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Metcash Limited

Submission to ACCC Supermarkets Inquiry 2024-25 Issues Paper

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1 Overview of Metcash

Metcash Limited (**Metcash**) welcomes the opportunity to respond to the ACCC's Supermarkets Inquiry Issues Paper (**Issues Paper**). The maintenance and growth of a competitively significant independent grocery segment is a fundamental concern of Metcash's business. As such, it is pleased to comment on matters raised in the Issues Paper from its perspective.

Prior to addressing some of the matters raised in the Issues Paper, Metcash provides some background to its operations below.

Metcash is a wholesale distributor and services company operating in the food, liquor and hardware industries. Metcash is listed on the Australian Stock Exchange.

Metcash's business purpose is "Championing Successful Independents in Support of Thriving Local Communities". Across our food, liquor and hardware pillars, we work with our customers to make Metcash-supplied stores the 'best store in town', such that independent retailers consider us as their business partner of choice. Independent retailers occupy an important competitive position in Australia. In addition to providing a pricing constraint to the large dominant vertically integrated retailers, they provide real differences in product offerings and opportunities for local suppliers which benefit both consumers and suppliers. For example, in the context of its 2022 review of the potential acquisition of SUPA IGA Karabar, the ACCC concluded that the SUPA IGA Karabar "offers a different shopping experience to Woolworths, Coles and Aldi. This differentiated shopping experience generates competitive tension in the local area...". That statement could apply to any IGA retailer throughout Australia.

Metcash organisational structure

Metcash has three internal divisions (or business pillars):

- **Food:** a dry grocery and fresh foods wholesaler to independent supermarkets and convenience stores, including those operating under the IGA, Foodland, FoodWorks and Lucky 7 brands, as well as the operation of the Campbells convenience and food service business. On 5 February 2024, Metcash entered into a share sale agreement with Quadrant Private Equity to acquire Superior Food Services – the transaction is conditional on Metcash obtaining clearance from the ACCC;
- **Liquor:** a broad range liquor wholesaler which supplies products to hotels, liquor stores, restaurants and other licensed premises, including those operating under the Cellarbrations, IGA Liquor, Bottle-O and Porter's Liquor brands; and
- **Hardware:** a wholesaler of hardware, tools and home improvement products to independent retailers as well as company-owned and joint venture retailers operating under the Mitre 10, Home Hardware, Total Tools, Thrifty-Link Hardware, True Value Hardware and Hardings brands, as well as to non-bannered independent stores.

This submission relates primarily to Metcash's Food Pillar, and as a result, any references to Metcash throughout this submission should be read accordingly as relating to Metcash's Food Pillar alone.

Metcash's revenue associated with each of its three pillars is set out in the figure below.

Figure 1: Metcash revenue by Pillar¹







Metcash grocery retail customers

Metcash is a supplier to over 1,600 grocery stores located across Australia. These include a network of bannered independent retailers where Metcash licenses the brand (such as IGA) and provides support services including marketing and promotional services, as well as non-bannered stores and third-party banners such as FoodWorks.

IGA Network

Members of the IGA network, which operate 1,299 retail grocery stores, are key customers of Metcash. The IGA network contains a variety of store formats from small local convenience-oriented retailers to full-service grocery stores. Whilst IGA stores are located throughout Australia in both metropolitan and regional areas, Metcash and IGA retailers are particularly important components of grocery supply in regional and rural Australia.

Table 1 – IGA supermarkets format

Brands	Store Format	# of stores
	Large format catering to price-sensitive catchments	4 (<1%)
	Large	252 (20%)
	Medium	644 (50%)
	Small	399 (30%)

¹ Note: FY23. The FY23 sales values for each Pillar are as follows: Food - \$9.6 billion, Hardware - \$3.4 billion, Liquor - \$5.1 billion.

The location of IGA’s national store network is set out in the figure below.

Figure 2 – IGA supermarkets locations²



In addition to IGA stores, Metcash supplies approximately 300 other supermarket/grocery retailers throughout Australia.

Metcash considers that a key competitive advantage of the IGA network is that stores are run by independent operators who are integrated into their local communities. Metcash considers that these owner operators are best suited to understand and meet the demands of these communities. IGA independent retailers have the ability to source products from suppliers other than Metcash (as outlined further below), and in doing so support many local and regional businesses that are not often listed in the national vertically integrated chains.

Core components of the Metcash/IGA offering include:

- **Price:** IGA stores compete locally on price and run market competitive promotions.
- **Variety of product:** Independent operators have a strong understanding of the community they operate in and range products that are tailored to the community’s tastes – this is a point of differentiation to the major supermarkets.

