

Public hearing – Sydney
1 April 2008

Time: 10am – 5pm

Address: Crowne Plaza Darling Harbour, 150 Day Street

Room: Blackwattle Room 3

Witness	Submission	Summoned
Australian Consumers Association Mr Peter Kell Chief Executive Officer	143	No
Ingham Enterprises Mr Kevin Radich National Operations Manager	n/a	Summoned & compelled to appear by ACCC
Franklins Pty Limited Mr Roni Perlov Finance Director Mr Aubrey Zelinski Managing Director	104 and 148	No
Nestle Australia Limited Mr Mark Mackaness General Manager - Sales Mr Richard Anderson Company Secretary/General Counsel	n/a	Summoned & compelled to appear by ACCC
<i>Lunch 1-2pm</i>		
George Weston Foods Mr David Kirby Sales Director – Baking Division	n/a	Summoned & compelled to appear by ACCC
Arnotts Biscuits Limited Mr Trevor Stevens Sales Director	53 and confidential submission	Summoned & compelled to appear by ACCC
Kiama Milk Supplier Collective Dr Peter Haertsch President Ms Lynne Strong Secretary Mr Geoffrey Quinn Consultant	86	Summoned & compelled to appear by ACCC

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TRANSCRIPT OF PROCEEDINGS

AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

MR GRAEME SAMUEL, Chairman
DR STEPHEN KING, Commissioner
MR JOHN MARTIN, Commissioner

GROCERY PRICE INQUIRY HEARING

CONDUCTED AT: CROWNE PLAZA, SYDNEY

DATE: 10.00 AM, TUESDAY, 1 APRIL, 2008

THE CHAIRMAN: I think we will start, because we've got our first witness here so good morning. My name is Graeme Samuel. I'm the chairman of the Australian Competition and Consumer Commission and the chair of this public inquiry into the competitiveness of retail prices for standard groceries. As chair, I welcome you all and declare this hearing open. I'm joined by Commissioner John Martin and Commissioner Stephen King, who are the other two presiding members for this inquiry. This hearing is convened under Part VIIA of the Trade Practices Act 1974. It is held pursuant to our request from the Assistant Treasurer and Minister for Competition Policy Consumer Affairs, Minister Chris Bowen, which was received by the ACCC on 22 January 2008.

Matters to be taken into consideration by the inquiry shall include but not be restricted to the current structure of the grocery industry at the supply, wholesale and retail levels, including mergers and acquisitions by the national retailers; the nature of competition at the supply, wholesale and retail level of the grocery industry, the competitive position of small and independent retailers, the pricing practices of the national grocery retailers and the representation of grocery prices to consumers, factors influencing the pricing of inputs along with supply chain for standard grocery items; any impediments to efficient pricing of inputs along with supply chain and the effectiveness of the Horticultural Code of Conduct and whether the inclusion of other major buyers such as retailers would improve the effectiveness of the code.

I note the ACCC has so far received over 150 public submissions to the inquiry as well as confidential submissions. The ACCC will endeavour to take into account all of the information that has been provided and thanks industry participants for the contributions that have been made. We understand that the competitiveness of retail grocery prices is of significant concern to all Australians. The purpose of these hearings is to give the ACCC an opportunity to investigate in detail the issues raised as part of the inquiry with industry participants. The ACCC is organising hearings throughout Australia during April with several hearings occurring in Melbourne in May.

I wish to emphasise that many witnesses of these hearings are not attending voluntarily and have been summonsed to appear under section 95S of the Trade Practices Act. In particular I note that in general the ACCC has summonsed all supplier companies. Therefore no conclusions can be drawn regarding a company's willingness to participate in the inquiry from the fact that a company is appearing at the hearings. The ACCC has also used its information-gathering powers to compel the provision of documents and information from many organisations. It did so to ensure that it had access to the most reliable information direct from industry participants.

Much of the material covered in some hearing sessions will be confidential and commercially sensitive and therefore significant parts of the hearings will not be open to the public. In particular where a supplier company has been summonsed, it is likely that much of the material will be confidential. As such, media

representatives and attendees should not expect all of the hearings to be public. Where there are industry associations or representative organisations who are attending voluntarily, it's more likely that most of those hearing sessions will be in public. Now, in terms of procedural issues, all witnesses will have received a
5 document that outlines how we intend to approach these hearings so I won't go through the procedural points in detail.

I just wish to emphasise that although we are not taking evidence under oath at this hearing, it is a serious offence to give false or misleading evidence to the ACCC. A
10 transcript of the proceedings, apart from any proceedings held in private or in confidential session at the inquiry will be made available on the ACCCs website. The ACCC recognises that some witnesses will be asked to give evidence that, if disclosed, would damage their competitive position or which may for other reasons be confidential. If a witness believes that a particular question or a series of
15 questions are likely to require him or her to disclose such information, the witness should indicate an objection to answering the question on that basis.

I will then consider whether the inquiry should take evidence in private from that witness. I note that although the ACCC is not utilising external counsel at this
20 hearing, witnesses will be questioned by the ACCCs internal lawyers. Well, that concludes my preliminary remarks. I thank all the witnesses that are attending at the hearings, particularly those that have been summonsed to attend. We realise that you are busy people and attending these hearings can be a significant imposition on you and your organisation. The first witness is the Australian Consumers Association.
25 Peter Kell. Are you on your own, Peter?

MR KELL: Yes.

THE CHAIRMAN: Thank you. I note again that it is an offence under the
30 Criminal Code to give evidence at this inquiry that a witness knows is false or misleading or omits any matter or thing without which the evidence is misleading. Although we will not normally be letting witnesses summarise their submissions, given that this is the first day, perhaps, Mr Kell, you could spend a couple of minutes outlining your key concerns?
35

MR KELL: Thank you. Thank you, chairman, and I would just like to thank the ACCC for the opportunity to appear this morning and put some evidence forward about consumer concerns around grocery prices. It is an area of considerable concern to consumers. We have recently conducted a survey of more than 1000
40 consumers in February this year and found that 83 per cent of consumers believe they are spending more on groceries compared to three years ago and the figures bear that out. There is no doubt that food price inflation has been greater in Australia over the last 10 to 12 years than other developed countries, having increased by almost 44 per cent since 1996.
45

So we see this inquiry as a very important opportunity to shine some light on the factors that are driving these price increases and also an important opportunity to

look at reforms and proposals that could bring transparency to food pricing in ways that help consumers. There is no doubt that Australian consumers believe there should be greater price competition in the grocery sector. Our survey again found that just under two thirds of consumers believe there is insufficient price competition
5 between supermarket chains. Only 16 per cent of consumers believe there is adequate price competition and again, our regular contacts with Choice as an organisation bear that out.

10 So we have proposed in brief several options that we think might assist consumers to manage better in terms of finding the best deal on their food and grocery prices at the overall level, if you like. We're suggesting that a food and grocery consumer price index would help all the players in this area understand the drivers of food and grocery prices. We think it would be useful to have that separate from the overall
15 consumer price index, although food obviously should be retained within that index and that that would be one way of understanding what are the drivers in this area. We're very strongly in favour of comparison pricing or unit pricing being introduced into Australia as it already exists in many overseas jurisdictions. We're certainly supporters of a grocery website, which has been suggested as a site that would be arranged by the ACCC to allow consumers to more easily determine the prices
20 charged by supermarkets in their area.

We also believe there are reforms in the area of competition and barriers to entry, including issues around the control of sites and properties that should be examined. So that's a brief summary of some of the issues that we're putting forward. In an
25 environment where there seemed to be a range of factors contributing to higher prices, we believe it is vitally important that consumers can have confidence that the prices that they're being charged for essential food and groceries are fair and not the result of market power, particularly when we have such a concentrated market sector in Australia. Thank you.

