef and lamb.\textsuperscript{34}

The CPI sub-groups (and therefore ABARE’s average prices) for beef and lamb both fell in the December quarter (beef/veal by 1.87 per cent and lamb/mutton by 0.69 per cent). They had both been at their highest (nominal) levels earlier in 2006.

Retail prices for beef/veal and lamb/mutton are charted with their respective livestock indicator price in section 4.3.

4.3 Longer term movements in livestock and retail meat prices

4.3.1 Beef

Figure 7 charts ABARE’s average retail beef/veal prices and the trade steer indicator for 1998–06. Throughout this period retail prices of beef have tended to not fall significantly following decreases in livestock prices. There was a decrease of approximately 3 per cent in the average retail price of beef in the 2002 September quarter; however, the trade steer indicator had fallen 24 per cent between September 2001 and September 2002.

This decrease does, however, tend to support the notion that a sustained decrease in the livestock price would result in a much smaller percentage decrease in the retail price, all things being equal.

Figure 7: Comparison of average retail beef and trade steer livestock prices, 1998–2006

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure7.png}
\caption{Comparison of average retail beef and trade steer livestock prices, 1998–2006}
\end{figure}

\textit{Source: MLA}

\textsuperscript{34} Price estimates are formed by indexing forward from actual average prices of beef, lamb and mutton during the 1973 December quarter, based on meat sub-groups of the consumer price index. These indexes are based on average retail prices of selected cuts (weighted by expenditure) in state capitals.
4.3.2 Lamb

Figure 8 charts ABARE’s average retail lamb/mutton prices and the trade lamb indicator for 1998–2006. Throughout this period, there has been a greater fluctuation between average lamb retail prices and livestock prices, with noticeable decreases in retail prices after most decreases in livestock prices.

This may be due to the fact that there is greater seasonality and less reliance on grain feeding in lamb production. It may also be due to supermarkets relying on more saleyard purchases of lamb (as compared to cattle).

However, as with beef, a decrease in the livestock price of lamb has resulted in a much smaller percentage decrease in the retail price.

Figure 8: Comparison of retail lamb prices and trade lamb livestock prices, 1998–2006

Source: MLA

4.3.3 A widening gap between livestock and retail meat prices

The South Australian Farmers Federation (SAFF) submitted that since 1981 retail prices for beef and lamb have increased at a greater rate than livestock prices.

Figure 9 charts ABARE data\(^{35}\) of retail and livestock prices\(^{36}\) from 1981 to June 2006. The data shows that during this period the saleyard cattle price increased by around 150 per cent while the retail price of beef increased by around 190 per cent.

\(^{35}\) ABARE, Australian commodity statistics (154,155), 2006.

\(^{36}\) Cattle price is a weighted average of yearling, ox and cow prices.
Similarly, for lamb the saleyard price increased by around 160 per cent, while the retail price of lamb increased by 235 per cent.

Source: ABARE
As SAFF recognised in its submission, accurate identification of the cause of this divergence is difficult. As SAFF suggested it could be due to the increasingly competitive nature of livestock production and/or increased value added at the retail end of the supply chain. It could also reflect changing costs at various levels within the supply chain, such as increased transport or processing costs.

Since 1998, however, retail prices for beef and lamb have increased at a slower rate than saleyard prices. The saleyard price of cattle has increased by just over 70 per cent whereas the retail price of beef has increased by less than 60 per cent. For lamb, the saleyard price has increased by approximately 88 per cent while the retail price has increased by around 77 per cent.

Likewise, data provided by MLA for cattle and lamb typically purchased for sale by Australian butchers and supermarkets reveals that, since March 1998, the retail prices of beef and lamb have increased at a slower rate than saleyard prices. The retail price of beef has increased by less than 60 per cent while the livestock price of cattle has increased by 75 per cent. The retail price for lamb has increased by around 76 per cent while the livestock price has increased by just under 80 per cent.