² As at 12 March 2024.

- **Personal service to customers:** Local owners make a particular effort to be able to provide friendly and personal service to their customers.

Approximately 77% of the total revenue (inclusive of Tobacco) for Metcash Food's Supermarkets business unit relates to IGA, Foodland, Local Grocer and Supa Valu stores.

Metcash distribution model

Independent grocery retailers purchase products in three primary ways:

- direct purchases from the Metcash warehouses;
- through what is referred to as 'charge-through' purchases, where Metcash suppliers deliver goods directly to the retailers; and / or
- direct from third party suppliers.

Metcash has a national distribution capability through its five major distribution centres as set out below.

Table 2 – Metcash distribution centres

Distribution Centre	Address
Crestmead DC	137 Magnesium Drive, Crestmead, QLD 4132
Huntingwood / Eastern Creek DC	71 Huntingwood Drive, Huntingwood, NSW 2766
Laverton DC*	75 – 79 Fitzgerald Road, Laverton, VIC 3028
Gepps Cross DC	600 Main North Road, Gepps Cross, SA 5094
Canning Vale DC	210 Bannister Road, Canning Vale, WA 6155

* Metcash will be opening a new Distribution Centre (DC) in Truganina (Victoria) in July 2024. Metcash expects to cease operations at its Laverton DC in October 2024.

The below figure shows Metcash's broader distribution network including Campbells and Superior locations (noting that the Superior acquisition has not completed and is subject to ACCC clearance).

Figure 3: Metcash distribution network



Metcash notes that it is not the exclusive supplier to Metcash retailers including to members of the IGA network. Except in limited circumstances, there are no obligations on Metcash retailers to acquire products exclusively from Metcash. While Metcash has a business incentive to ensure that it is the preferred supplier to independents and to deliver products which meet the demands of its retailers, it recognises that supply flexibility may be a competitive advantage for retailers. For example, retailers may make purchases from local suppliers in local markets, which may include situations where overall demand may not be sufficient to make that product available through Metcash’s distribution centres.

Approximately 74% of all IGA purchases are made through Metcash (either through direct purchases from the Metcash warehouse, or charge-through). The remainder of the supplies are sourced from alternate sources such as fresh markets or other suppliers – in the fresh food category, independent retailers source between 50-90% of their supplies from alternative suppliers to Metcash with a strong preference for local producers.

2 Grocery retailing

2.1 Competition dynamics

2.1.1 Market structure

As noted in the Issues Paper, there has been some increase in the number of competitor grocery stores in Australia. For example, the Issues Paper notes that Aldi has increased the number of its stores from approximately 170 in 2008 to 593 in 2024. Likewise, Costco entered the Australian market in 2009 although its presence is very limited.

From Metcash’s perspective, it is focused on working with retailers and potential retailers to develop and implement a network expansion strategy. Metcash is currently targeting 20 new stores opening annually with the focus on store formats of approximately 1,200 square metres. Metcash has supported 360 new stores to enter the market since the start

of FY15,³ however the net number of IGA branded stores has decreased from 1,455 in FY15 to 1,299 in FY24 to date (a net decrease of 156 stores).

However, notwithstanding any growth in competitor numbers, it is clear that the Australian market continues to be dominated by the two large vertically integrated grocery retailers in Woolworths and Coles. The below table provides current market share figures based on data received from IBISWorld.

As demonstrated in the figures below, Metcash considers that Woolworths and Coles account for at a minimum approximately 65% of grocery sales in Australia.

Table 3: Estimated market shares (excluding Tobacco, source: IBISWorld)

Entity	Market share
Woolworths	37.2%
Coles	28.3%
Aldi	10.3%
Metcash	6.5%
Others	17.7%

The entrenched dominant position of Coles and Woolworths is facilitated by scale and scope advantages in grocery markets and the fact that Woolworths and Coles are able to exploit these advantages. These benefits include purchase efficiencies, logistics efficiencies and economies of scale in marketing and promotion functions. Scale and scope economies will be relevant to supermarkets at a number of levels, including store size, numbers of stores and product range.

Metcash seeks to obtain efficiencies in its operations by servicing a large number of retailers. As such, it assists retailers in overcoming certain disadvantages associated with smaller scale. Having scale allows Metcash to recover relevant investment costs and to obtain more favourable supply terms than may otherwise be available to each of its individual retailers, allowing them to more effectively compete with the larger vertically integrated chains.

That said, the large difference in scale as between Metcash and Woolworths/Coles, and the consequential market power enjoyed by Coles and Woolworths, will have a negative impact on competition as well as the possibility of entry and expansion. For example, Woolworths and Coles may use their market power to extract terms from suppliers which they may be unwilling or unable to provide to Metcash, which reduces the competitiveness of the independent sector.