30 THE CHAIRMAN: Thanks, Mr Kell. Perhaps I should now introduce counsel that will be insisting the inquiry. We've got Damien O'Donovan and he will be assisted by Catherine Freeman, both internal members of the ACCC legal team and I will hand over to you, Mr O'Donovan.

35 MR O'DONOVAN: All right. Thank you, chairman. Now, I just wanted to explore briefly with you some of the suggestions which the Consumers Association has made in its submission to the commission and the first one, obviously, was the introduction of a food and grocery CPI?

40 MR KELL: Yes.

45 MR O'DONOVAN: Now, you're aware that the ABS already breaks down the CPI into food and household items. What change do you see at least in the presentation or the format of what's produced in relation to CPI that would be of assistance to consumers?

MR KELL: Well, yes, we are aware that the ABS currently does include a subsection on food and grocery prices in the overall CPI. We see, however, some distinct advantages in having a measure that, if you like, breaks that out and provides more detail on the driving forces and the trends in that area. One of the problems at the moment is that the headline CPI - for want of a better word - hides trends in food and grocery prices, so over the last decade or so there's no doubt that the overall CPI has been considerably less than the, if you like food and grocery price increase that we've seen in Australia. To some extent that has meant that the problem around food and grocery prices for ordinary households has perhaps been a little slow in getting the attention that it deserves.

So, of course, let me emphasise that we would say food and groceries need to be retained within the overall CPI but we believe there is scope for providing a separate and slightly more detailed report on food and grocery prices on and around the same timeframe as the current CPI. We think that there would be benefit in adding some additional information around a couple of different baskets of goods of groceries that might match the spending habits of typical families in that food and grocery CPI, so you might have a basket of goods, track a basket of goods that a family of five might purchase on average, a couple and a single person, and that would give some greater indication of the way in which food prices are travelling for different family sizes.

Also that there is scope for providing some additional explanation as to why some food prices are going up, why some food prices are going down, what food and grocery price changes are likely to be temporary, what food and grocery price changes seem to be part of a longer term trend, so that we have a much clearer understanding of what's going on in terms of price changes in this area. The material that's currently in the ABS CPI is useful as far as it goes, but we're talking two or three paragraphs, typically, you know, halfway through the ABS report. We believe that given the fundamental significance of food and groceries in every household that it deserves a somewhat more detailed analysis and we don't believe that that would be particularly onerous given that, as you say, there is already the groundwork there to build on.

MR O'DONOVAN: Sure. Would you see it as the ABS who should be responsible for these additional - - -

MR KELL: Look, I don't think we have strong views on that. The ABS is the logical place to start because they currently, obviously, put together the CPI. It's the sort of measure, it's the sort of exercise that I think several agencies could do; the ACCC could potentially do it but the ABS would seem the logical place to start in terms of looking at that.

MR O'DONOVAN: Sure. All right. Now, moving onto your second recommendation, which is really advocacy of unit pricing, which is where the consumer can effectively assess on a gram by gram or litre basis and compare easily between products. Now, it seems, I suppose, reasonably obvious that anything that makes a comparison between sizings within a supermarket will assist the consumer

to make the correct choice about what actually is the cheapest product. In terms of actually driving competition between stores, do you have any information that suggests that unit pricing has a role to play in that?

5 MR KELL: Look, I suppose the evidence we have on that is that in the UK there has – where it's been introduced, there have been surveys which indicate that consumers are keen to ensure that unit pricing goes across all food retailers and goes across their entire product range. There is certainly – our own survey indicates that consumers are keen to see it in grocery outlets generally and part of that is because,
10 we would argue that, they do find it difficult – consumers do find it difficult to compare prices across groceries.

Our own survey of more than 1000 consumers suggested that more than a third of consumers, 37 per cent of consumers find it very difficult or difficult to compare
15 prices and make comparisons between supermarkets and 28 per cent don't even try. So the extent to which unit pricing – I can't see how it would do anything other than help. I can't give you an exact estimate of how much it would help but we would image that it would certainly make it much easier to compare prices across outlets if that's what people wanted to do.

20 MR O'DONOVAN: Sure. Now, you've also indicated that any unit pricing that's introduced, your strong preference as I understand it is that it's standardised across all stores to make the comparisons genuine. Do you have a particular regulatory model in mind?

25 MR KELL: Look. If it was possible for the industry itself to reach an agreement in a timely fashion – I think we've been waiting for this for far too long and I think to some extent the supermarkets in Australia have taken consumers for granted in not introducing such a scheme earlier, so if the supermarkets could agree to an industry
30 model that was consistent across products and consistent Australia-wide, then that would be terrific if that could be done without regulation in the first instance.

However, I'm, to be blunt, not overly confident that we're going to arrive at that sort of outcome and therefore I think a regulatory requirement has to be seriously looked
35 at because if there is inconsistency, if there are different models that each supermarket has in terms of how they display unit pricing and what goods they decide they're going to – that are going to fall under a unit price model, then that actually undermines part of the rationale for having it, that ability to compare across stores. So inconsistency would be highly unfortunate.

40 So, look, if it could be achieved without regulation terrific but, to be blunt, it hasn't been achieved so far despite the fact that other jurisdictions have it in place; despite the fact that even some of the operations of some of the supermarkets in Australia and overseas jurisdictions have had it for a while. We haven't got it here yet. I don't
45 think consumers should be waiting a lot longer, so regulation may be required.

MR O'DONOVAN: All right. Now, the third issue that you raise in terms of remedies that you're suggesting is based on a concern about creeping acquisitions; that small acquisitions of additional stores which in themselves don't raise a competition problem should be looked at on an aggregate basis and that accordingly
5 there needs to be some change to the law in relation to how those issues are dealt with. Have I understood your submission correctly in that matter?

MR KELL: Broadly speaking. I mean, choice has supported reforms to section 50 to deal with the creeping acquisitions issue for some time and for reasons that go
10 beyond the grocery sector. I mean, we see this as an issue that comes up in a range of industries, so let me emphasise that in the first instance. Look, it's an interesting issue here about, I suppose, how you measure the market in particular industries. Obviously there are some very localised competition issues in the supermarket sector. Our survey again indicated that convenient location is a real driver when it
15 comes to the reasons why consumers select supermarkets.

So, on the one hand you might say it's very important to look at local issues and so that creeping acquisitions problem therefore may not be such an issue. However, we would argue that overall the dominance of the two large players in Australia, the fact
20 that we don't have sufficient competition, means that those acquisitions of smaller players over time across the landscape doesn't help deliver better competition; it doesn't help in terms of making supermarkets more consumer responsive and it's something that we believe the ACCC should be able to take into account.

MR O'DONOVAN: Sure. Now, I think if you look at the history of Coles and Woolworths in recent years, in terms of their growth, most of it's been by the establishment of new stores, rather than through this process of creeping acquisitions. Does Choice have a view, does the Consumer Association have a view about
25 whether there should be some restriction on the establishment of new stores as a way of, I suppose, restricting the growth of the supermarkets, which you appear to see as a problem, or is it just in relation to the acquisition of existing stores that you
30 think - - -

MR KELL: Look, it's more in relation to the acquisition of existing stores. The opening of new stores, if that's in an area where there's currently just one player and a second player comes in, well, that's a step forward. We would typically like to see a third and fourth player come in and some small retailers to provide competition. It's an issue that also might go to an area that we know has raised concerns, but one that we don't pretend to have great expertise in and that is that the barriers to entry
35 created by control of suitable sites and properties. I think it's very important that this enquiry looks closely at that issue, but our concern is more related to acquisition of existing competitors.
40

MR O'DONOVAN: Right, which I suppose you accept if we only regulate acquisition of competitors, there still may be substantial organic growth from the major supermarkets and in fact, we may see the situation arise where there is as
45 much concentration now in the future as there is now. That's a possibility, isn't it?