The ACCC has not sought to identify the reasons for these changes over time. It considers such an inquiry to be beyond the scope of the minister’s request. This analysis does, however, provide an indication of the complexity of the relationship between livestock prices and retail meat prices. Accordingly, the ACCC urges caution in interpreting movements in the margin between saleyard and retail meat prices, particularly over short periods of time.

### 4.4 Findings of Whitehall Associates’ research

The relationship between livestock and retail meat prices has previously been explored in *Price determination in the Australian food industry*, a research report prepared for DAFF by Whitehall Associates.  

The Whitehall report warned that there are dangers associated with making simple comparisons between farmgate and retail prices for both beef and lamb. It notes that the limited time series for price data shows that there is little correlation between levels of prices over time; and that increasing integration up and down the supply chain reduces the number of transactions occurring throughout traditional market channels, further decreasing the usefulness of this information as an indicator of market conditions.

### 4.4.1 Relationship between livestock and meat prices

The report finds that in the domestic market, competing sources of meat drive prices at the consumer end of the supply chain, while export returns dictate costs at the other end.

The report found that buyers of cattle for the domestic market compete against export buyers, processors and marketers. The prevailing farmgate price at which a major domestic buyer purchases cattle will be influenced by:

- the strength of international demand
- the demand for store and breeding cattle
- the level of available supply
- prevailing export prices.

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37 Quarterly data was averaged over each year to account for seasonal effects.
40 ibid., p. 39.
The report also found that despite the higher proportion of total lamb meat production sold in the domestic market, returns to the lamb production and processing sector are strongly influenced by international markets. With the growing influence of exports, the supply of lamb and prevailing prices are driven by factors which include:

- exchange rate relativity and volatility
- seasonal conditions which affect both quality and quantity
- greater exposure to commodity risks (such as feed grain prices and import restrictions on feed grains) as the incidence of grain feeding of lambs increases
- returns from wool, although this influence is weakening because of the strong role played by cross-breeding and increasing specialisation in lamb production.  

The report also notes that higher value lamb cuts have increased at a greater level relative to legs and forequarter chops, indicating a stronger demand for premium product and cuts as consumers become more conscious of quality.

4.4.2 The effect of increasing integration throughout the supply chain

The Whitehall report also noted the increasing degree of integration throughout the supply chain, noting that producers such as AACo and Stanbroke were increasingly integrating vertically to manage breeding, finishing processing and retailing/branding. At the same time, retailers are vertically integrating through the use of direct supply agreements. Accordingly, the vast majority of beef supplied domestically is increasingly supplied through the use of direct arrangements that integrate producer, processor and retailer. The report also noted that wholesale markets ‘for beef carcasses and portions of beef are used in the minority of cases’.  

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41 ibid., p. 44.

42 ibid., p. 42.
5. Relationship between livestock and retail prices

The long and complex supply chain discussed in section 3 means it should not be assumed that there will necessarily be a direct and immediate relationship between the price of the raw product (livestock) and the final good (packaged meat).

This section examines three factors that may mitigate concerns that large buyers are exerting market power:

- Costs throughout the supply chain may move in the opposite direction to livestock prices.
- The relevance of saleyard livestock prices as an indicator of input costs.
- The existence of competitive forces at both ends of the supply chain.

5.1 Costs added throughout the supply chain

The cost of livestock is only one component of the total cost incurred by supermarkets (and other retailers) in providing fresh meat to consumers. A large percentage decrease in the price of livestock, such as was seen in the 2006 December quarter, results in a much smaller impact on retail meat prices because the price of livestock is only a small part of the total costs of producing fresh meat for domestic consumption. For example, if saleyard costs represent 20 per cent of retail prices, and saleyard prices fall by 10 per cent, retail prices would be expected to fall by only about 2 per cent, if the price of all other inputs remains the same.

Figure 11 reproduces a supply chain map published by Whitehall Associates in its report examining costs and value added throughout the beef supply chain. The examination was undertaken as part of wider research into the determination of food prices in Australia for DAFF.

Taking a whole-of-carcass approach to the measurement of returns, the Whitehall report estimated a snapshot of gross returns to each major sector throughout the supply chain.