Likewise, creeping acquisition strategies implemented by the large vertically integrated chains affect market structure and levels of competition. Acquisitions by Woolworths or Coles reduce Metcash's scale or deny increased scale to Metcash in circumstances where an existing or alternative purchaser is an independent grocery store. Metcash considers that the dominant position of the vertically integrated chains, both nationally and in local markets, has been materially facilitated by the acquisition of independent stores over an extended period of time (ie more than 20 years). As such, Metcash considers that creeping acquisitions by large vertically integrated retailers not only have a negative impact by removing a differentiated competitive choice within local markets, but also have broader competitive impacts by affecting economies of scale available to the independent sector.

In circumstances where an acquisition involves the removal of an independent retailer, the local market loses the product and service variety offered by that independent

³ The total number of 360 new stores is made up of new sites opening as IGA (including Foodland IGA) stores, or from other non-IGA stores re-bannering as an IGA (including Foodland IGA) store.

competitor, as well as the pricing constraint provided by it. The loss of an independent retailer, and its replacement by a large vertically integrated chain, has broader consequences. It entrenches the position of that vertically integrated chain but also may reduce the overall efficiency and effectiveness of the Metcash network.

In this respect, the effects of creeping acquisitions by vertically integrated chains on Metcash and the independent grocery sector may include:

- Reductions in scale and expected profitability, which will impact new investment. Metcash has, and continues to make, significant investments in its distribution centre capabilities and its distribution systems across Australia. However such reductions over time may result in higher costs, including higher fixed costs as a proportion of sales, slower deliveries and reductions in product range which will, in turn, have impacts on future prospects in terms of profitability and investment both at the wholesale and retail level; and
- Reductions in scale may also lead to loss of volume, which may result in less favourable terms with suppliers thereby increasing retailers' Cost of Goods (COGs) across the network. That is, pricing offered to retailers through negotiations with major suppliers are, to a degree, dependent on volumes.

In the circumstances above, Metcash considers that there are both immediate and longer-term competitive issues associated with the market dominance of Coles and Woolworths. As such, in prior submissions to the Competition Taskforce's Merger Reform Consultation Paper, Metcash has expressed support for changes in the merger clearance regime to address ongoing concerns with creeping acquisitions by Coles and Woolworths.

2.1.2 Price and non-price competition

Metcash notes that it does not set retail pricing. Its retailers are independent and make independent pricing decisions. That said, Metcash seeks to work with suppliers and retailers to allow Metcash-supplied retailers to offer competitive pricing. There is a significant variation between the types of IGA retailers. Whilst there will be exceptions, smaller convenience-oriented retailers may choose to adopt a different form of pricing strategy as compared to larger format stores. It is also noted that independent IGA retailers are not in a position to cross-subsidise freight costs as between stores. This may also impact the pricing strategy for more remote retailers where freight costs are materially higher.

Metcash considers that both price and non-price components are important aspects of supermarket competition. While independent retailers must be price competitive, there are material non-price elements of competition which may advantage independent operators. Metcash considers that independent retailers are in a better position to provide a real and differentiated offering for consumers. As a general proposition, owners of independent retailers live and work in the communities they serve, and can best make decisions regarding service levels and the scope of products which will best meet local demand.

Metcash works directly with its retailers and representative bodies representing groups of retailers to provide products which its retailers consider will meet local demand. In addition, and as noted above, except in limited circumstances Metcash retailers are not obliged to acquire their products from Metcash. This means that retailers can, and do, negotiate directly with suppliers and/or other wholesalers to procure and offer products which are different to or superior to what might be offered at the local store of one of the vertically integrated chains where product range is centrally determined. In this respect, many IGA retailers have sought to tailor their offering including, for example, having expansive Italian and Asian sections or ranges, in order to service local demographics. This is a real point of differentiation. As noted above, in doing so Metcash retailers support many local and regional businesses that are often not listed in the national chains.

In addition, Metcash considers that IGA retailers are more likely to have a full-service butcher or delicatessen located within the store as compared to a Coles or Woolworths. Metcash seeks to support this broader offering including by providing additional materials and services to support in-house butchers and delis.

Whilst recognising the importance of non-price competition, price remains a key driver of competition especially in the context of cost-of-living concerns. Short term promotional pricing remains a key component of grocery retailing. However, for a variety of reasons including increased pricing transparency through the internet, Metcash considers that consumer perceptions regarding every day pricing are a growing driver of consumer decision making. As such, in addition to seeking to ensure that its retailers are competitive in regard to promotional activity, there has been an increased emphasis on everyday pricing within the IGA network over the last ten years or so.