MR KELL: Look, I suppose that is a possibility but we would hope that through a range of reforms, that an environment is created where it is more attractive for new competitors to come into the field, to come into the market and where existing competitors are in a more robust situation and are not necessarily so exposed to take
5 over.

MR O'DONOVAN: Sure. All right, now I think in some of your earlier answers you indicated a concern about the level of concentration in the market, is that fair to
10 say?

MR KELL: Yes.

MR O'DONOVAN: Sure, all right. Well, look can I just take you to the survey that you actually conducted- - -
15

MR KELL: Yes.

MR O'DONOVAN: - - - that you submitted to the commission?

20 MR KELL: Mm.

MR O'DONOVAN: And no, sorry, not that one, the actual submission to the commission.

25 MR KELL: Yes, Yes.

MR O'DONOVAN: Yes, all right, and if I can just take you to page 10 and the answers to questions 11 and 12?

30 MR KELL: Yes.

MR O'DONOVAN: Now, if I can just be clear hat I understand, this survey was of a thousand consumers?

35 MR KELL: Yes.

MR O'DONOVAN: Selected at random – from the Choice subscribers- - -

40 MR KELL: Members.

MR O'DONOVAN: Choice membership. All right, and they were asked the questions that are identified here?

45 MR KELL: Yes.

MR O'DONOVAN: All right. Now, in relation to question 11, the question was about where people normally buy their packaged groceries and just looking at those

numbers, the answers was Woolworths 42 per cent and Coles 37 per cent, giving them a combined total of 79 per cent, which is roughly the, I suppose, the 80 per cent market concentration number that's often put about for the supermarket chains. Now, if we go to question 12 where people are asked about where they buy their
5 fresh fruit and vegetables, again there we see quite different answers, where the market share of Coles and Woolworths drops pretty dramatically, doesn't it, to roughly 32 per cent, you'd agree with that? So it suggests that at least in terms of fruit and vegetables, the market domination that's regularly discussed isn't - certainly hasn't turned up in your survey.

10 MR KELL: It is, it is profound. That's right.

MR O'DONOVAN: And in fact it's quite dramatically different to the packaged grocery sector. All right, now, if we could just turn to your – turn to an article that
15 was published in Choice last year in July.

MR KELL: Mm.

MR O'DONOVAN: Now, it's entire – yes, it appeared in the July 2007 edition of
20 Choice.

MR KELL: Right.

MR O'DONOVAN: Now, it's a survey that Choice conducts.
25

MR KELL: Yes.

MR O'DONOVAN: It conducts it every - - -

30 MR KELL: Four yearly.

MR O'DONOVAN: In this case at four year intervals.

MR KELL: Mm.
35

MR O'DONOVAN: All right, and what happened there was I think you described them as shadow shoppers, is that right? Turn up to shops and buy various packaged groceries from supermarkets and then a price comparison is made.

40 MR KELL: Mm.

MR O'DONOVAN: Okay. Now, in terms of the results that we're looking at there, the average price increase for the major supermarkets, looking at those results, was
45 12 per cent.

MR KELL: Yes.

MR O'DONOVAN: Okay, and you also record that the inflation rate for food was 16 per cent, so in terms of packaged groceries, its fair to say that the major supermarkets are tracking below the level of food inflation on the data that's available to you.

5

MR KELL: For the results from our survey, for packaged groceries, suggests that. This doesn't include fresh food and fresh items where the increases have been substantially above that. That's right, so around about at that rate, yes.

10 MR O'DONOVAN: Right. So if I understand you, that I suppose the difference between the packaged grocery, I suppose the relatively low packaged grocery number and the higher rate for food inflation you'd account for by the fact that your survey doesn't pick up fresh fruit and veg, is that?

15 MR KELL: Primarily, yes.

MR O'DONOVAN: Primarily. All right. Now, if we just go back to the market concentration figures, in terms of the market concentration, it's in the packaged grocery areas that the major supermarkets, on your figures, have roughly 80 per cent and the rate of packaged grocery inflation appears to be lower than the general rate of food inflation.

20

MR KELL: With the fresh food component in there, that's right.

25 MR O'DONOVAN: Yes. So if I can just explore that for a moment, that would suggest at least that in terms of market concentration – sorry, that at least in relation to packaged goods that market concentration may not be as big a problem as people might think?

30 MR KELL: Well, if I can provide a couple of clarifying comments there, one is and as our submission makes clear, we're not suggesting for a moment that the concentration in the Australian sector is the only factor influencing grocery prices, it's one of the reasons why we've argued for a food and grocery CPI, but even that 12 per cent over a relatively short time is and far higher rises for some items, is something that we have concerns about for a start. It's, you know, something that is higher than the general inflation rate but in terms of the packaged groceries well, I suppose the other factor there that is leading us to raise a question mark around that outcome even allowing for the factors that you've raised, is the difference in price with ALDI as well, for what are relatively similar goods, suggests that to our mind there are some interesting factors at play there that must be put in or that you must look at in terms of explaining the price differential between some of the supermarket outlets in that sector and for those packaged goods.

35

40

MR O'DONOVAN: Sure, and when you're referring to ALDI, I think your finding was that there was actually a price decrease in the 4-year period at ALDI.

45

MR KELL: That's, I mean, yes, I'm not sure that – you know, I'm not saying that I can offer some magic explanation for that, but its interesting that as we said, the overall price increase was 12 per cent. The basket of price for ALDI products had, well, remained the same or gone down marginally, I think, you know, that's a very
5 interesting sort of outcome and does suggest some interesting price factors at work. I am not sure that I can fully explain it, but the similarities in the pricing between the other majors is – but then the very distinct difference in price with ALDI is one that I think does require some explanation.

10 MR O'DONOVAN: Sure, but just going back to the question of market concentration again. So in terms of your view that the bigger contributor to the food price inflation si the fresh fruit and veg and on your figures that's a much less concentrated part of the market than - - -

15 MR KELL: And there are obviously climate factors, short-term climate factors that have had some role there and things like that. Yes, based on our figures that is less concentrated

MR O'DONOVAN: Sure, which seem to suggest that there is not necessarily a lack
20 of a correlation between high concentration of, I suppose, market share with major supermarkets and price increases?

MR KELL: Again, I would say we do think the concentration is a problem but we are not suggesting it is the only issue. That's right, yes.

25 MR O'DONOVAN: Now, the other question was the question which you ask consumers about the relationship between how much they were spending on groceries. Whether or not they believed they were spending a higher proportion of their weekly income?

30 MR KELL: Spending more?

MR O'DONOVAN: Yes, sorry, let me just find the question?

35 *Compared to three years ago do you feel that you are spending less or more or about the same proportion of your household income on groceries?*

Okay, so that was a question really about their perceptions. What they felt about that proportion?

40 MR KELL: Well, given the nature of a survey like this, you can't ask them to document exactly what they were spending, you know, in week 20, three years ago.

MR O'DONOVAN: Sure, it is not a criticism. I am just trying to make sure I
45 understand and what they have to say. So there is a widespread view out there, clearly, if 83 per cent believe that they are spending more, so there is a strong perception. In terms of analysing whether it is actually true that they are spending a

higher proportion, do you have access to any data comparing average weekly earnings, for example, and the raise in average weekly earnings against the grocery prices.

5 MR KELL: No, it is interesting – I don't want to make any comment about the timeframe of these inquiries but it is an interesting question that we have been asking ourselves and looking at whether we can do something on this. I mean, I suppose we also look at the CPI figures and see how food overall is tracking there. No, we don't have any hard data on that at the moment.