Figure 11: Value and cost added from farmgate to retail, beef

![Value and cost added from farmgate to retail, beef](source: Food price determination in Australia, a report)
Costs and value are added via ‘finishing’ on grain to meet quality specifications and by activities such as slaughtering, processing, transporting, butchering and packaging. There is no reason to believe that these costs will necessarily remain unchanged while livestock prices move. One of these costs, the price of feed grain for the finishing of livestock seems to be of particular importance in the current conditions.

5.1.1 Grain ‘finishing’ to specification

Market participants stated that the vast majority of meat sold in supermarkets and butcher shops is from livestock that has been ‘finished’ on grain. It was widely accepted among market participants that meat sourced from grain-fed livestock is of superior quality.

While grain finishing of beef is commonplace (it is estimated that 80 per cent, if not more, of beef sold in supermarkets is sourced from grain-fed animals) the increased feed prices would not normally be such a significant factor in lamb production. However, the current lack of pasture means that an increasing number of lambs are being ‘supplementary fed’ on grain and fodder. One independent butcher chain indicated it was currently sourcing all of its meat (including lamb) from feedlots.

ALFA agreed that feed grain prices were an important input into beef production and submitted that there is a clear inverse relationship between the price of livestock and the price of feed grain, particularly in times of drought. There is a shortage of grain (resulting in increased feed grain prices) and farmers seek to de-stock their properties due to a shortage of pasture and high feed costs (resulting in decreased livestock prices).

Figure 12 plots the EYCI and three common feed grain prices. The chart supports ALFA’s view that there is an inverse relationship between livestock prices and feed grain prices as the EYCI and grain prices have typically moved in opposite directions since 1998. The chart also shows that feed grain prices in late 2006 were at their highest levels since the last drought in 2002–03.

Figure 12: Comparison of EYCI and feed grain prices, 1998–2006

Note: The scale in this chart is not the same for all series. The EYCI is c/kg cwt, while the feed grain prices are $/tonne.

Source: MLA and ABARE
Coles and Woolworths both submitted that their long-term supply arrangements involve setting prices based on the prevailing costs of production and that this included the cost of feed grain. Increasing grain costs throughout the course of 2006 have been adding to the supermarket costs. Mr Michael Luscombe, chief executive officer of Woolworths, made media representations that the gains from lower livestock prices were outweighed by higher feed costs. This general argument, that increasing grain prices were offsetting lower livestock prices, was widely supported by industry participants.

High feed costs have had a particular impact on the feedlot industry. ALFA contends that fodder and feed costs represent around 60 per cent of feedlot input costs (of which grain accounts for over 75 per cent) while feeder cattle prices represent around 30 per cent of input costs.

One market participant provided data revealing that the total cost of yearling cattle delivered to the processor in December 2006 was only negligibly lower than in December 2005 despite a decline of over 12 per cent in the price of feeder cattle. The comparison revealed that feed costs had increased by $70 per tonne (an increase of almost 40 per cent) and this had all but offset the reduction in the cattle price. The data also showed that, in December 2006, feedlot activities and costs accounted for 30 per cent of the value of cattle ready to be processed compared to 21 per cent in December 2005.

ALFA agreed that increased overall production costs, caused by high feed costs, increased the overall costs of producing good quality grain-fed beef, even as some input costs (such as feeder cattle) may be pushed downwards.

5.1.2 Other costs of production

There may also be other changes in other costs throughout the supply chain that mitigate decreasing livestock prices.

Woolworths provided a detailed comparison of its end-to-end costs for beef and lamb in November 2005 and November 2006. The data revealed that Woolworths’ margin on beef fell in 2006 and that a reduction in the purchase cost of beef was matched by an equivalent percentage reduction in the average sell price of beef (per kilogram). For lamb, Woolworths’ average sell price also fell in 2006. While Woolworths’ purchase cost of lamb had fallen by more than its sell price, some input costs for lamb had increased significantly in 2006.