Metcash retailers, including IGA retailers, can set their own pricing. However, Metcash seeks to work with retailers to ensure competitive pricing through the following mechanisms:

- In discussions with suppliers, it seeks to ensure that goods are acquired and sold at a price which allows retailers to price competitively while maintaining a reasonable margin. As explained in more detail below, Metcash does not make a wholesale margin on the resale of goods at a wholesale level. Rather, Metcash passes on its purchase price directly to retailers and earns additional revenue principally through the negotiation of trading terms with suppliers.
- In cooperation with suppliers, Metcash offers a discounting/promotional pricing program supported by its catalogue, as well as online and/or loyalty program advertising. Metcash's promotional programs generally operate for a one-to-two-week period in-store. Consistent with consumer demands in terms of everyday pricing expectations, Metcash has also implemented a Low Prices Every Day (**LPED**) program. Products available through the LPED program will be available in-store at no higher than the advertised price for at least 13 weeks. There are currently over 3000 products which are part of the LPED program. 35% of all IGA scan retail sales are sold as part of a promotion. Approximately 10.7% is made up from lines part of the LPED program.
- Where a retailer agrees to participate in a Metcash promotion, that retailer agrees to sell the promoted product at a price no higher than relevant promotional price.
- Metcash has developed a Price Match program which allows retailers to match the lowest regular shelf price of certain comparable products at the vertically integrated chains. In late 2022, this program was extended to all IGA stores. Under this program, small stores match the prices of around 200 products, medium IGA stores match the prices of around 600 items and larger IGA stores match prices on over 1,200 items. As part of this program Metcash monitors competitor pricing. Where there is a pricing decrease at a monitored competitor, Metcash will adjust its retailer pricing data file, thereby allowing the IGA retailer to implement the decreased new price. Metcash has created a fund by which it will make rebate payments to retailers to support price reductions under the Price Match program.
- Metcash also seeks to ensure price competitiveness in respect of products which are not part of any promotion, LPED or Price Match program. It monitors pricing at the large vertically integrated chains and regularly meets with retailers to discuss their pricing strategy. As noted above, retailers make their own decisions regarding pricing and will consider factors such as costs, targeted returns and the state of competition within their local market. However, as a general proposition, Metcash emphasises in meetings with retailers that there are longer term benefits associated with being competitive across the range of

products throughout the year and that a combination of competitive pricing along with an emphasis on service and meeting the product demands of the local community will allow the retailer to sustain its business long-term.

- The differential between Woolworths pricing and that of IGA retailers is consistently narrowing. As noted in Metcash's 2023 Annual Report, the IGA price gap to the major supermarkets has narrowed to the most competitive position ever.⁴

Loyalty programs

Metcash considers that loyalty programs can have a material impact on consumer decision making. The size and nature of the loyalty programs offered by the vertically integrated chains provide them with a significant tying advantage as well as providing them with a data set which reinforces their market position.

Metcash has a loyalty program, IGA Rewards, which it launched in 2018. IGA Rewards is an opt-in program for retailers. Certain IGA retailers operate their own rewards/loyalty programs, and may offer these programs in addition to or instead of the IGA Rewards program.

IGA Rewards members receive automatic entry into prize draws at their local IGA as well as certain travel deals available to members. However, most relevantly, IGA Rewards members are emailed personalised weekly offers. By agreeing to participate in the IGA Rewards program, access is provided to the IGA shopping history associated with a particular account. This allows Metcash (through the IGA Rewards program) to alert members to promotional activity which may be of most interest to them. In addition, IGA retailers may offer particular specials which are only available to members – to do this, retailers select member pricing across a range of products at store and relevant discounts are provided at check out.

Recognising that loyalty/benefits programs are factors that consumers will consider in making purchasing decisions, Metcash is considering ways in which the scope and benefits associated with IGA Rewards can be expanded. Metcash analysis shared with retailers indicates that the basket size of an IGA Rewards member is larger than the basket size of a standard IGA shopper. This is consistent with consumers considering there are benefits associated with loyalty.

IGA Rewards are provided on a retailer-by-retailer basis (on an opt in basis). There are material differences in the size and scope of the Metcash/IGA model and the offerings of Coles (FlyBuys) and Woolworths (Everyday Rewards). FlyBuys and Everyday Rewards programs include the collection of points and the redemption of points for value at various businesses. The broader scope of businesses at which reward points can be collected and earned (which include businesses owned and operated by Woolworths and Coles as well as third parties) provides a material advantage to the vertically integrated chains. Offers where points are earned and can be redeemed across a broad set of businesses are more likely to tie consumers to Woolworths and Coles. Furthermore, the expansive data sets generated through multiple points of contact with consumers provide for analytical possibilities which enhance and entrench the existing dominant position of the vertically integrated chains.