10 MR O'DONOVAN: All right, that was all I had.

THE CHAIRMAN: Thank you. Mr Kell, I have got three or four questions and I know my colleagues have some as well. Mr O'Donovan put some propositions to
15 you concerning creeping acquisition. I think he indicated that statistically the number of existing stores acquired by the majors was somewhat limited but that their significant growth appeared to be through organic growth. That is the establishment of new stores. You said that your concern was to deal with the acquisition of existing stores as distinct from the opening up of new stores. I remember
20 Mr O'Donovan put the proposition to you that by that process you could lead to significant increasing concentration or dominance of the two major retailers without any acquisition of any existing stores from existing operators.

Indeed, the establishment of a new store might well see the demise of an existing
25 store that was operated by a smaller independent that was perhaps less favoured by consumers. I want to put a proposition to you. Do you think that that might lead to a proposition that there ought to be a market share cap on the major retailers?

MR KELL: Look, I know there is a natural reaction against such propositions in the
30 regulatory environment in Australia but I think in some sectors it certainly is an issue that needs to be considered. Perhaps it needs to be considered in part on a regional basis as well. If you get a particularly heavy concentration in certain regions, in the Australian environment I believe it is worth exploring that issue, yes. I don't have the magic figure off the top of my head let me add but it is certainly something that
35 we would be happy to have a look at and provide further information to you about.

THE CHAIRMAN: In your price comparisons you have made a comment to Mr O'Donovan that your price comparison which showed the relative significant difference in the price of ALDI from the basket that is chose in respect of the major
40 supermarket chains. I think your words were:

That with ALDI on relatively similar goods there was a lower price.

Now, I just want to test that because we will obviously be talking to ALDI and to the
45 major supermarket chains about the comparison of the products they are selling. Have you actually compared the products that are sold by ALDI with those that are sold by the major supermarket chains? Are you comparing ALDI's product with the

supermarket chains home brands or with the supermarket chains branded goods?
That is, specialty brands and the like. What is the comparison that has been made?

5 MR KELL: That's a good question and one that we are often asked about at Choice
and we have done some work on this. Obviously, with ALDI you don't get the same
well-known national brands for particular products but our research has suggested in
quite a range of product lines that the difference is minimal and in certain cases the
ALDI products are actually preferred by consumers. So I don't want to suggest we
10 have looked at every single product in this basket and done a comparison in terms of
consumer preferences but we have done taste tests across common products such as
cheese and baked beans and their items such as – non-food items such as aluminium
foil.

15 A wide range of items and what we typically find is that the ALDI items come out at
a very similar level in terms of consumer satisfaction in taste tests or on other
measures. So that gives us a reasonably high level of confidence that the
comparisons are pretty robust. We have published some of those results as well. I
think we might have provided you with an article where we compared well-known
20 brands with both the supermarkets own brands and the ALDI brand. Again, it came
out in some cases that the ALDI product might be the most preferred. In other cases
the supermarkets home brands. It was typically very close.

THE CHAIRMAN: Yes, we actually did a similar taste test supervised by one of
my commissioners here and I won't reveal the – it was related to chocolate biscuits, I
25 might say.

MR KELL: We did do choc-chip cookies and they all came out at a reasonably
similar level. So, again, people certainly weren't rejecting the ALDI ones in blind
taste tests - I should emphasise that these are obviously blind taste tests – as inferior.
30

THE CHAIRMAN: All right, let me move to one of the critical issues. Choice is
well known for its testing. It is well known for its public surveys in analysis of
consumer preferences and the like. I just wanted to check with you the processes
that you adopt in terms of some of the survey work you do. Particularly, I am
35 interested in the survey questions that you have asked and received answers on in
respect of the question:

Do you feel there is sufficient price competition between supermarket chains?

40 That is question 8 and it appears on page 10 of your survey. These surveys, they are
conducted with professional assistance or under professional guidance?

MR KELL: Yes, we have a very experienced survey department. We are surveying
consumers on a whole range of issues on a regular basis.
45

THE CHAIRMAN: Do you test the results of the survey? In other words, test the
reasons for a consumer perception? I am interested in this one about – this is, in a

sense, not an economic analysis of price competition but this is a consumer perception that there is not sufficient price competition. I think 64 per cent felt that there was not sufficient price competition and, you know, 16 per cent only said that there was. So I think you have got about a thousand respondents. Do you test the development of those perceptions and, you know, how they are arrived at and the validity of them?

MR KELL: Look, as to the particular reason in this instance, in this case and in the timeframe, we just simply haven't had the opportunity to further explore this issue arising out of question 10. I think it is something that we would like to do and may be we could seek to do it. At this point in time we haven't had the opportunity to delve down further in any of these questions at this stage, sorry.

COMMISSIONER KING: Yes, thank you. I should just respond to the chairman's comments. May I say that in the blind taste test of the commission, the relevant commissioner involved actually preferred the ALDI chocolate.

THE CHAIRMAN: This is not an advertising

COMMISSIONER KING: Can I take you just back to the questions that the chairman was just asking you questions – asking you about, in particular 11, 12 and also 13, which Mr O'Donovan didn't ask you about. Obviously, from the question 11, where do you buy your grocery products, we're looking at 79 per cent approximately Woolworths and Coles. Fruit and vegetables, when we move down to that we of course find that fruit and vegetable shops and others account for about 50 per cent of the sales or where your customers go, I should say, whereas Coles and Woolworths are under a third. If we go on to question 13 then we're looking at meat and the same number of your respondents buy from butchers as buy from Woolworths and Coles.

So it strikes me that there's obviously some significant differences between those areas. In fact if we want to use say international benchmarks on concentration levels, if we looked at meat or fruit and vegetables, based on either the European or the US merger guidelines, neither of those sectors would be even considered concentrated in those two jurisdictions. Obviously it would be very different for grocery products which would be considered highly concentrated in either the US or the European Union. Given that background, I want to ask you Mr Kell, from the ACAs perspective, is there a competition problem for consumers in fruit and vegetables and meat or is it really a competition problem in packaged groceries and if it is a competition problem that goes right across purchases from supermarket chains, why should this inquiry be concerned with fruit and vegetables and meat, given the range of alternative outlets that are available for consumers?

MR KELL: Right. So the first part of the question is: is there is a concentration problem there? Look, in I suppose our surveys have also suggested over time that – and the anecdotal evidence as well that we receive, that even those figures for fruit and vegetables and fresh meat that more people have been going to supermarkets

over time for those products. So even though they're not concentrated at this point in time they were even less concentrated, if you like than in the past. But it's an issue whereby we would say there are concerns about the pricing in those sectors for a start before you get to competition.

5

So perhaps to go back to the original rationale for this inquiry there are clearly concerns about the way the prices of fresh fruit and vegetables and the price of meat have travelled because of a range of factors – international factors, climate factors, droughts, floods, and being able to explain that and to work out what dimension of those price movements can be explained by those factors we believe is very important and then you get into the territory of well, are there also some additional factors there in those sectors that go to competition issues, the fact that even though the major players may not have a huge impact, they may nonetheless, because of their overall market size and their buying power and what not, be price setters, in a way and in a way that others follow.

I don't know exactly how that works, we don't pretend to know exactly how that works at the moment. But there is certainly evidence that that is the sort of things that people are concerned about. So we obviously believe there are a range of factors contributing to the price movement in fruit and vegetables and the meat sectors, but we would like to understand if you could untangle them, what are the competition aspects of that as well? So we believe you should be concerned about that, that that should be part of your overall examination of this sector.

25 COMMISSIONER MARTIN: Just a couple of simple brief questions, one on the – you mentioned on product quality taste testing and so forth, have you done any work with technicians looking at the actual quality of product, vis-à-vis choc chip cookies and things, as opposed to people just doing taste tests?

30 MR KELL: We typically – you're talking about things like for example, that I can see more fat, less fat or that sort of thing?

COMMISSIONER MARTIN: Yes, well, real chocolate or compound chocolate in it, for example?