5.2 The relevance of saleyard livestock prices as an indicator of input cost

The relevance of saleyard indicator prices as an indicator of retail input prices appears to be problematic for two reasons. First, the extensive use of direct supply agreements means that a large number of transactions occur outside the traditional saleyard and they include risk management arrangements to reduce the effect of price shocks to both producer and retailer. Second, several industry participants commented that the livestock in saleyards is often not of the quality that ends up on supermarket and butchers’ shelves.

5.2.1 The effect of direct supply agreements

As noted in section 3, the two larger supermarkets purchase most of their meat through direct supply agreements rather than from saleyards and these direct supply agreements provide a degree of risk management.

Both Coles and Woolworths provided details of their actual buy and sell prices in their submissions: Coles for 2006 and Woolworths for two-and-a-half years to December 2006. The data revealed that Woolworths’ average sell price of beef (per kilogram) and buy price (per kilogram) had remained consistent over the last two years. Similarly for lamb, Woolworths’ average sell and buy prices had remained relatively consistent over the last two-and-a-half years although prices had fluctuated more than beef prices.

The Coles data also revealed that its average buy price for beef was relatively stable (within 4 per cent) throughout 2006. While prices for lamb were more volatile, its average buy price remained above the saleyard indicators.

43 On ABC’s The Country Hour (27 December 2006) Mr Luscombe said that the cost of cattle had decreased about $40.00/head, but the cost of a 90 feed had increased by about $75.00.
5.2.2 Quality of livestock

A common view expressed by market participants was that Australian consumers are accustomed to eating meat of the highest quality and they expect to be able to buy consistent, good quality meat all year round.

The supermarkets submitted that their buying strategies are driven by quality and they want a consistent supply of quality meat all year round. The supermarkets argued that they have strict quality specifications in place and they will not buy livestock unless they meet these criteria. This argument was supported by interested parties from other sectors of the meat industry. ALFA stated that:

... the much higher product specifications, including tighter specification grids and/or the use of additional quality assurance (QA) modules with greater requirements, means that the product sold to major retailers is significantly differentiated from competing products (especially non-QA grass-fed product, such as might be available cheaply during forced drought sales).

The supermarkets, as well as other market participants, expressed the view that much of the livestock sold in saleyards is not of the quality that supermarkets demand.

Coles submitted that only about one-third of livestock at saleyards is ‘trade’ quality (i.e. is suitable for processing as meat) and, of that, only about one-third is ‘prime livestock’ which Coles may buy. Coles argued that their additional weight specifications meant that ‘the percentage of suitable livestock for Coles is usually very small’. Likewise, Woolworths argued that the majority of livestock being sold in saleyards did not come close to meeting Woolworths’ specification criteria.

A number of market participants stated that the poor quality livestock passing through the saleyards is ‘not the same meat that ends up on supermarket shelves’. The livestock president of the VFF, Ailsa Fox, was quoted as saying:

A lot of the lamb sold through the saleyards … is not suitable for killing immediately for consumption. If you slaughtered them there would be next to no meat on them…so these lambs are being bought by the feedlotters or producers who are … feeding them up, which in turn costs a lot of money.

In fact, participants stated that despite the higher number of yardings, there had actually been a decrease in the number of quality livestock coming on to the market. Coles submitted that prime livestock had generally been in short supply at saleyards. This view was supported by Metcash who submitted that given the drought, there was less quality meat available from wholesalers and processors.

Several processors confirmed that due to seasonal conditions there had been a significant reduction (some estimated over 30 per cent) in the amount of quality lambs to be processed. Another market participant stated that there had been a 7–8 per cent year-on-year reduction in the supply of supermarket/butcher quality meat between October 2005 and October 2006 and a 26 per cent reduction between October 2004 and October 2006.

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44 Submission from the Australian Lot Feeders Association.
45 Herald Sun, 29 November 2006, p. 12.
5.3 Competition in livestock and retail meat markets

Both Coles and Woolworths submitted that they are buying livestock in a competitive market where they buy a relatively small share of total production, and exports play a vital role. Industry participants and observers generally agreed, noting that no one purchaser was able to ‘distort’ the market because producers that were dissatisfied could alter the specifications of their stock to target other purchasers or export markets.