The material larger scale of loyalty programs offered by Coles and Woolworths may result in a stickier customer base, due to the significant level of coverage of these loyalty programs in Australian households. In addition, Metcash understands that these data sets are used by Coles and Woolworths to inform supplier negotiations and to increase the scope of individually targeted promotional activity. Metcash's loyalty programs are materially different in both scope and scale. Its loyalty program is not a material consideration in discussions with suppliers.

⁴ See: Metcash Annual Report 2023, p 20.

Private label / home brands

In respect of private label / home brands, Metcash's approach differs from the large vertically integrated chains. Home brands account for approximately 7.2% of Metcash sales. Metcash understands that this compares to at least 24% at Woolworths and 28% at Coles. Metcash does seek to develop home brands where its retailers demand a product to meet a certain price point / customer demographic. It has developed its Black and Gold and Community Co brands with this in mind. However, Metcash does not control retail shelving, and cannot replace a branded product with a home brand product, as purchasing and shelf decisions are made by retailers. Furthermore, Metcash has made a decision to focus, in large measure, on the promotion of branded products. It considers that this approach is most likely to result in favourable negotiations with suppliers and deliver products at a competitive price to its retailers.

2.2 Barriers to entry and expansion

There are material scale and scope benefits associated with grocery retailing. As such, any prospective new entrant will need to consider whether they have a sufficiently differentiated offer to overcome issues associated with scale.

While Metcash understands that the decision by Kaufland to abandon its plans to enter in Australia was a result of a myriad of commercial factors, including some unrelated to the potential business in Australia, reporting suggested that a consideration of sufficient scale, and the difficulties in obtaining that scale, were relevant to the decision.

At a local level, Metcash provides services and support which assist retailers in overcoming certain scale advantages held by the large vertically integrated chains.

One means of expansion is through expanding the capacity and/or services provided by an existing shop front. Metcash has introduced programs such as the Diamond Store Accelerator (**DSA**) and Network Future Excellence programs, which provide funding rewards to participating retailers for modernising and upgrading their stores. Metcash further incentivises retailers to participate in the DSA by offering growth rewards in the form of volumetric rebates based on the incremental increase in purchases following the store upgrade.

In terms of new stores, Metcash seeks to assist retailers open a new store including by:

- Assisting retailers or potential retailers to identify appropriate sites;
- Providing design and store lay out assistance;
- In certain instances:
 - entering into head leases or providing lease guarantees;
 - providing acquisition finance; and/or
 - investing directly in the new store as a minority owner.

However, notwithstanding the support that Metcash provides retailers and potential retailers, there are material barriers to entry for new independent retailers, including in respect of the availability of suitable sites and the site management practices of vertically integrated chains. In particular, Metcash notes the capacity of vertically integrated chains to leverage their financial power to the detriment of the independent grocery segment. Metcash has observed the following:

- Coles and Woolworths will often outbid (sometimes materially) an independent retailer for a relevant site; and
- Given the financial resources of Coles and Woolworths, they can afford a longer time horizon to development than an independent retailer with the result that they can engage in land banking with the view to future development.

2.3 Consumer experiences

There are clearly a wide variety of consumers with differing expectations. However, Metcash's overall observation is that supermarket and grocery consumers expect more from their retail experience in terms of in-store presentation. There is also an increased emphasis on ready-to-eat or almost ready-to-eat products reflecting increased competition from restaurant delivery, encouraged by the growth of services such as UberEats etc. Metcash has responded to these developments by funding stores to refurbish and by considering its product mix.

In addition, Metcash does not impose on its retailers any requirements regarding the mix as between self-checkout stations and staffed checkouts, and consider that is a matter for retailers in assessing the requirement of their local market. Retailers have the choice as to whether to install self-checkouts at each individual store, and exercise that choice in accordance with their knowledge and understanding of the local customer preference.

Online offering

In part driven by the COVID-19 experience, in Metcash's view there is a substantial proportion of consumers who are seeking to have products delivered. As noted, Metcash is not a retailer, but has sought to support retailers in meeting demand for online delivery. For instance, Metcash developed its IGA Shop online platform in 2020. Prior to that, some individual Metcash-supplied retailers had developed their own online shopping / delivery service, but there was no centralised Metcash-operated platform for customers to order groceries from IGA retailers for home delivery. Currently, 426 stores participate in the IGA Shop platform.