35

MR KELL: Look, I don't think we've looked at that in detail, other than to say - across the full range of products, I think it's – and I shouldn't rely on my recollection here, but I think we have for a few products looked at it and found it fairly similar. But I should get back to you in terms of whether we've done some actual studies on the actual quality issue. But my recollection is that there aren't significant differences across many of the products we're talking about. But let me take that on notice and get back to you, John.

45 COMMISSIONER MARTIN: The other thing that I just wanted to briefly mention on price movements and you talk about enhancing APA, ABS type analysis of that component, the CPI, have you talked to ABS, firstly and secondly, on unit pricing you've mentioned UK experience, etcetera, in this area have you looked at the

position in Europe and UK and in terms of the relativity and clearly there's been growth – I think you said 10 to 12 years the growth has been higher in the CPI in Australia, I mean it will depend a bit on the starting point and where Australian consumers are at the moment in terms of – in comparison to consumers in Europe or the US?

MR KELL: Now, the first part of your question was, sorry?

COMMISSIONER MARTIN: Was ABS.

MR KELL: ABS. No, we haven't spoken to the ABS yet, we're keen to do so, I'm sure they're keen to speak to us about this as well and we have in the past spoken to them about the various components of the CPI and the potential benefit from occasionally netting some of those out and talking about them separately. So, no, at this stage we haven't had a chance, John. On the unit pricing experience in the UK, well, we've - - -

COMMISSIONER MARTIN: It was more their experience with pricing increases and the current sort of assessment of where consumers are in terms of costs of groceries and other food products in their budget.

MR KELL: Look, I – we certainly have access to surveys that our counterpart organisations do in the UK and other consumer organisations. I couldn't quote any of them to you now, but I'm very happy to look at providing them and on the sort of unit pricing area there are surveys from the UK, they're just around that issue which suggest, you know, interesting results, that providing unit pricing information, reduce the average time needed to identify the cheapest option from 58 seconds down to 18 seconds on average and when provided with that information 78 per cent of people identified the cheapest option fairly easily without that information across some of these areas, you were down to figures like 6 and 7 per cent of people identifying it accurately. So there are a range of surveys in different areas that we'd be very happy to provide you with from some of our overseas counterparts.

COMMISSIONER KING: Just one very short follow up, Mr Kell, just on the unit pricing issue. I mean given the sort of numbers you just mentioned, do you have any opinion on why the major supermarkets haven't introduced it, I mean we have, for example, ALDI has introduced it. I understand that a number of the on-line sites have unit pricing. Why haven't we seen it in the major supermarket chains?

MR KELL: Look, I suspect there are a number of reasons. Look, to be fair, I don't have any exact figures but there would no doubt be an establishment cost in particular. Our understanding is the ongoing costs of maintaining such a system are relatively modest but the establishment cost is certainly there. Why would you go and – you know, unfortunately, you've got one of those classic positions whereby the first mover, you know, sort of bears some of the costs, trials, some of the stuff, made some of the mistakes, so there's not necessarily an incentive to be first.

The other, sort of, I suppose, reason goes to issues that you'd be familiar with from the sort of economics literature as to, you know, it certainly helps to ensure that people focus on non-price attributes. If they're confused about prices and they don't have the ability to easily assess price and compare across prices, then they are more likely to focus on non-price marketing attributes that you can devote more time and attention to. We'd like to see them to be able to find it just as easy to devote attention to and to gain an understanding of the price attributes.

THE CHAIRMAN: Yes, if I recall correctly, Mr Kell, and probably I'm the only one old enough to recall it, but I think Safeway before it was acquired by Woolworths actually had unit pricing and then ceased it so that the establishment costs was probably more a cessation cost or a termination cost.

MR KELL: Yes. Yes.

THE CHAIRMAN: You say the ongoing cost of providing unit pricing is not significant; it's the establishment cost?

MR KELL: Well, I have no doubt friends in the supermarket sector would suggest otherwise but it doesn't seem to be crippling the supermarket sector in the UK or Europe. They still seem to be turning a dollar and consumers are very happy with it over there.

THE CHAIRMAN: All right. You have anything else you want to add?

COMMISSIONER KING: I think that's covered it.

THE CHAIRMAN: All right. Thank you very much. Thank you for your assistance.

MR KELL: Thank you.

THE CHAIRMAN: Now, I'm afraid, ladies and gentlemen, that we're going to be moving into several private sessions now. We have a number of suppliers that are joining us. In addition, we have Franklins but I've had it indicated to me that the majority of what they want to say will be commercially sensitive information. So I'm going to have to ask those that are not involved directly with the witnesses that are coming – the next witness is going to be Mr Kevin Radich from Inghams Enterprises. So with the exception of those associated with Inghams, I'm going to have to ask the room to be cleared. Now, I'd have to say to you I think that it is unlikely that we'll be moving into public hearings probably for the rest of the day, Mr O'Donovan.

MR O'DONOVAN: Some of the Franklins evidence can and should be dealt with in public.

THE CHAIRMAN: Okay. What we'll do is then we'll deal with Mr Radich and then we're scheduled to start Franklins around 11.15, some time between 11.15/11.30. Some of that will be public, the early part, but then we'll move into private hearing on that and then I think, as I read it for the rest of the day – which is
5 basically after lunch – it will be private.

MR O'DONOVAN: Kiama Milk Collective.

THE CHAIRMAN: They'll be public?
10

MR O'DONOVAN: Will be public.

THE CHAIRMAN: I beg your pardon. All right. So just to give you a sense, all right, so that I can give you a bit of guidance, will be private for Inghams, which is
15 starting now until about 11.30, thereabouts. We'll then go into a short period of public with Franklins, and then they'll go into private. Nestle, I think, will be private. Then we'll go into a lunchbreak and then after lunch George Weston Foods will be private; Arnotts will be private and Kiama Milk, which is likely to be around 4 o'clock, will be public. All right. Sorry, to sort of throw your schedules around.
20 Thanks Peter.

COMMISSIONER KING: Thanks, Peter.

25 **CONTINUED IN TRANSCRIPT-IN-CONFIDENCE**

CONTINUED FROM TRANSCRIPT-IN-CONFIDENCE

5 THE CHAIRMAN: All right, I think we'll start. Gentlemen representing Franklins Pty Ltd, could I just ask you to state your name and position just for the record.

MR ZELINSKI: My name is Aubrey Zelinski, managing director of Franklins.

10 MR PERLOV: Roni Perlov, financial director of Franklins.

THE CHAIRMAN: Thank you very much. Thank you for attending this hearing. I just note for the record that it is an offence under the Criminal Code to give evidence at this inquiry that a witness knows is false or misleading or omits any matter or thing without which the evidence is misleading. Do you understand that?

15 MR PERLOV: Yes.

THE CHAIRMAN: Thank you. Now, Mr O'Donovan will be putting questions to you. I think you're aware through the material that's been provided to you before
20 coming here that at a point of time, if you have information that you wish to give in a confidential area as distinct from on the public record, if you just simply indicate that in response to Mr O'Donovan then we can determine as is appropriate to move into private session.

25 MR PERLOV: Sure.

MR O'DONOVAN: All right. Now, Mr Zelinski, just to start with, I might get some history about Pick and – now, Franklins is owned by Pick n Pay. Is that – the South African - - -

30 MR ZELINSKI: Pick n Pay South Africa - - -

MR O'DONOVAN: Yes.

35 MR ZELINSKI: - - - own Franklins Australia.

MR O'DONOVAN: Yes. All right.

40 MR ZELINSKI: So it's a wholly owned subsidiary of Pick n Pay.

MR O'DONOVAN: Right. Pick n Pay's entry into the Australian market came in 2001 when the Franklin's supermarkets were up for sale?

45 MR ZELINSKI: That's right, yes.

MR O'DONOVAN: All right. Now, were you involved in that process?

MR ZELINSKI: I have been involved since trying to negotiate the deal.