Coles stated that the domination of exports in the meat sector has historically led to tight supply and quality problems for Australian retailers and that these limitations were the catalyst for Coles developing its own vertically integrated meat supply chain in 1998. A similar view was also expressed by wholesaler Metcash who stated that the strong export market leaves an ever diminishing supply of quality product available for domestic sale. Woolworths also submitted that it faces significant competition from the export sector for the purchase of livestock.

Given the relatively small share of total production being purchased by even the largest domestic retailers, it seems unlikely that any one party would be able to suppress prices and/or impose onerous terms and conditions without producers altering their specifications to target alternative markets.

Similarly in retail markets, both Coles and Woolworths submitted that they operate in a competitive environment and that they face significant competition from independent supermarkets and butchers. Coles and Woolworths argue that any attempt to inflate prices would see them rapidly lose market share.

While Coles and Woolworths are the two largest competitors with about half of all meat sales, they face competition from each other, other supermarkets and about 3000 independent butchers. It seems unlikely that an attempt by any one party to charge unreasonably high prices could be sustained without losing market share.
6. Conclusions

While there is a relationship between the price paid to farmers for livestock and retail meat prices, there are many factors throughout the supply chain that make drawing a simple linear relationship problematic. The assumption that there should be a direct and immediate link ignores the complexity of the supply chain itself and of supply arrangements within the chain.

The supply chain is long and complex and there is a considerable amount of work and cost involved in transforming livestock into fresh meat available to consumers for purchase. The costs incurred throughout the supply chain (and changes to them) are not always as observable as, or as readily identifiable with, the production of meat. They may also move in the opposite direction as livestock prices. For example, the increase in the cost of feed grain throughout 2006, and its subsequent effect on the cost of production of beef (and to a lesser extent lamb), is not immediately as obvious in the determination of retail meat prices as it is in saleyard livestock prices; it has, however, had a significant effect.

Because the price of livestock is a relatively small proportion of the total cost of the final product, a large percentage decrease in the price of livestock, such as was seen in the 2006 December quarter, results in much smaller percentage decreases in retail meat prices because the retail price is significantly higher than the livestock price. For example, if saleyard costs represent 20 per cent of retail prices, and saleyard prices fall by 10 per cent, retail prices would be expected to fall by only about 2 per cent, if the price of all other inputs remained the same.

Australian consumers demand a particular quality of meat and much of the livestock sold in saleyards will not meet these requirements. To help ensure consistent quality supply supermarkets use direct supply agreements. These supply agreements provide less volatile livestock purchase prices than are typically observed in saleyard prices and provide both retailers and producers with greater certainty. This flows through to consumers in the form of more consistent quality and less volatile prices. The greater the extent of such supply agreements, the less direct or the more muted will be the effect of saleyard livestock prices on retail prices.

Other factors in the supply chain may also have an influence. For example, the large number of livestock being sold in saleyards led to near record slaughtering rates in late 2006. This led some industry participants to comment that decreasing livestock prices may have been a signal that meat processors were at or approaching capacity. The ACCC was not, however, able to obtain data or to verify whether or not capacity constraints in meat processing were a particular issue.

Coles and Woolworths have both provided the ACCC with detailed information about their involvement at various levels of the supply chain, their actual buy and sell prices for meat and details of their margins on red meat over time. This information confirms that their average buy price is generally higher and less volatile than saleyard price indicators.

Finally, the ACCC notes that both the livestock and retail meat markets appear to be reasonably competitive. The major supermarkets face competition from other buyers (for both domestic and export markets) when purchasing livestock and they purchase a relatively small percentage of Australia’s total red meat production. Under these conditions it seems unlikely that they would be able to suppress prices and/or impose onerous terms and conditions without producers altering their specifications to target alternative markets.

Likewise, in retailing, while Coles and Woolworths are the two largest competitors with about half of all meat sales, they face competition from each other, other supermarkets and about 3000 independent butchers. In these conditions, it seems unlikely that an attempt by any one party to charge unreasonably high prices could be sustained without losing market share.
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