When a customer uses the IGA Shop platform, they select the store they wish to shop from, or a store is suggested by reference to postal code. The available product range and pricing is then determined by reference to that individual store, with pricing called from the store's point-of-sale system. Order delivery is then managed through the individual stores, where the retailer will manage the physical delivery of an order to a customer.

For retailers, Metcash's online shopping platform is an opt-in system – retailers notify Metcash if they would like to participate and provide a delivery service, and Metcash will then incorporate that retailer into the platform. The actual physical deliveries will, however, remain the responsibility of the individual retailer, albeit Metcash provides support for this as set out below.

Metcash has also partnered with Uber Eats and DoorDash to provide IGA retailer groceries to consumers through these platforms. Participation in these marketplaces are opt-in products for individual retailers, who again manage their own picking operation, product range, and pricing offer across these marketplaces. While access to Uber Eats and DoorDash is an attractive option for certain IGA retailers, there are material costs imposed by the platform providers, and overall performance/revenue generated from these channels has declined following the decisions by Woolworths and Coles to also offer their products through these platforms.

Online capability is an expectation of a significant proportion of Australian consumers and Metcash will continue to support its retailers in this respect. That said, Metcash considers that the proportion of revenue generated by online sales for IGA retailers will be materially less than in respect of Coles and Woolworths. Metcash does not have data regarding online sales by retailers using alternative systems. However, it notes revenue from online sales generated by the IGA network using IGA Shop the last 12 months was less than 1% of total retail sales.⁵

⁵ Metcash notes that some retailers may use other online selling platforms, and therefore Metcash cannot identify those sales.

3 Grocery supply chains

3.1 Competition in grocery supply chains

While Metcash provides services to retailers beyond the supply of groceries (ie brand licences, financing and business support services) its core business is grocery wholesaling. The figures below show what might be considered the prototypical supply chain for fresh food and packaged groceries.

Figure 4: Typical supply chain for fresh food

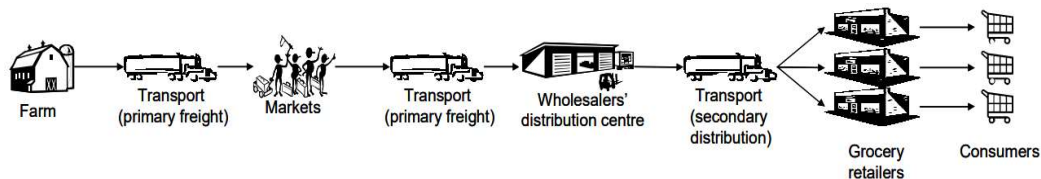
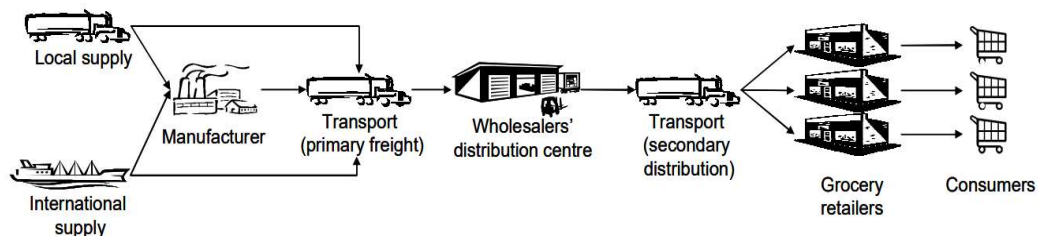


Figure 5: Typical supply chain for packaged groceries



In fact, actual supply chains in Australia differ from those shown in the figures above in a number of ways. Relevantly:

- Large grocery chains are vertically integrated and principally provide their own wholesale function;
- Independent retailers who are not vertically integrated back into wholesale supply to a greater or lesser extent also deal directly with manufacturers or local importers to obtain supply thereby bypassing Metcash or other wholesalers;
- While Metcash does not have any material farm gate contracts, it understands that the large vertically integrated chains do contract back to the farm gate, thereby bypassing produce markets and wholesalers. In comparison, Metcash generally purchases directly from produce markets at the prevailing market price and does not negotiate whole of season pricing with producers or distributors.

Consequently, the linear process shown in the above figure has, in fact, lines showing bypass of various functions.

Metcash faces wholesale competition

Metcash is the largest grocery wholesaler to the independent grocery segment in Australia. There are, however, a large number of other wholesalers operating in Australia including, in particular, specialist meat, seafood and fresh produce distributors, wholesalers who focus on particular cuisine types (eg Chinese, Italian) as well as a certain number of general wholesalers in addition to Metcash. Many suppliers have a wholesale function insofar as they supply retailers directly.