MR O'DONOVAN: Sure. Okay. Now, casting your mind back, do you have a
5 recollection of what the company's assessment of the Australian market was at that
point, in terms of how competitive, how easy it would be to enter, what sort of
market share was possible for the stores that were required?

MR ZELINSKI: We saw an opportunity to commence with a third chain that we
10 believe we would be successful in the New South Wales market and the planned
longer term for us was once we had established a base in New South Wales, the
strategic plan was to move outside interstate.

MR O'DONOVAN: Right. So notwithstanding that Franklins, as owned by I think
15 it's Dairy Farmers at that point - - -

MR ZELINSKI: That's right.

MR O'DONOVAN: - - - had not been a success. You saw a market opportunity?

20 MR ZELINSKI: Yes.

MR O'DONOVAN: Did you assess the market as being particularly competitive
between Coles and Woolworths at that time?

25 MR ZELINSKI: We saw it as being competitive but we always believed that there
was a niche for a third player to come into the market.

MR O'DONOVAN: Sure. In terms of that niche, was it primarily a price
30 competitor?

MR ZELINSKI: The original discussion we had was to really format our stores
around the very successful No Frills brand that was dominant in the market in the
early 80s and prior to Dairy Farmers or the old Franklins moving into the whole fresh
35 concept.

MR O'DONOVAN: In terms of the fresh concept, was it your intention to scale
back from the fresh concept and concentrate on packaged groceries or did you - - -

MR ZELINSKI: That was the original idea, yes.
40

MR O'DONOVAN: Sure. Okay. So at the time that you made the acquisitions, the
store numbers were around about 70 that you were able to acquire?

MR ZELINSKI: We acquired two companies, one was the 50 stores from Franklins
45 and the second was a group of 20 franchise stores called Fresco and we acquired the
two companies believing that that would give us sufficient critical mass to enter into
the market.

MR O'DONOVAN: Sure. The market at this stage was New South Wales?

MR ZELINSKI: The market at this stage was New South Wales.

5 MR O'DONOVAN: Okay. Now, can you just give us an indication of the geographic spread of Franklins within New South Wales?

MR ZELINSKI: We have stores in Wagga - so throughout the rural area we have stores and also in metropolitan Sydney.

10

MR O'DONOVAN: Right. Okay. In terms of the Fresco stores that you acquired, they were run by franchisees but are now

MR ZELINSKI: No, they were run by one company that owns 20 franchise stores and Metcash was the wholesaler supplying those 20 stores.

15

MR O'DONOVAN: Right. Okay. So then those 20 stores became corporately owned by Franklins?

20 MR ZELINSKI: Yes, that's correct.

MR O'DONOVAN: All right. So at that stage you had 70. Now, my understanding is that you now operate 80 stores?

25 MR ZELINSKI: We have 80 stores, yes, operating today.

MR O'DONOVAN: All right. Can you just give us a brief outline of how you expanded from 70 stores to 80 stores?

30 MR ZELINSKI: We acquired six stores through a company called - - -

MR PERLOV: Tamsco.

MR ZELINSKI: - - - Tamsco where we purchased six stores and the rest of the stores we've - we have opened greenfield sites throughout New South Wales, so over the period. I might add that we have, during the last seven years, closed about six or seven stores that weren't profitable. So this is not just about opening; this is about closing unprofitable stores.

40 MR O'DONOVAN: Sure. If I can just go back to that, so that the closure of stores, has that been across a broad geographic spread?

MR ZELINSKI: Primarily the city centre, metropolitan Sydney.

45 MR O'DONOVAN: Sure. That's been a business decision based on profitability, not because of loss of lease or - - -

MR ZELINSKI: One was loss of lease. The balance have been non-profitable.

MR O'DONOVAN: Sure. Just on the loss of lease, the one that closed because of the loss of a lease, what happened to the lease or the space that you were occupying?

5

MR ZELINSKI: Today I believe there is discussion about Coles moving into the centre.

MR O'DONOVAN: Sure. Was that anticipated at the time that the lease was terminated? Was it your intention to – would you have liked to have renewed the lease if you could?

10

MR ZELINSKI: The landlord, the lease had expired and the landlord and ourselves agreed to a month by month lease with a clear understanding that a development plan was to be put into council to redevelop the centre which would then facilitate another supermarket group. We expected that to be ourselves.

15

MR O'DONOVAN: Right. In terms of the negotiations, when did you discover that – I'm assuming that can be publicly discussed or would you - - -

20

MR ZELINSKI: Yes. We were given notice, or three months notice, to leave the store.

MR O'DONOVAN: Sure. You would have been willing to enter into a fresh lease?

25

MR ZELINSKI: Without a doubt because we don't have representation in that area and so the last thing we would have wanted to do was lose the store.

MR O'DONOVAN: Sure. So in terms of what changed the landlord's mind, are you aware of what factors were at play that caused them to terminate your lease rather than entering into renewal discussions with you?

30

MR ZELINSKI: I could but I think that the response would have to be confidential.

MR O'DONOVAN: Sure. Okay. We'll make a note of that and come back to it. All right. Now, in-between 2001 and 2004, Metcash was your wholesaler?

35

MR ZELINSKI: That's right.

MR O'DONOVAN: For all your stores but since then you've moved to a model where you provide your own wholesaling services effectively. You've got a distribution centre in Sydney?

40

MR ZELINSKI: We have our own distribution. We have our own buying team. We do our own logistics and distribution.

45

MR O'DONOVAN: Sure. So all of your relationships now are direct with the - - -

MR ZELINSKI: With suppliers.

MR O'DONOVAN: With suppliers. Okay. I think this is on, well, I'm sure this is on the public record that there have been disputes with Metcash about that
5 arrangement and it's fair to say it wasn't a happy or successful relationship?

MR ZELINSKI: No, it was not happy and we are still in dispute.

MR O'DONOVAN: All right. And so a decision was made in 2004 to end that
10 relationship and establish your own wholesaling arrangements?

MR ZELINSKI: Yes.

MR O'DONOVAN: Now, you've said in your public submission to the commission
15 that the decision made by the company was that it was uneconomical to survive as a retailer competing with Coles and Woolworths while buying from a wholesaler?

MR ZELINSKI: Correct.

MR O'DONOVAN: Okay. Now, if I can just unpack that idea, is it because of the
20 particular wholesaler you had to deal with or is there something fundamentally uncompetitive about dealing through a wholesaler when you're dealing with an integrated – when you're competing against integrated, vertically integrated
25 supermarkets?

MR ZELINSKI: I think as a retailer who is trying to – Franklins tried to establish
itself as a third chain in New South Wales. In order to be successful, one would have to compete with Woolworths and Coles on price, amongst other things, that being the
30 most important. And the arrangement with Metcash at the time did not leave us with sufficient margin to compete equally with Coles and Woolworths.

MR O'DONOVAN: Yes. Now, in terms of the market that you faced, if there had
been an alternative wholesaler, so if instead of Metcash being the only – well, first let
35 me confirm. Your view is that Metcash is the only wholesaler that can supply independent supermarkets? There is no other grocery wholesaler that you could turn to?

MR ZELINSKI: In New South Wales, Metcash is a monopoly in terms of
40 wholesale.

MR O'DONOVAN: Sure. Okay. So obviously if there were two wholesalers
operating in New South Wales, that the wholesaler would lose volume in terms of their negotiation with suppliers?

MR ZELINSKI: Or maybe the prices would be a lot keener to their retailers?

MR O'DONOVAN: I guess yes, that's the question that I'm asking.

MR ZELINSKI: Yes.

MR O'DONOVAN: Do you feel that, in your assessment, that if there were two
5 wholesalers, a more competitive market would evolve or do you think that the loss of
volume to any new entrant in the wholesaling market would actually diminish the
retailer's ability to compete against Coles and Woolworths?

MR ZELINSKI: I think more competition is good for the market. The consumer
10 ultimately wins when there's more competition, not less competition.

MR O'DONOVAN: Sure. Okay. Now, looking at the way in which you've
structured your business, at the moment you have a wholesaling – you're vertically
integrated providing your own wholesaling and you've added some stores
presumably to improve your volumes through your warehousing?

15 MR ZELINSKI: Yes, we have.

MR O'DONOVAN: The more you improve your volumes, presumably the more
efficient the warehousing operation becomes?

20 MR ZELINSKI: Correct, yes.

MR O'DONOVAN: Okay. Now, in terms of adding stores, I understand from
publicly available material that initially you were able to attract some people who
25 were IGA franchisees to the Franklins group?

MR ZELINSKI: Correct.

MR O'DONOVAN: And you do run some stores on a franchise model?
30

MR ZELINSKI: We do.

MR O'DONOVAN: All right. So in a sense – and, again, if this is confidential we
can discuss it later but does that mean that you, to an extent, operate as a wholesale
35 competitor of Metcash in terms of offering wholesale franchise opportunities to
independent retailers?

MR ZELINSKI: I wouldn't call it a wholesale. Our franchisees would entertain
exactly the same prices that we have in our Franklins corporate stores. So from a
40 franchisee's point of view, they would be viewed as just being another corporate
store.

MR O'DONOVAN: Right.

45 MR ZELINSKI: The difference is that they have their own entrepreneurs that have
an ability to operate far more efficiently than a corporately run supermarket, we
believe.

MR O'DONOVAN: Yes but just take the position of the independent IGA coming to the end of its arrangement with Metcash. Is it possible for them to use migration to Franklins as a means of negotiating better terms with Metcash?

5 MR ZELINSKI: Well, they would have to. A conversion would mean that a franchisee has to carry the brand Franklins, not IGA. So for the public and in order to entertain our prices and our ranges of house brands, the independent would have to take the – to operate under the Franklins banner.

10 MR O'DONOVAN: Sure, and is that – and again if it's confidential don't feel obliged to answer – is that a business model that Franklins is pursuing?

MR ZELINSKI: This model is a very successful model for our parent Pick n Pay in South Africa and today there are approximately just under 200 independents that
15 operate under the Pick n Pay brand in South Africa as a very successful franchise business. Our plans are to build the franchise arm. As we gain more critical mass and more importantly, I think, as the Franklins brand gets greater acceptance in the New South Wales market, we believe once we've got a story to tell, there will be a lot more independents that would want to take up the brand of Franklins.

20 MR O'DONOVAN: Sure. Okay. So at least in that limited sense, an independent at various points in its agreements with Metcash might have an alternative in terms of switching its, who is doing its warehousing and wholesaling activities?

25 MR ZELINSKI: Only on condition that they would change their brand.

MR O'DONOVAN: Sure. Okay. Now, in terms of the initial business model that you had, it was to go mostly into packaged groceries and to avoid, I guess, retailing in fresh food, fruit and veg deli. Has that changed?

30 MR ZELINSKI: It has changed. I think the model that was successful for Franklins in the '80s of having excellent independent operators outside, specialists outside of the checkouts and Franklins operating the packaged groceries inside was a good model. I think once the shopping hours, trading hours changed, that had a dramatic
35 effect towards the sort of the demise of the old Franklins brand. They could not compete with Coles and Woolworths after five.

MR O'DONOVAN: Because of the speciality stores outside?

40 MR ZELINSKI: Because of the speciality stores, yes. And the market, the whole market moved more from package groceries into fresh perishables?

MR O'DONOVAN: Sure. Okay. So at what point did Franklins make the business
45 decision to start putting fresh fruit and veg and deli items into its stores?

MR ZELINSKI: I think it emerged after sort of the third or fourth year that if the model was to be successful, we would need to widen our ranges in order to compete with Coles and Woolworths.

5 MR O'DONOVAN: Right. And is that based on just a strong consumer preference for one stop shopping or is it really tied in with the fact that specialty stores were just closing too early?

MR ZELINSKI: I think it was a combination of both.

10

MR O'DONOVAN: Right. So you think there has been a shift in consumer preferences to one stop shopping?

MR ZELINSKI: Yes.

15

MR O'DONOVAN: All right. So in terms of setting up a fresh operation, how difficult was it to introduce that expanded range into Franklins?

MR ZELINSKI: Well, it's a process that we're still undertaking at the moment. Our parent company has just invested another 50 million into the business for two things. One, to upgrade our stores because many of the old Franklins stores are outdated and a lot of those stores were in desperate need for refurbishment. So at the time of refurbishing now, we are adding the fresh ranges to our business and we're in the process, quite an ambitious program, of refurbishing 10 stores this year and the plan is to do 10 stores next year.

25

MR O'DONOVAN: Sure. Okay.

MR ZELINSKI: So to modernise our business.

30

MR O'DONOVAN: Now, in terms of the competition that you faced, how would you describe, I guess, the intensity of competition in the supermarket markets in which you operate?

MR ZELINSKI: I think this is a highly competitive industry and I think for a small independent or a small retailer to survive, one has to worry about more than just price because I think we need to differentiate ourselves away from Woolworths and Coles by offering better service, a lot more activity on the floor, interacting with customers, looking at other means maybe to try and see if we can retain our customer base.

40

MR O'DONOVAN: Sure. The competitiveness of the market, is that, do you think, fairly reflected in, I suppose, the difficulties that appear to be there, at least on the public information in Franklins being profitable since its introduction into Australia?

45

MR ZELINSKI: Well, we're in a close trading period, so, yes, so it makes you doubt our result, but in the investments in past years, the company has not made

money. Our plan always was to partner with Metcash in terms of them being our wholesaler and having a transparent distribution which would allow us to compete with the major retailers in this country. Unfortunately that never materialised and very clearly at the time of our exiting Metcash, we had one of three choices at that time. The decisions were either to stay with Metcash and not be competitive or to do our own distribution and logistics even though we had not achieved the critical mass that we were needing, or the third radical was to actually sell our business and move back to South Africa, and that was serious consideration as well, as one of the options.

10 MR O'DONOVAN: Right, and putting aside the difficulties with Metcash, which I guess to a degree must have now been overcome, the ongoing difficulties, and I'm not talking about this trading year but in perhaps the last two, which again weren't profitable, is that a reflection of the intensity of the competition and the kinds of margins that you can make selling groceries or is it a reflection of some other feature of the market that makes it hard for an independent player to compete?

MR ZELINSKI: I think today, without talking too much about our profits, our business and efficiencies that are coming – that we're obtaining out of our distribution, gives us the confidence to know that this business has longevity and will make a profit and we've been fortunate in that our parent company was not looking for a short term gain, that the Pick n Pay philosophy is to stay here in the long term and to invest long term and so on that basis we are a lot more confident with the business today.

25 MR O'DONOVAN: All right. Now, you've indicated again in your public submission, I'm pretty sure this is right, in relation to Shop-A-Dockets, are you happy to discuss Shop-A-Dockets in public?

30 MR ZELINSKI: Sure.

MR O'DONOVAN: What was the effect on the Franklins' business of the introduction of Shop-A-Dockets?

35 MR ZELINSKI: As petrol became available and the discounting was there for Woolworths and Coles, we found that our market share or our sales dropped by about 13 per cent, so it had an immediate effect on the sales volume in our stores and for an independent who doesn't own petrol, it's very difficult to compete when you're having to subsidize the two or four cents for that petrol because it comes straight out of your costs, it is an expense, whereas if you are Coles or Woolworths, you could subsidise or cross-reference that discount.

45 MR O'DONOVAN: Sure. So in terms of the analysis that you've done on your business, that there was an immediate effect and a substantial effect in terms of customer loyalty, I guess, when those things were introduced.

MR ZELINSKI: Without a doubt.

MR O'DONOVAN: Has that diminished over time?