As noted above, IGA-branded stores acquire a material proportion of goods from parties other than Metcash. This is evidence of other wholesale channels including bypass by suppliers who supply directly to retailers. On average IGA retailers acquire approximately 74% of goods from Metcash. Approximately 50% of fresh products are sourced from

suppliers other than Metcash, but alternative suppliers are also used for a broad range of grocery products.

Metcash notes that it is not a supplier to Harris Farms, Drake's Supermarkets (outside of Queensland) or SPAR stores in Australia. Again, this demonstrates the ability of retailers to access supply from sources other than Metcash.

Metcash faces sustained competition from the vertically integrated chains

Whilst Metcash considers that it faces material competition in the supply to independent retailers, a focus on wholesale competition would ignore the key competitors to Metcash and its system.

While it is not vertically integrated to any material extent, Metcash's key competitors are the vertically integrated supermarket chains, namely Coles and Woolworths. Metcash's business model is dependent on providing pricing and services to independent supermarkets which allow them to compete with the vertically integrated chains. The need to deliver value to retailers is what ultimately drives business decisions for Metcash. Metcash also needs to work cooperatively with suppliers to demonstrate to them that Metcash and its retailers represent a meaningful route to market and an alternative to the vertically integrated chains. Any analysis which is focused on wholesale markets without properly considering the context of the two dominant vertically integrated chains and their impact on Metcash would ignore the competitive realities facing Metcash.

Metcash has supply arrangements with approximately 2,700 suppliers in respect of approximately 27,000 SKUs. Metcash does not control shelf space at IGA retailers. Rather, retailers must make their own purchase decisions. Metcash assists retailers in this respect seeking to focus on 'shopper led' product ranging decisions both in respect of Metcash as a retailer and in respect of store ranging. It works with retailers to consider network wide sales data in order to identify trends or emerging sales patterns in certain components of the network which might benefit a retailer. It also considers broader trends both in Australia and overseas which may impact product ranging decisions. It may also seek to onboard suppliers where they have demonstrated success in supplying directly to some segments of the network but where access to broader Metcash distribution, ordering and marketing would increase the scope of sales. All these factors, as well as limitations on warehouse capacity, will ultimately be considered in making a determination to range certain products.

3.2 Trading arrangements

3.2.1 Trading terms and practices

Metcash became a signatory to the Food and Grocery Code of Conduct (**Code**) in September 2020. In anticipation of its entry into the Code, Metcash conducted a broad review of its supply agreements and restructured its standard agreements to ensure compliance with the Code. Whilst there is some variation amongst the roughly 2,700 suppliers which Metcash deal with, the format of the agreements and the process of negotiations are relatively standard.

In most cases, a supplier and Metcash will enter into two broad agreements. The first agreement includes general Terms and Conditions of Supply and the second constitutes a Trading Terms Agreement under which suppliers provide Metcash with certain rebates or payments in support of Metcash distribution and sales activity (as described in further detail below).

Metcash does not seek to resell goods at a profit. Rather, it on-sells goods to retailers at the price which it has acquired those goods. This is understood by suppliers. As such, in negotiations with suppliers, Metcash seeks to obtain a supply price which will provide sufficient margin to retailers to allow Metcash retailers to be price competitive. Accepting that the manufacturer-recommended retail price may not be used by any particular

retailer, this generally is used to frame discussions as between Metcash and the relevant supplier in terms of the available margin to retailers. Whilst Metcash will emphasise in its discussions with suppliers the need for retailers to obtain competitive pricing, and the benefits to suppliers for providing that pricing (ie support of the product by the retailer and additional sales), Metcash is not in a position to demand particular pricing from suppliers. As noted below, it does not have market power as an acquirer of relevant products and must demonstrate value to the supplier in supporting the independent channel as part of any agreement.

Metcash earns revenue from suppliers through the negotiation and settling of trading terms which are subject to common definitions within relevant Trading Terms Agreements. There are, broadly, two types of trading terms. The first relates to the costs of Metcash's core distribution functions and the second relates to promotional activity undertaken by Metcash and retailers in support of relevant products (the latter being referred to as "co-op" terms). The non-co-op trading terms will vary depending on the cost Metcash incurs to supply the product. For example, chilled or frozen products cost more in respect of storage and delivery than ambient or dry grocery products. As such, the trading terms will differ as compared to chilled and dry grocery products. The nature of each trading term and the service to which it relates is defined within relevant documents and clearly understood by suppliers. Whilst Metcash, along with other industry participants, has experienced increases in labour or other costs over the past few years, there has not, as a general proposition, been any relative increase in the trading terms paid to Metcash.