MR ZELINSKI: What has happened is that initially we lost customers. Today I think, because of the way we manage our business, and we have introduced our own
5 loyalty card, we are seeing that customers are coming back to our stores and our customer accounts have improved over the last year, particularly 18 months.

MR O'DONOVAN: Right. Do you think that's a product of your initiatives or that consumers are less attracted to the - - -
10

MR ZELINSKI: No, I think that is our initiatives.

MR O'DONOVAN: Right. Now, in relation to I suppose, your competitive response, there were some schemes trialled at independent supermarkets where
15 people could bring in a petrol docket and receive a 4 cent per litre discount. Were they effective in terms of drawing customers back?

MR ZELINSKI: Not really. All it does for us and we have that docket system in about five or six of our stores out in the country, all it does is it keeps your customer,
20 it doesn't attract new customers.

MR O'DONOVAN: Right, and does it adversely, obviously it adversely affects margin to some degree, but to an unsustainable degree?

MR ZELINSKI: It does affect margin, but the volume is not that great so the cost is not relative to – is not that high.
25

MR O'DONOVAN: Right, okay. Now, in terms of the private labels, the only private label which you offer is the no frills label, which is - - -
30

MR ZELINSKI: That's correct.

MR O'DONOVAN: And in terms of the demographical market position that it's aiming for, what's that?
35

MR ZELINSKI: It would be more of a fighting house brand. So it wouldn't be a value added product, it's more of a commodity based product.

MR O'DONOVAN: Sure, and are you looking to grow that in terms of the market share that it attracts.
40

MR ZELINSKI: When we purchased the Franklin's brand, no frills, the old dairy farmers, was about 7 per cent of our sales and today it operates at about 11 per cent of our sales and we would anticipate not growing that to more than 15 per cent of our sales. Our philosophy is to promote national brands. We believe that's the market
45 that we need to cater for, not house brands.

MR O'DONOVAN: Sure, now, the other major supermarkets are introducing I suppose more and more house brands, Woolworths Select, You'll love Coles, Coles Smartbuys and in a number of different categories. Does that provide you with a market opportunity in terms of providing a home for second tier brands that don't fit
5 into the major supermarkets categories or is it neutral as far as your business is concerned?

MR ZELINSKI: Well, I think once, you know, a supermarket our size - it would be difficult to sustain the volumes of other house brands at this stage. Longer term,
10 once we have more critical mass, we would entertain the thought of a value added or a higher end brand, but at this stage, our volumes don't allow us to work down that avenue.

MR O'DONOVAN: Sure. All right, so in terms of growing the business, what - and again stop me if this is confidential, in terms of the critical mass that would be ideal
15 for you to operate as a competitive retailer in the New South Wales market, how many additional stores do you think you need?

MR ZELINSKI: I think we are at above critical mass now, so I would say 80 stores
20 allows us the critical mass to become a profitable business.

MR O'DONOVAN: All right, and are there any threats that may cause a reduction in the number of stores that you have at present?

MR ZELINSKI: I think there would be, but I would maybe do that in a - - -

MR O'DONOVAN: Discuss it confidentially? No, that's fine. All right.

MR ZAURRINI: Mr Donovan, sorry, could I clarify one issue? The issue about
30 critical mass. Could we define that geographically as is there a geographical limitation on that being New South Wales or is it national.

MR ZELINSKI: Yes. In New South Wales. I only talk about New South Wales.

MR O'DONOVAN: Yes, all right. Well, I think that they were the questions I
35 wanted to pursue in public. Actually no, there is one proposition that I should test with you. Again feel free to decline to answer if you don't feel it's appropriate to answer in public, when Metcash was merging with other wholesalers and effectively the situation where Metcash is the sole wholesaler to grocers arose, the argument was
40 put that Metcash had an incentive to keep its retailers, the retailers who it supplied competitive against the Coles and the Woolworths and that it had incentives to drive demand which would mean that it wouldn't exercise monopoly power in the way you might otherwise expect a monopolise to do so. In your opinion, is that theory about the operation of a monopoly wholesaler sound in the Australian market? Do you
45 think that Metcash does have strong incentives to make sure its retailers are competitive against the major supermarket chains?

MR ZELINSKI: I can only talk for our experience. We were not competitive while we were with Metcash and I think if we had remained with Metcash, we might have a very different model of a convenience business today, as opposed to a third supermarket chain.

5

MR O'DONOVAN: Okay. All right.

THE CHAIRMAN: Just to test that one step further and I think Dr King has a question, what that's implying is that – correct me if I'm wrong, but what that's implying is that you have been able to establish your own vertically integrated wholesaler and distribution operation and to deal with suppliers on terms and conditions which give you a better financial return than utilising the wholesale and distribution arrangements offered by Metcash. Is that correct?

15 MR ZELINSKI: Absolutely correct.

THE CHAIRMAN: I think Mr O'Donovan was asking a question before and I am not sure that we actually got to the final point of the question which is that by breaking up the wholesaling operations within New South Wales between Metcash and – I am going to call it for this purpose – Franklins, that reduces the total volume of purchasers by Metcash, clearly, by the reduction of volume that is going over to Franklins. Franklins itself, in terms of its own internal wholesale operation, has a lower volume than would otherwise have been the case, clearly, if it had been all totally aggregated within Metcash. Has that resulted in less favourable terms from suppliers or have you been able to maintain the same terms from suppliers that has enabled you to – do you follow me – to get the more favourable commercial result?

MR ZELINSKI: I think our terms have improved since we have become self-sufficient. How do they compare to other retailers? I would have no idea. I think that for us the relationship of dealing with suppliers has given us an advantage in terms and also the rebates that are passed on to owning your own warehouse adequately cover the cost of the warehouse for use.

THE CHAIRMAN: If that is the case, why then have you not seen an opportunity or why has there not been pursued the opportunity to gather more independent retailers, for example, in New South Wales as part of your wholesale buying operation?

MR ZELINSKI: If I can answer that question confidentially?

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THE CHAIRMAN: Yes, and you might also want to answer confidentially as to why if you had pursued that option, that they haven't taken it up.

MR ZELINSKI: Sure, okay.

45

COMMISSIONER KING: You nicked my question.

COMMISSIONER MARTIN: Look, just one in terms of how the 80 stores operate. What is the size dimensions and configurations?

5 MR ZELINSKI: We have – when we bought the – purchased the basket of stores, we have stores that are 800 square metres and stores that are about 3800 square metres. So we have a very diverse basket of stores.

10 COMMISSIONER MARTIN: And you say in your submission, competition is vigorous in metropolitan areas.

MR ZELINSKI: Yes.

15 COMMISSIONER MARTIN: We have had some comments come in about – that it is not as competitive as say in parts of Sydney as it is in Perth. Do you

MR ZELINSKI: I can't talk outside of New South Wales.

20 COMMISSIONER MARTIN: You do make some comments about – like you mention, you have had some growth in greenfields sites.

MR ZELINSKI: Yes.

25 COMMISSIONER MARTIN: In terms of planning and zoning restrictions, I mean, what has been your experience?

30 MR ZELINSKI: Very difficult to obtain sites. Planning departments, DA approvals, council hold-ups, the process takes an enormous length of time. We have a store that will open this year that we have been negotiating and building for the last six years. It has just taken six years to get there.

COMMISSIONER MARTIN: Much problem in terms of foreclosure from competitors?

35 MR ZELINSKI: There are objections that are raised by other retailers.

THE CHAIRMAN: Do you want to elaborate on that in public hearing?

MR ZELINSKI: I think in private.

40 THE CHAIRMAN: Ladies and gentlemen not associated with Franklins, I am afraid I have got to ask you to leave. You probably think that the answer we are going to get in private is going to be quite titillating

45 **CONTINUED IN TRANSCRIPT-IN-CONFIDENCE**