Co-op terms reflect the investment a supplier makes into the Metcash and independent retailers' business through trade spend. They provide for payments by the supplier in recognition of promotional/marketing programs, activities and events Metcash coordinates on behalf of the supplier. Suppliers can invest their co-op spend into the network in a variety of ways such as through promotion in Metcash catalogues, digital packages, television and radio promotions or participation in specific sales events. The value of each item available to suppliers is based on a rate card developed by Metcash and independently reviewed by a third-party company. Metcash typically meets with its suppliers every 6 months to discuss how co-op monies are to be spent and how the supplier may participate in certain activities as part of spending their co-op money.

It is noted that the co-op trading terms relate to the costs for the delivery of promotional programs, rather than the funding of those programs from the perspective of a retailer. Metcash will have separate discussions with suppliers regarding the funding of promotional programs. At a high level, suppliers will offer Metcash (and by extension thereof Metcash retailers) discounted pricing for a particular period so as to allow for the delivery of a promotional program at retailers. Metcash promotional activity is developed in conjunction with, and at the request of suppliers, rather than at the demand of Metcash. Suppliers, as a general proposition, recognise the importance of promotional activity throughout the year in order to increase brand awareness and generate additional sales. Suppliers will have set views regarding when promotions should be offered which will take into account promotional offers which they have agreed to with other retailers.

3.2.2 The impact of buyer power

Metcash acknowledges that it has scale, in that it has a relatively large network of retailer customers, and to that extent, Metcash considers that it is an attractive prospect for suppliers. However, Metcash's experience in its dealings with suppliers is not consistent with Metcash having any buyer power or any ability to significantly influence terms of supply. Namely:

- Metcash and its associated retailers account for a relatively small share of grocery sales at both retail level and as a percentage of acquisition of grocery products from manufacturers/suppliers. As noted above, IGA retailers account for approximately 6.5% of retail grocery sales. This compares to the approximately 65% market share held by Woolworths and Coles on a combined

basis. Whilst Metcash considers that suppliers should value distribution to independent retailers, there is no basis to conclude that Metcash with an attributed market share of approximately 6.5% could have any material market power in its dealings with suppliers.

- Metcash does not control the shelf space at IGA locations. Ultimately, purchase decisions are made by retailers and not Metcash. This is very different from the vertically integrated chains where the chains are making final decisions regarding the amount of purchases and/or product placement for each store.
- Metcash does not control access to IGA retailers (or Metcash supplied retailers more broadly). With very limited exceptions, Metcash retailers can make purchases from other sources of supply, including directly from suppliers. The possibility of bypass (which does not exist in respect of negotiations with the vertically integrated chains) is a material component of any discussions. If Metcash does not provide sufficient value to a supplier, that supplier may decide to bypass Metcash and deal directly with relevant retailers.
- Metcash's market position means that Metcash must deliver value to suppliers in its negotiations. Metcash must demonstrate to suppliers that not only is it an efficient way in which to distribute goods to independent retailers, but that the independent retailers themselves are an important channel for the sale of relevant goods. Metcash needs to show material levels of investment into the network by both Metcash and its retailers to demonstrate to suppliers the longer-term value in investing in the network, including in respect of standard pricing terms but also in relation to the funding of promotional programs.
- Metcash is generally not in a position to resist supplier price increases. It will express concerns if a price rise will impact on network competitiveness and will be concerned if pricing at vertically integrated chains does not suggest any similar price rise to them. However, where a supplier indicates that it needs to impose a price rise, that price increase will be accepted. In circumstances where it clearly does not have market power, Metcash's concern is that the exercise of market power by the large vertically integrated chains on certain suppliers may result in sub-optimal terms being offered to Metcash as suppliers seek to regain margin in discussions with Metcash to account for margin loss in their arrangements with Woolworths and Coles.

3.3 Margins and price transparency in grocery supply chains

With very limited exceptions, Metcash also does not resell products at a margin to its retailers. Rather, it on-supplies products at the price negotiated with suppliers. Metcash considers that its suppliers have good visibility in respect of its business model.

Furthermore, Metcash is a public company. As such, there is a high degree of transparency in respect of its performance including in relation to margin obtained across the business as a whole and within the Food pillar. As shown in the table below, overall margins within the Food pillar have remained consistent since FY16. In this respect, Metcash does not consider that changes in its functions and/or the costs of its business have had a material impact on retail prices.

Figure 6: Metcash Food pillar EBIT margins

